Startia Inc.

3393

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FISCO Ltd. Analyst
Hiroyuki Asakawa

FISCO Ltd.
http://www.fisco.co.jp

Index

Summary

Both business segments recovered and returned to profitability for operating income
Aiming to take a further leap forward on the transition to a holding company structure in April 2018

Startia Inc. <3393> (hereafter, also "the Company") provides digital marketing-related software and one-stop solutions for IT-related services for medium and small enterprises (SMEs) with 300 or fewer employees that cannot afford to hire an IT manager and which are not served by large system integration companies and network equipment dealers.

1. Both business segments recovered, achieving higher sales and returning to profitability for operating income

In 1H FY3/18, the Company achieved net sales of ¥5,372mn (up 12.5% year on year (YoY)) and operating income of ¥221mn (compared to a loss of ¥119mn in the same period in the previous fiscal year), for higher sales and a return to profitability on the recording of operating income. The initial forecast was for an operating loss in 1H, but net sales were ¥450mn above the forecast, and due to this, operating income was also ¥347mn above its forecast and returned to profitability. In the Digital Marketing segment, sales of the AR software COCOAR and other products steadily grew, while in the IT Infrastructure segment, the customer-orientated structure has become established, and its original sales capabilities led to an increase in profits.

2. Will transition to a holding company structure on April 1, 2018. The businesses will be operated by four core companies.

The Company has decided to transition to a holding company structure from April 1, 2018. After the transition, the current two business-segment structure will become a four business-segment structure. In the Digital Marketing segment, one part of the business segment will be split off as a new company, and in the IT Infrastructure segment also, the cloud storage services business will be split off as a new company. In addition, the overseas business being undertaken in Asia will be supervised by a new company to be established in Singapore. By transitioning to a holding company structure, the Company is aiming to not lag behind in responding to the changing times in the IT industry, and while keeping a watch on the latest technological trends, to promote timely decision making and flexible management.

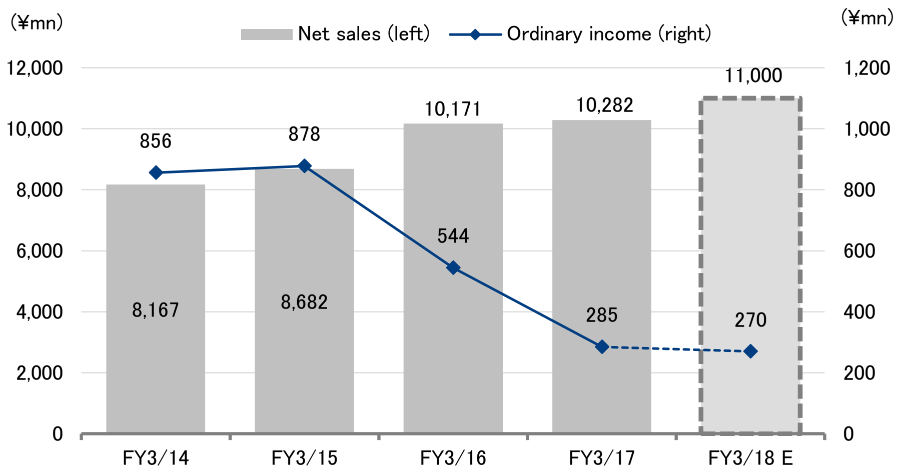
3. On December 29, 2017, upwardly revised the full fiscal year forecasts. Profits are expected to continue to grow in FY3/19.

On December 29, 2017, the Company upwardly revised the FY3/18 full-year forecasts to net sales of ¥11,000mn (up 7.0% YoY) and operating income of ¥270mn (up 1.7%). Despite the fact that 1H results had exceeded the forecasts, the Company had postponed revising the forecasts and left the full fiscal year forecasts unchanged, as the costs that it will incur and other factors relating to the transition to the holding company structure remain unclear. However, its results are noticeably seasonal and tend to accelerate in 2H, and so even on considering the costs for transitioning to a holding company structure, at FISCO we think it is highly likely that it will secure profitability. With regards to FY3/19, it is considered that the recovery and growth trend in FY3/18 will be maintained and that sales and profits will continue to rise. In addition, the fact that it is the first year of the transition to the holding company structure is likely to raise employee morale and so contribute to improved results.

Key Points

- Officially decided to transition to a holding company structure on April 1, 2018
- Four core companies will operate its businesses; Three domestic operating companies and one company responsible for the Asia business
- Is making steady progress in results in 2H. Will cope with the costs related to the transition to the holding company, and the outlook is for results to exceed the Company forecasts.

Result trends



Source: Prepared by FISCO from the Company's financial results

Result trends

Both business segments recovered and achieved higher sales and returned to profitability for operating income

1. Overview of 1H FY3/18 results

In 1H FY3/18 results, the Company achieved a double-digit increase in net sales and a return to profitability for operating income and ordinary income, with net sales of ¥5,372mn (up 12.5% YoY), operating income of ¥221mn (compared to a loss of ¥119mn in the same period in the previous fiscal year), and ordinary income of ¥235mn (a loss of ¥110mn). Profit attributable to owners of parent was ¥210mn (up 739.7%), which was an increase of more than eight times YoY due to the recording of extraordinary income.

