COMPANY RESEARCH AND ANALYSIS REPORT

System Integrator

3826

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FISCO Ltd. Analyst

Yuzuru Sato

FISCO Ltd.

http://www.fisco.co.jp

Index

Summary

After eliminating the impact of an unprofitable project, the Company is returning to a path of sales and profit growth

System Integrator <3826> is an independent software developer that holds a high share of the Japanese market for tools to support the development of databases, and these tools are very profitable. The Company also sells the GRANDIT of Web-Enterprise Resource Planning (ERP) software packages to medium-sized companies and software packages for construction electronic commerce (EC) websites. It is promoting its SI Object Browser Designer (OBDZ), a tool to support the design of applications, and its SI Omni Channel Services (SOCS), which are cloud services for the integrated management analysis of all sales channels, as its next main products.

1. FY2/17 sales and profits fell YoY due to an unprofitable project

On April 14, 2017, the Company announced its non-consolidated business results for the fiscal year through February 2017, i.e., for FY2/17. Net sales declined 10.2% year-on-year (YoY) to ¥3,176mn, and recurring profit fell 50.2% to ¥222mn. Sales and profits in the Object Browser Business and in the EC and Omni Channel Business grew briskly YoY, but the ERP Business posted a ¥280mn provision for loss on order received for a project valued at about ¥500mn. The Company has almost finished repairing the defects in this unprofitable project and expects most of the sales from this project to contribute to sales and profits in FY2/18.

2. The Company projects a return to sales and profit growth in FY2/18, led by a recovery of the ERP Business and increased sales of the OBPM

For FY2/18, the Company forecasts a 19.6% jump in net sales to ¥3,800mn and a 103.4% surge in recurring profit to ¥453mn. Both these figures would be record highs, eclipsing the highs of FY2/16. The Company anticipates a 28% YoY increase in sales in the ERP Business and a 17% rise in sales in the Object Browser Business, the latter led by sales of a new, "light" version of the SI Object Browser PM (OBPM), a tool for integrated project management that have been many customer inquiries. Although the Company expects its personnel costs and outsourcing costs to increase YoY in FY2/18, it does not foresee any provisions for losses on unprofitable orders. Furthermore, it expects sales of the OBPM and increases in sales in the EC and Omni Channel Business to contribute to profit growth.

3. By developing and promoting products that are likely to become de facto industry standards, the Company aims for double-digit annual growth in sales and profits.

As a strategy to achieve growth over the medium-to-long term, rather than rely on a single product, the Company plans to strengthen its profit base by developing new products for which it projects market growth and making them profitable. The Company targets the development of software products that are likely to become the de facto standards in their respective fields and the provision of cloud services. It expects cloud services to propel sales and profit growth and to stabilize profits. While promoting new products, such as the OBDZ and the SOCS, the Company plans to increase its sales of existing products, such as the OBPM and GRANDIT, thereby achieving double-digit growth in sales and profits.

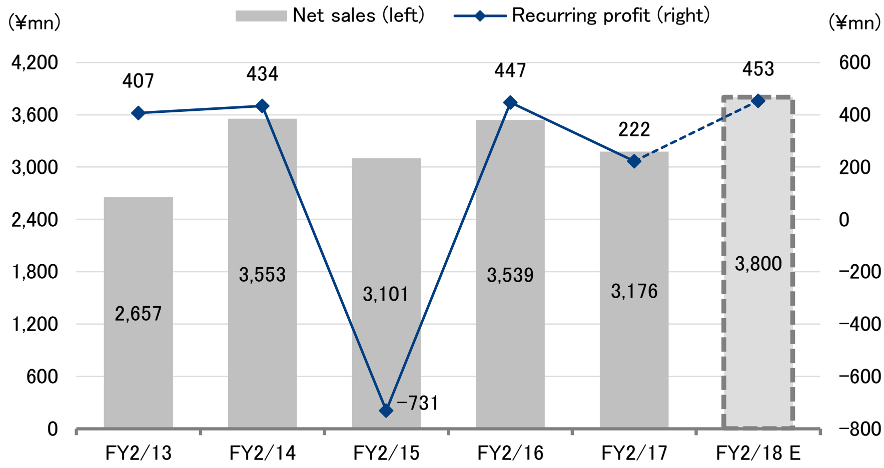
4. Company maintains a dividend payout ratio of at least 30%

As a means of shareholder return, the Company has set a standard dividend payout ratio of at least 30%, thereby linking its dividend payments to its profits. For FY2/18, the Company plans to pay dividends of ¥16.0 per share, which would increase ¥8.0 per share more than the dividends it paid for FY2/17. This planned dividend would result in a dividend payout ratio of 31.3% based on the Company's EPS forecast for FY2/18. In addition, the Company presents a gift of koshihikari rice grown in Niigata Prefecture to shareholders who hold the Company's shares for more than six months.