Overview of 1H FY3/18 results

(¥mn)

	FY3/17		FY3/18			
	1H	Full year	1H (E)	1H	YoY	Vs. initial forecast
Net sales	4,774	10,282	4,922	5,372	12.5%	450
Operating income	-119	265	-126	221	-	347
Operating income margin	-2.5%	2.6%	-2.6%	4.1%	-	-
Ordinary income	-110	285	-126	235	-	361
Profit attributable to owners of parent	25	5	-76	210	739.7%	286

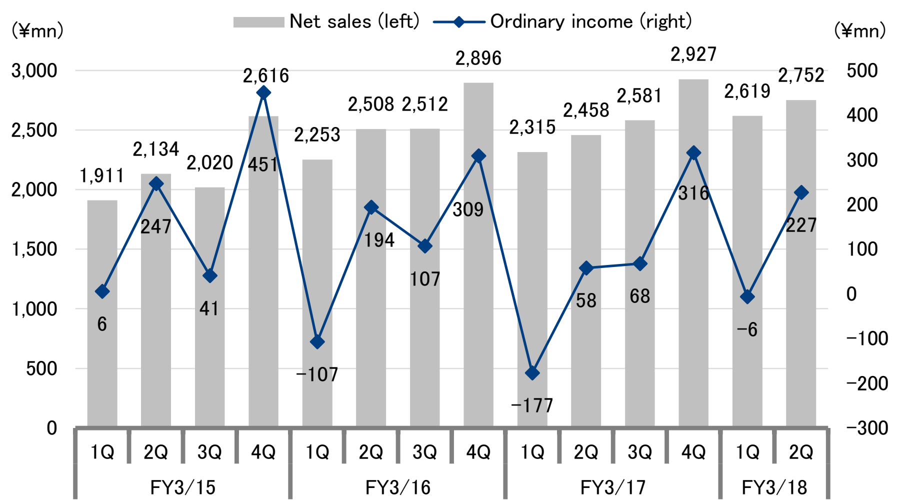
Source: Prepared by FISCO from the Company's financial results

On November 8, 2017, the Company announced that it had upwardly revised its 1H forecasts, and the results were in line with these new forecasts. The reasons given for the upward revision were the strong sales of MFP (multifunction printers) and network equipment-related in the IT Infrastructure segment, that the growth in SG&A expenses was being kept down through the efficient use of costs, and that some costs scheduled for 1H had been pushed back to 2H.

The Company's results are seasonal, and in Q1 of a typical year, it records a loss due to the rise in personnel costs from the increase in newly recruited employees, and then from Q2 (July to September) onwards, it gradually recovers from the contribution to profits of these new employees. Also, there is a tendency for further profit growth in Q4 due to demand as the end approaches for the quarter and fiscal year performance. In this situation, in FY3/17 Q1, the fall was greater than in a typical fiscal year, while subsequently, the momentum of the recovery was weak. So on a full fiscal year basis, operating income declined for the second consecutive fiscal year.

In FY3/18, the Q1 operating loss was greatly reduced to ¥6mn, and in Q2 (July to September), operating income significantly increased. Looking on a quarterly basis, we can clearly see that the Company's results bottomed out. As is described in more detail below, both the Digital Marketing segment and the IT Infrastructure segment are on a recovery track compared to FY3/17, which is leading to a rapid recovery (a return to profitability) in the results of the Company as a whole.

Result trends by quarter



Source: Prepared by FISCO from the Company's financial results

Results by segment

(¥mn)

	FY3/17			FY3/18		
	1H	2H	Full year	1H	YoY (%)	YoY
Digital Marketing segment	795	1,015	1,810	868	9.1%	73
IT Infrastructure segment	3,988	4,501	8,489	4,513	13.2%	525
Others segment	-	-	-	-	-	-
Net sales before adjustment	4,783	5,516	10,300	5,381	12.5%	598
Adjustment amount	-9	-8	-18	-8	-	0
Net sales	4,774	5,508	10,282	5,372	12.5%	598
Digital Marketing segment	-99	97	-2	32	-	132
IT Infrastructure segment	-3	311	308	200	-	204
Others segment	-16	-17	-33	-12	-	4
Operating income before adjustment	-119	391	272	221	-	340
Adjustment amount	-	-7	-7	-	-	-
Operating income	-119	384	265	221	-	340

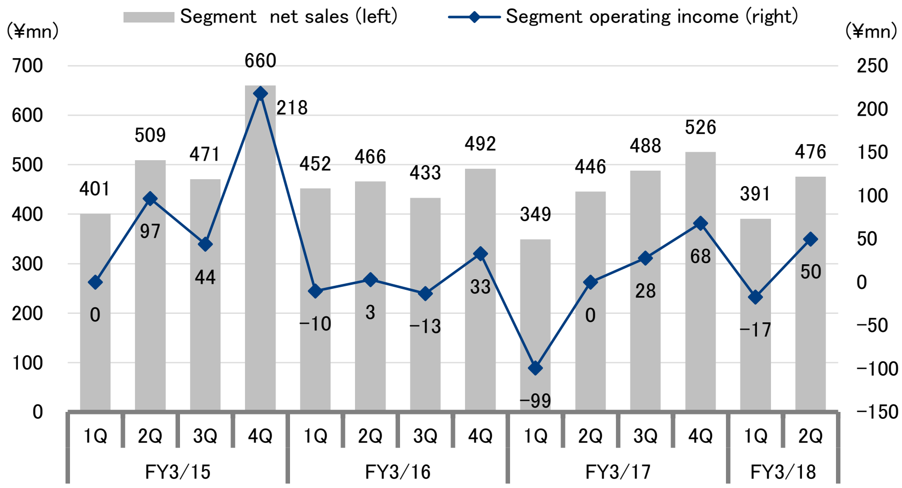
Source: Prepared by FISCO from the Company's financial results

Fully fledged expansion of the AR software COCOAR
Also making steady progress in introducing the freemium model

2. Digital Marketing segment

In the Digital Marketing segment in 1H, net sales were ¥868mn (up 9.1% YoY) and operating income was ¥32mn (compared to a loss of ¥99mn in the same period in the previous fiscal year).

Quarterly results trend in the Digital Marketing segment



Source: Prepared by FISCO from the Company's financial results

This segment started slumping in FY3/16, mainly due to coinciding with a time when customers were changing. A feature of the products in this segment is that they are highly novel, such as the software for sales support and promotion for creative companies (including advertising agencies and printing companies). Previously, the Company expanded the business to customers in the early adopter group, who are highly motivated to introduce novel products. But this demand ran its course, so it shifted to the next target customer, of the majority group (particularly the early majority group within this group). However, from FY3/16 to FY3/17, sales to this majority group did not proceed as expected, and as a result the segment struggled.

In FY3/18, the Company decided to drastically change its sales strategy and introduced "freemium." Freemium is a business model in which basic functions are provided for free, and customers are billed for the portion that goes beyond a certain amount and for special functions in the form of pay-as-you-go fees or additional fees. It can be said to be a model similar to F2P (free to play) in online gaming.

The Company has sequentially added freemium to its product offerings, starting with "creca," which is software for creating landing page websites for smartphones, then the app-creation software App Goose, and then the MA (marketing automation) tool BowNow. Among them, the greatest expectations are for BowNow, which was launched at the end of July 2017. But as only 2 months had passed for it, its contribution to results is not yet visible in 1H results. However, the provision of the free plan has been proceeding steadily and the feeling is that it will become a source of profits in the future. Going forward, the Company plans to sequentially add the software to which it applies the freemium model.

It seems the driving force behind the recovery in results in 1H was the AR (augmented reality) software COCOAR (please refer to the report of June 24, 2014, for COCOAR's features and details). In 1H, citing only the main examples, COCOAR was used for the marketing of Halloween-limited products of Calbee <2229>; for Dragonball Run, which is a fan event of the popular anime Dragon Ball; and for a collaboration event between TOKYO SKYTREE TOWN® and the popular anime Yowamushi Pedal. As of the end of September 2017, COCOAR had been introduced by 1,414 companies, and the app in order to use COCOAR had been downloaded 1.5 million times. Compared to the time in the past when the Actibook e-book software was driving the Company's results, the speed of COCOAR's growth is fast. It took 5 years for 1,000 companies to introduce the Actibook software, but in practical terms, COCOAR achieved this in just 3 years, so the difference in speed is noticeable.

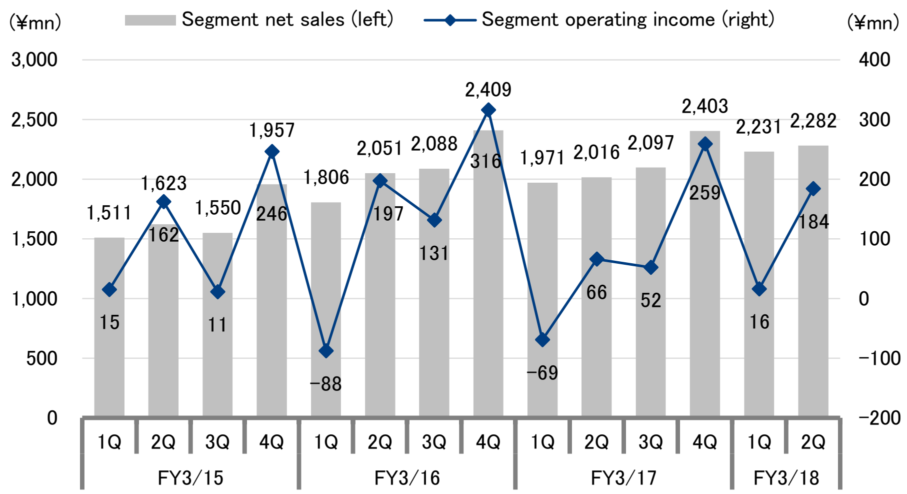
On entering 2H, COCOAR is maintaining its momentum, and the number of companies introducing it is expected to continue to increase. On the other hand, for the sales strategy from freemium, there are expectations that its effects in terms of contributing to profits will be realized in 2H from the passage of time and the enhancement of the product lineup. With COCOAR as the core product, we shall be watching to see to what extent the sales of software like BowNow and App Goose grow.

The customer-orientated structure has become established Completed the structure aiming to utilize the Company's original strengths and once again accelerate growth

3. IT Infrastructure segment

The IT Infrastructure segment posted net sales of ¥4,513mn (up 13.2%) and operating income of ¥200mn (compared to a loss of ¥3mn in the same period of the previous year).

Quarterly result trend in the IT Infrastructure segment



Source: Prepared by FISCO from the Company's financial results

Up to FY3/16, results in the IT Infrastructure segment trended steadily upward, but it then recorded a major loss in FY3/17 Q1. Subsequently, profits remained at a low level in Q2 and Q3.

The main reason for the slump in profits from FY3/17 Q1 to Q3 was the problems in the initial period of the change to the sales structure. From April 2017, the Company adopted a new structure, changing from its traditional product-orientated structure to a customer-orientated structure. With the slogan of the "Customer 1st," the new structure is based on the idea that in order to raise customer satisfaction, the account manager allocated to each customer must act as the point of contact for that customer for all of the Company' services, and provide it with a one-stop solution. However, it seems that some time was required for sales representatives working in the field to learn products and services with which they are unfamiliar.

The effects of improving the skills of the sales force gradually started to appear in FY3/17 Q4, and the fully operational structure was completed by the beginning of FY3/18. This has resulted in the higher sales and profits in 1H.

The IT Infrastructure segment has a long history as the Company's business since its foundation, and it also has a full product lineup and can be said to be essentially the area in which the Company is strong. Judged from the results of 1H, it can be said to have recovered from the initial turmoil following the change to the sales structure, and at FISCO, we think that from 2H onwards, the Company will utilize its strengths and results will trend steadily upwards.

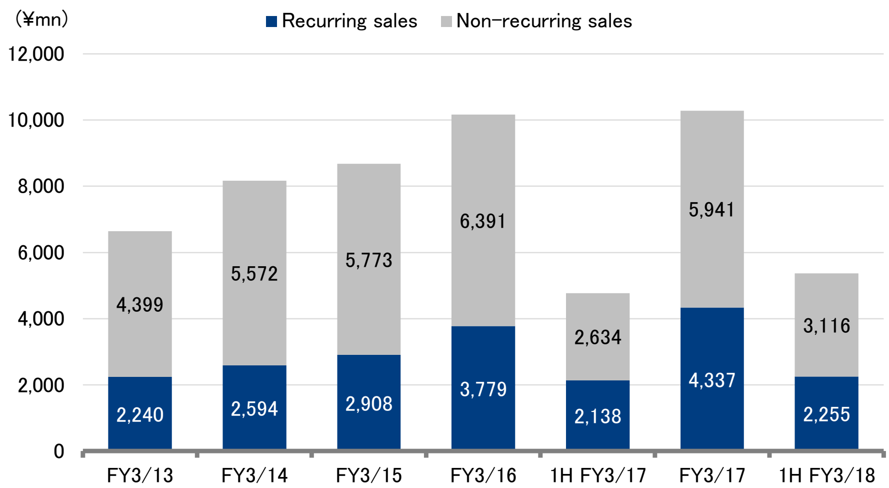
Recurring sales continue to steadily grow In the Digital Marketing segment, the ratio of recurring sales exceeds 50%