Key Points

- Independent software developer with a high share of the Japanese market for tools to support development
- For FY2/18, the Company projects sharp rises in net sales and profits as it foresees no provision for losses on an unprofitable project
- By promoting new products that are likely to become de facto industry standards, the Company aims for double-digit annual growth in sales and profits

Results trends



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

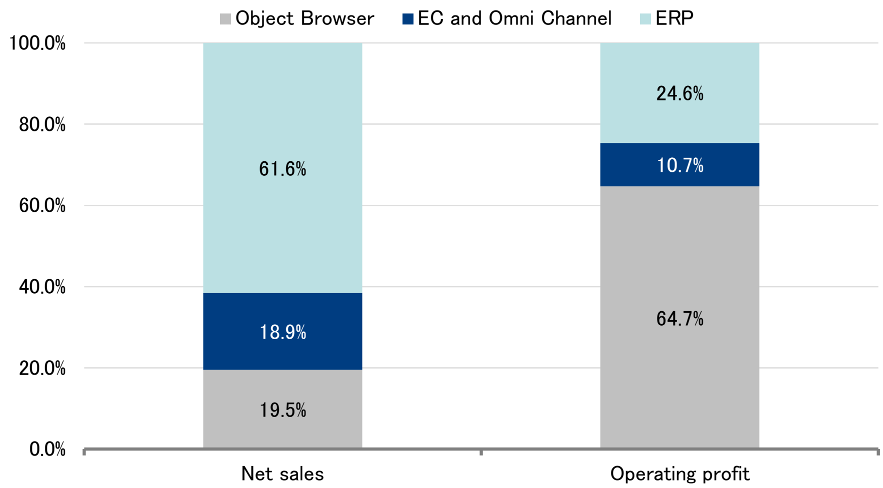
Business overview

Independent software developer with a high share of the Japanese market for tools to support development

The Company is an independent software developer that mainly develops, sells, and provides maintenance and support services for package software, and also offers consulting. For new products, its business is basically moving toward cloud services. Currently, its main products include the database development support tool SI Object Browser, the project management package OBPM, the Web-ERP package GRANDIT, and the EC sites construction package SI Web Shopping. In terms of its business segments, it has disclosed information on three segments; the Object Browser Business, the ERP Business, and the EC and Omni Channel Business.

In FY2/17, the ERP Business supplied 61.6% of the Company's total net sales, but the Object Browser Business provided 64.7% of its operating profit, while the EC and Omni Channel Business accounted for 10.7% of total operating profit, and the ERP Business, for 24.6%. The Object Browser business is accounted for the majority of operating profits. The profitability of the ERP Business was impaired by the unprofitable project cited earlier, but the Object Browser Business is the stable source of profit for the Company. The Company's businesses are described below.

Percentages by business (FY2/17)

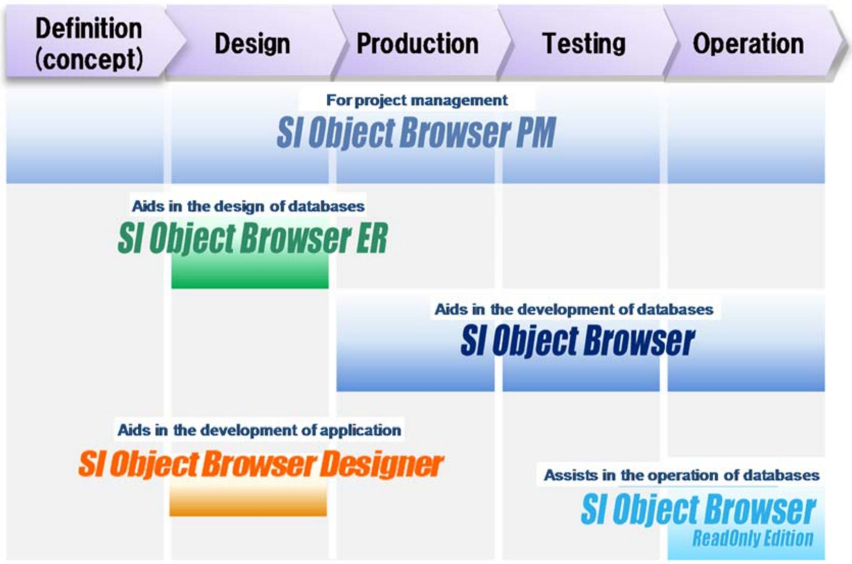


Note: Operating profit is based on before the deduction of Company-wide expenses
Source: Prepared by FISCO from the Company's financial results

1. The Object Browser Business

The Object Browser Business develops and sells software products, such as the SI Object Browser series, including the SI Object Browser to support the development of databases and the SI Object Browser ER tool to support the design of databases, the OBPM for integrated project management, and the OBDZ tool for the design of applications, which was released in June 2013. Previously, the SI Object Browser series was sold only as packaged software, but it is now also sold as a cloud service. The SI Object Browser series supplies about half the total sales generated by the Object Browser Business, and the OBPM provides the other half. Sales of the OBDZ are still minor.