4. Recurring model: The status of recurring sales and non-recurring sales

An initiative on which the Company is focusing on a Groupwide basis is strengthening stock-type products, and it has introduced the concept of the "recurring model" as the slogan shared throughout the Group to promote this. Generally in business, there is the approach of the recurring business, which refers to a type of business such as selling mobile phones or printer machines inexpensively and then obtaining recurring revenue from the call charges or sales of ink cartridges. The Company's recurring model is the same as this, and it is aiming to realize a strong profit structure that is unaffected by fluctuations in economic conditions through introducing and increasing sales of stock-type products.

Looking at the progress up to the present time, we see that recurring sales have continued to grow steadily year by year, and that the changes in net sales have been brought about by the good or bad performance of non-recurring sales. In 1H FY3/18, recurring sales were ¥2,255mn (up 5.5% YoY) and flow sales were ¥3,116mn (up 18.3%). The percentage of total net sales provided by recurring sales was 42.0%, down from 44.8% in the same period in the previous fiscal year. This was due to the growth in flow sales.

Recurring sales and non-recurring sales

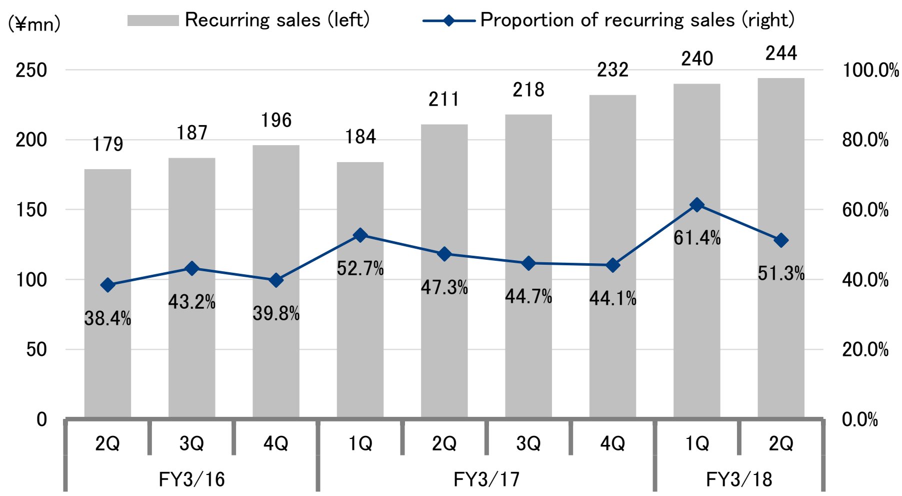


Source: Prepared by FISCO from the Company's results briefing materials

The target for advancing the recurring model is not just the IT Infrastructure segment, as the Company is also focusing on converting the Digital Marketing segment's business model to a stock type. Up to the present time, it has mainly sold its products through completed sales (meaning single-payment sales for the Company), because in this method, income temporarily rises and the gross profit margin increases. But its policy for the future is to mainly provide services on the cloud. In the Digital Marketing segment in FY3/18 Q2 (July to September), recurring sales were ¥244mn, and the percentage of total net sales provided by recurring sales was 51.3%. The result in Q1 of 61.4% was a value produced in a situation in which non-recurring sales were reduced by seasonal factors to extent barely more than a "murmur" However, the Q2 value, of a level of 50%, was produced in a situation in which flow sales grew sufficiently, so can be seen as evidence that the Company is making steady progress in converting the business model.

At FISCO, we think that the conversion of the Digital Marketing segment to a stock-type model is extremely significant. The reason is that when the Company's software is continually used by large companies for their marketing, if there is a single payment, it will only receive sales income of several million yen, but when the income is from a pay-as-you-go billing system on the cloud, the sales income could be much bigger than that. Also, when transitioning the sales method it adopts from a freemium system to a billing system, the natural flow is a transition to cloud-based services, and this is a stock-type model. On this point also, the percentage of stock-product sales will naturally rise.

Trend in recurring sales in the Digital Marketing segment



Source: Prepared by FISCO from the Company's results briefing materials

Longer-term growth strategies

Officially decided to transition to a holding company structure on April 1, 2018

1. Transition to a holding company structure

In a press release on November 10, 2017, the Company announced that it had officially decided to transition to a holding company structure on April 1, 2018. This was not a particular surprise, as it had already announced in a press release on April 14, 2017, that it was considering transitioning to a holding company structure.

The Company says its aim and objective for the holding company structure are to not to lag behind in responding to the changing times in the IT industry, and while keeping a watch on the latest technological trends, to promote timely decision making and flexible management. Given the speed of change in the IT industry to which the Company belongs, this would seem to be a reasonable decision.

At FISCO, we believe that one of the reasons why the Company decided to transition to a holding company structure at this time is its growing confidence that its results are recovering. If profits were to fall immediately after the transition to the holding company structure, even if the decision to do so was essentially correct, the transition itself might be viewed as a failure. The forecasts for the near future are described below, but the key point would seem to be the Company's growing confidence that its earnings are recovering and returning to a growth track.

Four core companies will operate its businesses; Three domestic operating companies and one company responsible for the Asia business

2. The corporate structure after the transition to the holding company structure

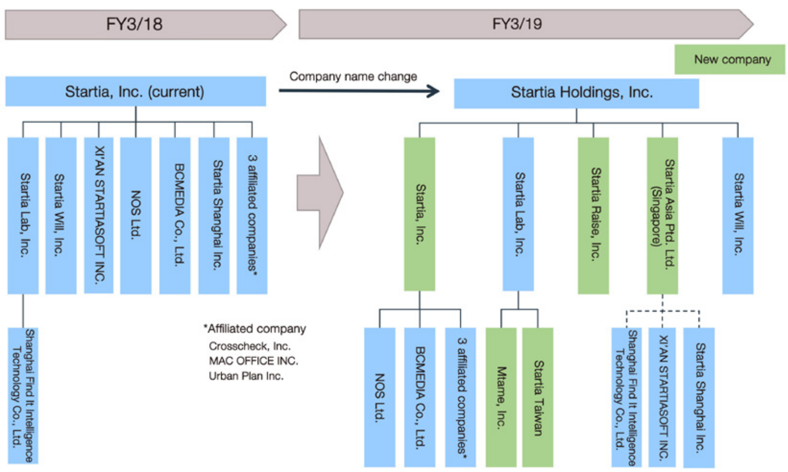
In terms of the sequence of events in the near future, on April 1, 2018, the Company will change its corporate name to Startia Holdings Inc. As the new operating companies, Startia, Inc. (at the time of its establishment, Startia Split Preparation Company) and Startia Raise, Inc., will be newly established and will succeed the businesses that are split off from the Company.

Within the current IT Infrastructure segment, Startia Raise will be responsible for the cloud storage services business and the IT solutions business, which will be split off from this segment.

In conjunction with the transition to the holding company structure, the Company plans to establish Startia Asia Ptd. Ltd. to be responsible for its overseas business. Startia Lab, Inc. will continue to be mainly responsible for the business of the Digital Marketing segment, and continue management of Startia Taiwan, which will be elevated from the Taiwan branch office. Also, the web promotion business will be split off from the business of Startia Lab, and it will become the responsibility of the newly established Mtame, Inc. In addition, Startia Will, Inc., was already established in July 2017 as a special subsidiary for the employment of people with disabilities.

Up to the present time, business management has been mainly conducted by two companies, the Company itself and Startia Lab. But after the transition to the holding company structure, the aim is to grow each respective business through four core companies, of Startia (the new company), Startia Lab, Startia Raise, and Startia Asia (the growth strategies of each operating company are described below).

Comparison of company structure before and after transition to holding company



Source: The Company's results briefing materials

Will succeed the current IT Infrastructure segment and be the core company responsible for profits

3. Startia (new company)

Startia will be responsible for the current IT Infrastructure segment, except for the cloud-based storage services business (in terms of products, Secure SAMBA, etc.)

It seems that Startia's mainstay businesses will include sales of MFP and accompanying copy counter services, the Startia Hikari fiber-optic lines, network equipment, and business phones. At the current time, these support the profits of the IT Infrastructure segment as its core products, and it is thought that this structure will not change even after the transition to the holding company structure.

As previous mentioned, the Company changed the sales structure in the IT Infrastructure segment from the previous product-orientated structure to a customer-orientated structure, based on the "Customer 1st" slogan. In the first year of FY3/17, there were some turmoil that was specific to this transition period, but by FY3/18, this had been resolved and results have been steadily improving since Q1. As the new structure is now on track, it would seem that after the transition to the holding company structure, the Company will aim to develop new products and services in the current structure and to further increase the customer numbers.

Will succeed the current Digital Marketing segment unchanged Will play the role of the growth engine.

4. Startia Lab

The same as up to the present time, Startia Lab will mainly aim for business growth for the Digital Marketing segment. In relation to the transition to the holding company structure, its web promotion business and the products of CMS Blue Monkey and BowNow will be split off and allocated to the newly established subsidiary Mtame. But when considering the roles of Startia Lab and the Group, we think there will be no major changes.

Startia Lab's growth strategy will be to focus on how to grow sales of the software it develops in-house to creative companies in the new customer group of the majority group. On this point, there is no change from now. The point to focus on will be to what extent it can grow sales for the target customer group, of those who are conservative about introducing freemium or who lack financial resources.

It is clear that the AR software COCOAR currently plays the driving role for Startia Lab. At FISCO, we feel that a virtuous circle is being created, in which there are examples of it being utilized by a series of major companies, which in turn becomes a topic among other companies, leading to its further introduction and utilization. The Company sells the software with a single payment, but we think that changing to cloud-based or pay-as-you-go billing, and its introduction and use by major companies, should lead to the maximization of profits.

Responsible for cloud-based storage services and the IT solutions business
Expected to provide services using RPA technologies

5. Startia Raise (new company)

From within the IT Infrastructure segment, the cloud-based storage services business will be split off from it, and this business will be mainly conducted by Startia Raise, which will also be responsible for a new IT solutions business.

In this business, it will handle Secure SAMBA, which is a SaaS-type online storage service. A feature of it is that customers can share files between their bases with the same feeling as when using an in-house server. From the viewpoint of BCP (business continuity plan), contracts for it grew significantly after a major earthquake.

The IT solutions business uses RPA (robotic process automation) technologies and provides services that mainly contribute to the improved operational efficiency of administrative departments (accounting, general affairs, personnel affairs, etc.) and to reforms of ways of working. The provision of RPA software is expected to start in earnest by Startia Raise after it becomes operational.

In terms of the profitability of Startia Raise, at FISCO we estimate that the Secure SAMBA business itself is already profitable. However, in the IT solutions business, as the provision of RPA software starts, it is considered that profits may be weighed down until the RPA business gets on track. RPA itself are technologies that have been rapidly growing since around 2016 but which are not yet widely used by the Company's main customers of SMEs and their use of them is expected to spread from now onwards. Therefore, it can be said that the start of the provision of RPA is a growth investment in itself, so first we shall be waiting for this business to get on track at an early stage.

Will supervise the overseas business deployment in Asia
Startia Shanghai's contribution to profits is in sight

6. Startia Asia (new company)

Startia Asia is the operating company that will supervise the Company's overseas business by its Asia bases, and the plan is for it to supervise three companies; Startia Shanghai, XI'AN STARTIASOFT, and Shanghai Find IT Intelligence Technology.