The software development process and SI products



Source: The Company's website

Since it was launched in 1997, the SI Object Browser series has been installed in 16,000 companies in Japan and has become the de facto standard for software to design and develop databases in Japan. Maintenance fees comprise 25% of the sales generated by the SI Object Browser series. These fees constitute a stable source of sales each year and require almost no sales costs. Thus, they contribute to the 90% gross profit margin on sales of this series.

The OBPM is a tool for the integrated management of progress in a development project. Its use prevents the emergence of unprofitable projects and raises the productivity of a development department. Since it was launched in 2008, this tool has been installed in more than 140 companies. As there is no competing product on the market, sales of the OBPM yield a gross profit margin of 70%. Most of the companies that have adopted the OBPM are well-established, medium-sized IT companies. Large IT companies use tools similar to the OBPM that they have developed in-house, while small-to-medium-sized IT companies buy software on the market, such as the Excel program, for project management. As the name recognition of the OBPM has spread and the tool’s high quality has been recognized, some large IT companies are considering using the tool. In addition, some companies not involved in software development have begun to inquire about buying the tool.

Since the Company released the OBDZ in 2013, it has gradually improved the function of this tool, and the number of companies using the tool, now surpassing ten, is growing steadily. The SI Object Browser series and the OBPM have been sold in China by Chinese business partners of the Company, but these sales are still insignificant.

2. The ERP Business

The ERP Business sells the GRANDIT of Web-ERP packaged software. This software is sold by a consortium of 14 IT companies. Since this consortium was established in 2004, the Company has been involved in planning and developing a new software product and has contributed to the market diffusion of this product. The GRANDIT of Web-ERP packaged software is targeted to well-established, medium-sized companies and has been sold to more than 910 companies by the consortium.

A distinctive feature of the GRANDIT software is that it is completely based on the Web. Therefore, customers can easily upgrade their software without maintenance. The software can also be used on smart devices. As the software is independent of hardware, it can be used anywhere in the environment where the Web operates. Because the GRANDIT software is jointly developed by the consortium, it offers a highly competitive performance.

The Company has a track record well over 100 companies selling the product and it has the best results within the consortium. It is currently expanding sales of a production management add-on module and an continuing transaction management add-on module for the manufacturing industry that enhances GRANDIT's basic functions, and a Project Management Template (IT template) that is linked to OBPM for the software industry have been developed in-house.

The Japanese market for ERP software was worth about ¥120,000mn in 2016, and it is projected to grow at a steady annual rate of about 8%. Venders of ERP software differ depending on the size of their customers. In sales of ERP software to large companies, SAP and Oracle hold dominant positions. In sales to well-established, medium-sized companies, the Company's ERP Business faces several competitors, including the GLOVIA software from Fujitsu Ltd. (6702) and the OBIC 7 software from OBIC Co., Ltd. (4684). The gross profit margin on the Company's ERP Business varies by product and specification, but it appears to average 20%.

3. The EC and Omni Channel Business

The EC and Omni Channel Business mainly develops and sells the Company's mainstay product of SI Web Shopping, which is Japan's first EC sites construction package. A feature of SI Web Shopping is its strength in large-scale EC sites. More specifically, if possesses scalability, being able to process large-volume transactions for sales amounts of several tens of billions of yen; high-level security functions; mobile-compliance functions, including for its use with smartphones; and is also compliant with multiple languages, such as English and Chinese. For its cumulative sales total since its launch, it has been used to build more than 1,100 EC sites.

In terms of the Company's position in the EC sites construction package industry, if limited to for large-scale businesses, there is basically a market oligopoly of 3 companies; the Company, ecbeing Corp, which is a subsidiary of Software Create Holdings <3371>, and Commerce21 Corporation. But recently this environment has become more severe, with market entrants increasing in number and price competition intensifying.

Other services within this business are SI Mobile Portal, which is an O2O marketing service released in 2012 that utilizes the Wi-Fi infrastructure, and SOCS, which is an omni-channel compliant, integrated management analysis cloud service released in 2015. The SOCS service can integrate management information, including product, inventory, and customer information, from multiple EC sites and real stores, and then analyze it from a unified interface. At the present time neither service has been introduced by that many companies, but their use is expected to spread in the future.