Startia Shanghai is the Company's wholly-owned subsidiary and it operates the Global Gateway (GG) service, which is a high-speed communication line service between Japan and China. Its customers are Japanese companies with bases in China and individuals. Startia Shanghai has secured the lines through a collaboration with a major Chinese carrier and it provides its customers with high-speed Internet services up to 10 times faster than normal (note: improvements from 0.4Mbps to 5.0Mbps have been confirmed in customer offices). Startia Shanghai's profits situation is that it is on the verge of becoming profitable in the coming fiscal period as a result of the steady increase in the number of GG customers.

XI'AN STARTIASOFT is an equity method affiliate in which the Company's investment ratio is 30%, and it conducts a software planning and development business. In terms of its relation with the Company, it is contracted by Startia Lab to develop software. Its results seem to fluctuate greatly over time, and at FISCO we think its impact on the Company's results is limited.

Shanghai Find IT Intelligence Technology was founded in June 2017 from the investment of Startia Lab (40%), XI'AN STARTIASOFT (20%), and 4 Shanghai printing companies (10% each). Its business objective is to sell in the Chinese market COCOAR, whose sales are growing rapidly in Japan. Currently, it is still in its start-up period and it seems that it is not yet profitable. The Company is aiming for COCOAR to have been introduced by 300 companies in FY19, and we think that this aim will serve as the standard for its contribution to profits.

When considering a future growth strategy, expectations are greatest for Startia Shanghai. As previously mentioned, GG itself is performing well, and in addition, Global Gateway for AWS, which connects cloud environments in Japan and Shanghai by high-speed communication lines, was launched in October 2017. Even in the leading cloud services that are used globally, in many cases the use environment that is provided in China is different to that provided globally, and similarly, AWS is managed separately than in other regions. Therefore, as access to AWS in China requires an exclusive account, it is inconvenient for users as they have no choice but to rely on unstable communication lines between Japan and China. Global Gateway for AWS eliminates this inconvenience by combining AWS and high-speed GG communication lines. In terms of services, it is collaborating with Shanghai Changxing Information Technology Co., Ltd., which is a major Chinese communications company and a leading agency of China Telecom, and the key points are that the contract- and regulatory-related risks have been cleared. Also, it will not only be used to connect cloud environments in Shanghai and Japan, as in many cases it will be used when connecting office environments in Japan and China, and the target customer is increasing. The Company expects sales to 300 companies by 2020.

Focusing on the new batch provision of 16 types of services across the segment

7. Release of the new service, BiziSUKE

At the same time and in parallel to the reforms of the organizational structure, the Company is also continuously enhancing the services that meet the needs of SMEs, which is one of its inherent strengths. As part of these efforts, on January 15, 2018, it began providing the new service, BiziSUKE.

BiziSUKE is the comprehensive provision of several of the Company's products and services with the main aim of being "useful for business." Its biggest feature is the provision of the products in the IT Infrastructure segment, which are mainly provided by Startia itself, and the digital marketing-related products mainly provided by Startia Lab, in the form of a single package that crosses the segment. On its launch, the service, which consists of a package of 16 types of products and services, is being provided at ¥5,800 a month (tax not included).

At FISCO, we are paying very close attention to this BiziSUKE attempt. One reason for this is that it provides services that cross the segment. As previously explained, the Company has a new sales structure following its change from a product-orientated structure to a customer-orientated structure. However, it cannot be denied that at the sales frontline, there are differences between the natures of IT Infrastructure segment products and Digital Marketing segment products, as well as in their suppliers. So it is thought that the products that are focused on are different for each sales representative (or by the needs of customers), and BiziSUKE can be said to resolve this issue.

Also, we think that in the background to the realization of the BiziSUKE service may be the change to the organizational structure, of the transition to a holding company structure. At the current time, we evaluate that BiziSUKE will be a model case for the synergies between Startia and Startia Lab that are expected to be realized from the transition to the holding company structure.

We have also placed a spotlight on the pricing of ¥5,800 a month. Compared to when using the services separately, there is an overwhelming sense that this service is very affordable. Since introducing freemium in 2017, the Company had been aiming to improve the name recognition of the services it provides and spread their use, and the pricing of BiziSUKE would seem to be on a line extending from this aim. It will be worth paying attention to how far the effects of this “loss leader” marketing method will extend.

16 types of services included in BiziSUKE

	Name of services	Content of services
1	BiziSUKE PC support	Telephone and remote support for devices, such as PCs, and for Office software
2	Special discount flat-rate plan	Provides a new maintenance service "flat-rate plan" at a special fee
3	Service to replace business phones free of charge	Replacement free of charge if there is a problem with the business phone provide by the Company
4	Anti-virus and spyware software	5 security software licenses can be used
5	Educational-support services	Computer schools, 20% off
6	Inexpensive BiziSUKE copy paper	Can purchase copy paper up to 20% off on the website
7	Inexpensive BiziSUKE office supplies	Can purchase office supplies on the smartoffice website at 5% off
8	BowNow Free	Can use a simplified version of the BowNow MA tool
9	AppGoose Free	Can use a simplified version of the AppGoose app-creation software
10	BiziSUKE Concierge	Telephone support with personnel allocated to each customer to confirm usage conditions and consult on individual problems.
11	Business succession support	Provides matching support for business succession, together with professional consultants
12	Online seminars	Provide online seminars, including on the latest IT, law, and management issues
13	Free books from Gokigen Business Publications	Can receive 3 e-books free of charge every month from Gokigen Business Publications
14	Security tests	Provides free in-house tests of the security-level surveys as a measure against targeted attack emails
15	Startia Hikari BiziSUKE Plan	Provides the Startia Hikari as part of Hikari Collaboration setup at a special price
16	Web production special plan	Provides at 10% off the total website production cost, and maintenance and renewal is provided free of charge

Source: Prepared by FISCO from Company materials

Outlook

Is making steady progress in 2H
Will cope with the costs related to the transition to a holding company, and the outlook is to exceed the Company forecast

1. FY3/18 forecast

On December 29, 2017, the Company upwardly revised the FY3/18 full year forecasts. The new forecasts are for net sales of ¥11,000mn (up 7.0% YoY) operating income of ¥270mn (up 1.7%), ordinary income of ¥270mn (down 5.5%), and profit attributable to owners of parent of ¥415mn (profit of ¥5mn in the same period in the previous fiscal year).

Overview of FY3/18 forecast

(¥mn)

	FY3/17			FY3/18				
	1H	2H	Full year	1H	2H (E)	YoY	Full year (E)	YoY
Net sales	4,774	5,508	10,282	5,372	5,627	2.2%	11,000	7.0%
Operating income	-119	385	265	221	48	-87.4%	270	1.7%
Operating income margin	-2.5%	7.0%	2.6%	4.1%	0.9%	-	2.5%	-
Ordinary income	-110	396	285	235	35	-91.2%	270	-5.3%
Profit attributable to owners of parent	25	-19	5	210	205	-	415	-

Source: Prepared by FISCO from the Company's financial results

As described above, the Company achieved operating income in 1H despite the initial forecast for an operating loss. The extent of the increase in profits above forecast was around ¥350mn for both operating income and ordinary income, which at FISCO we evaluate as strongly suggesting that the Company's results are recovering and have returned to a growth track. As a result, on considering the seasonality of the Company's results, in which the growth in profits accelerates in 2H, we thought that the initial forecasts for the full fiscal year were too conservative. While agreeing with our opinion, the Company wanted to be a little more certain about the progress made in Q3 and the outlook for Q4, so had decided against a revision at the time of 1H results. Subsequently, when the Q3 results had become more certain, it revised the forecasts.

One of the reasons why the Company was cautious about upwardly revising the forecasts was the various costs it will incur on the transition to the holding company structure. It will establish several new companies in Japan and overseas, and it seems that in addition to the direct establishment costs, it will also incur other costs, such as for offices and to deploy human resources, of a fairly substantial amount. The recording of some costs was also pushed back from 1H to 2H, and there is a tendency for advertising costs to be concentrated in 2H, which are also reasons why the Company has been cautious about revising its forecasts.

In Q3, while it seems that these various costs are being incurred as scheduled, it would also seem that the strong momentum from 1H is being maintained and that profits are continuing to steadily grow. Net sales were above the forecast, as within the IT Infrastructure segment, MFP and network equipment-related sales are trending strongly. In profits, operating income and ordinary income were also above their forecasts partly because efficient spending on costs and cost reductions in SG&A expenses are being realized throughout the Company.

In addition, the Company sold investment securities from the viewpoint of effectively utilizing assets held, and so in Q3, it recorded extraordinary gain of ¥313mn on the sale of investment securities. Reflecting this, the forecast for profit attributable to owners of parent has been significantly revised, from the previous forecast of ¥112mn to ¥415mn.

At FISCO, we think that even after the revision, there is still more room for operating income and ordinary income to exceed their forecasts. In 2H FY3/17, the Company earned operating income of close to ¥400mn. In contrast, in order to achieve the revised forecasts for the current fiscal period, in 2H it only has to earn operating income of ¥48mn. Even when considering the one-time costs that will be incurred on the transition to the holding company structure, we think that there is little possibility that operating income will decline greatly in 2H compared to in the same period in the previous fiscal year. We shall be paying close attention to how results trend in Q4.

The forecast is for the recovery and growth trend from FY3/18 to be maintained and for the higher sales and profits to continue

2. Prospects for FY3/19

At FISCO, we think that continuing on from FY3/18, the Company will achieve higher sales and profits in FY3/19. One reason for this is that we can expect steady growth in both of the Company's two segments (currently, the IT Infrastructure segment and the Digital Marketing segment). Since the beginning, the IT Infrastructure segment has been a highly profitable business, and the slump in FY3/17 was a temporary one due to the changes to the sales structure. In the Digital Marketing segment, it would seem that COCOAR has entered a phase of fully fledged expansion and it can be expected to create a foundation for profit growth. The extent of the increase in sales and profits will change depending on the extent to which the effects of freemium contribute to them.

On transitioning to the holding company structure, the Company plans to establish new companies and enter into new businesses, and as a result of this, it will incur costs that it has not previously incurred. Particularly worthy of attention would seem to be that Startia Raise's IT solutions business, or in other words, its RPA software business, is set to be launched at an early stage. Other than this, the increase in SG&A expenses is likely to be kept down to a slight increase only. However, RPA software will be managed under the Company's high cost-control capabilities, and therefore the possibility of an uncontrolled rise in costs would seem to be low.

Condensed income statements and key performance indicators

(¥mn)

	FY3/15	FY3/16	FY3/17	FY3/18	
				1H	Full year (E)
Net sales	8,682	10,171	10,282	5,372	11,000
YoY	6.3%	17.1%	1.1%	12.5%	7.0%
Gross profit	4,356	4,609	4,536	2,386	-
YoY	2.6%	5.8%	-1.6%	17.7%	-
Gross profit margin	50.2%	45.3%	44.1%	44.4%	-
SG&A expenses	3,609	4,106	4,271	2,165	-
YoY	5.7%	13.8%	4.0%	0.9%	-
Ratio of SG&A expenses to sales	41.6%	40.4%	41.5%	40.3%	-
Operating income	747	503	265	221	270
YoY	-10.0%	-32.6%	-47.3%	-	1.7%
Operating income margin	8.6%	5.0%	2.6%	4.1%	2.5%
Ordinary income	878	544	285	235	270
YoY	2.6%	-38.0%	-47.6%	-	-5.5%
Profit attributable to owners of parent	592	253	5	210	415
YoY	37.2%	-57.3%	-97.7%	739.7%	-
Adjusted EPS (¥)	58.09	24.82	0.58	20.82	41.08
Adjusted DPS (¥)	10.00	9.00	9.00	3.00	9.00
Adjusted BPS (¥)	389.90	400.57	393.04	-	-

Note: Conducted a 2-for-1 stock split on October 1, 2015
Source: Prepared by FISCO from the Company's financial results

Condensed balance sheet

(¥mn)

	FY3/14	FY3/15	FY3/16	FY3/17	1H FY3/18
Current assets	4,051	4,057	4,700	4,498	4,825
Cash and deposits	2,247	2,335	2,638	2,221	2,743
Notes and accounts receivable	1,438	1,319	1,597	1,772	1,506
Other	366	403	465	505	576
Non-current assets	1,115	1,604	1,828	1,396	1,236
Tangible non-current assets	105	150	172	108	102
Intangible non-current assets	502	811	927	531	447
Investments and other long-term assets	507	642	728	756	686
Total assets	5,167	5,662	6,529	5,894	6,062
Current liabilities	1,661	1,684	1,878	1,712	1,892
Trade accounts payable	618	565	640	681	676
Short-term borrowings, etc.	-	-	333	346	333
Other	1,043	1,119	905	685	883
Non-current liabilities	12	-	561	211	9
Long-term borrowings	-	-	559	200	-
Other	12	-	1	11	9
Shareholders' equity	3,450	3,960	4,095	3,932	4,082
Capital stock	795	824	824	824	824
Additional paid-in capital	937	965	965	926	926
Retained earnings	1,717	2,208	2,344	2,268	2,418
Treasury stock	-0	-38	-38	-87	-87
Accumulated other comprehensive income	42	15	-11	37	27
Subscription rights to new shares	1	2	2	0	-
Net assets	3,493	3,977	4,088	3,970	4,161
Total liabilities and net assets	5,167	5,662	6,529	5,894	6,062

Source: Prepared by FISCO from the Company's financial results

Statement of cash flows

(¥mn)

	FY3/14	FY3/15	FY3/16	FY3/17	1H FY3/18
Cash flow from operating activities	638	768	366	155	649
Cash flow from investing activities	-286	-595	-762	-165	118
Cash flow from financing activities	-24	-82	705	-403	-225
Changes in cash and cash equivalents due to currency exchange fluctuations	-1	48	-24	-6	-0
Absolute change YoY in cash and cash equivalents	326	139	284	-420	543
Balance of cash and cash equivalents at start of fiscal year	1,868	2,195	2,335	2,620	2,199
Balance of cash and cash equivalents at end of fiscal year	2,195	2,335	2,620	2,199	2,743

Source: Prepared by FISCO from the Company's financial results

Shareholder returns

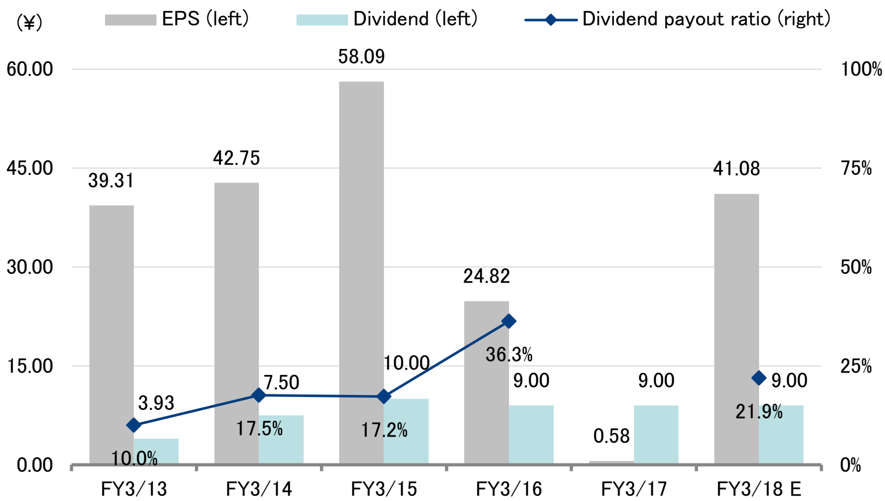
Investment in growth can be expected to maximize returns to shareholders in the medium- to long-term

The Company values its individual shareholders and actively returns profits to them. Dividends are fundamental to that approach, and its basic policy is to determine the dividend while maintaining a balance with supplementing internal reserves to invest in growth for the future. In the past, the Company adopted a rule of a dividend payout ratio of 10% as a guideline, but from FY3/15, it raised the dividend payout ratio target for the ordinary dividend from 10% to 15%.

For FY3/18, the Company has announced a dividend forecast of ¥9 (interim ¥3, end-of-period ¥6), which is unchanged YoY. As described above, on December 29, 2017, it upwardly revised its earnings forecasts for the full fiscal year, but it left the previous dividend forecast unchanged.

At FISCO, although for a while we have thought that results may exceed their forecasts, we are taking a cautious stance on a revision to the dividend forecast. This stance did not change even after the recent upward revision to the other forecasts, and we are continuing to be cautious about the prospects of the dividend forecast for the current full fiscal year being revised. One reason for this is that even after the recent revision to the earnings forecasts, the dividend payout ratio is at an average level of 21.9%. Another reason is that in addition to the development projects for new products and services from before, the Company requires new funds towards further growth, such as for RPA. We think that now that the Company's growth strategy has become clearer, allocating funds to growth investment will ultimately lead to maximizing returns to shareholders, rather than by paying dividends,.

Trends in the EPS, the dividend, and the dividend payout ratio



Note: The Company made a 2-for-1 share split on October 1, 2015.
Source: Prepared by FISCO from the Company's financial results

Information security

Has acquired several third-party certifications that it utilizes as the guidelines for establishing and strengthening the in-house structure

The Company provides its SME customers with advisory and consulting services, as well as products, on information security. Therefore, the Company itself is naturally strongly aware of the importance of information security and conducts measures for it. Specifically, it has acquired ISMS certification, which is an information security management system (ISO/IEC 27001), and PMS certification, which is a personal information protection and management system (JIS Q 15001). By acquiring these third-party certifications, the Company is supporting compliance with laws and regulations, the mitigation of risks, continuous improvements, and the strengthening of brands within the Startia Group. In addition, it is working to improve the trust in which it is held by stakeholders inside and outside of the Company.

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