Results trends

Net sales and profits declined YoY in FY2/17 due to an unprofitable project

1. Summary of the FY2/17 results

In FY2/17, the Company's net sales decreased 10.2% YoY to ¥3,176mn, its operating profit fell 50.8% to ¥219mn, its recurring profit dropped 50.2% to ¥222mn, and its net profit was down 62.3% to ¥137mn. These results were all below the Company forecasts announced in October 2016.

FY2/17 results

(¥mn)

	FY2/16		FY2/17				
	Result	% of sales	Company target	Result	% of sales	YoY change	Change vs. target
Net sales	3,539	-	3,300	3,176	-	-10.2%	-3.7%
Cost of sales	2,508	70.9%	-	2,296	72.3%	-8.4%	-
SG&A expenses	586	16.6%	-	660	20.8%	12.8%	-
Operating profit	444	12.6%	250	219	6.9%	-50.8%	-12.5%
Recurring profit	447	12.6%	253	222	7.0%	-50.2%	-12.0%
Net profit	364	10.3%	146	137	4.3%	-62.3%	-5.9%

Note: Company targets are as of October 2016.
Source: Prepared by FISCO from the Company's financial results

The Company attributes its profit declines in FY2/17 to the emergence, in the second quarter (2Q) of the fiscal year, of an unprofitable project within an order of about ¥500mn. Because of this project, the Company posted a ¥280mn provision for loss on order received in its cost of sales. The Company dispatched additional personnel to assist in the development of the problematic project. Therefore, its ERP Business lacked enough personnel to pursue new orders, and this contributed to the sales decline. If the unprofitable project had not arisen, the Company believes that its net sales and profits would have increased YoY in FY2/17.

In FY2/16, the Company reversed its provision for loss on order received by ¥91mn. Thus, the contributions to this reserve increased by ¥371mn between the two years, lowering gross profit and operating profit by the same amount. Other factors increased gross profit by ¥220mn YoY in FY2/17, but SG&A expenses increased by ¥74mn, mainly because personnel costs and advertising and sales promotion costs returned to normal levels in FY2/17, after having been squeezed in FY2/16 to improve profits.

Factors contributing to changes in operating profit

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

The Company has corrected the defects leading to the unprofitable project in 2Q FY2/17, and is now testing operations for this project. This project will accrue to sales in stages, but it now appears that most of its sales will be recognized in the second half (2H) of FY2/18, which is about nine months later than the Company had originally planned to recognize them. The Company is unlikely to change its reserve for unprofitable orders in FY2/18. With regard to another unprofitable project that arose in FY2/15, the Company is now negotiating a final contract with the customer, but it does not expect to incur expenses in addition to the provision for loss on order received already made.

Object Browser Business and EC and Omni Business contributed to profit growth

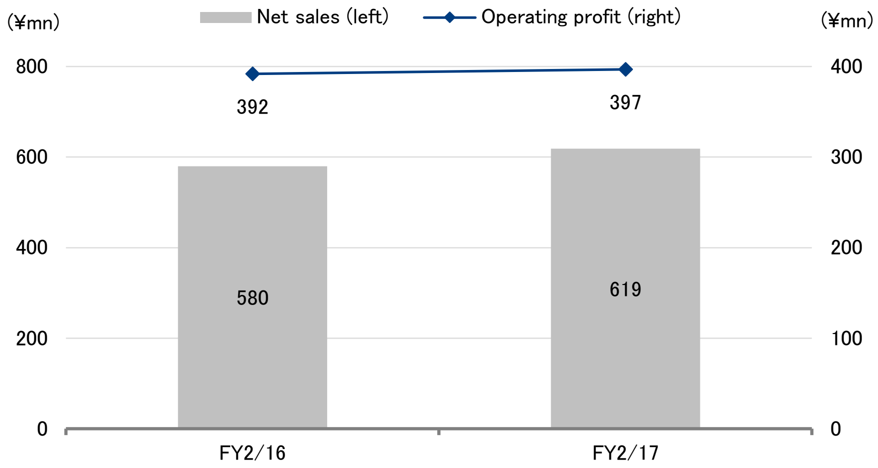
2. Earnings by business segment

(1) The Object Browser Business

In the Object Browser Business, sales increased 6.8% YoY in FY2/17 to ¥619mn and operating profit grew 1.1% to ¥397mn. Sales of the SI Object Browser series remained unchanged YoY. This series has been adopted by about 16,000 companies, making it the de facto standard for its industry. The Company is now promoting sales of this series in the cloud market. Sales of the OBPM increased by double-digit YoY in FY2/17. Over the eight years since this product was launched, it has gained increased market recognition, and the cumulative number of companies using it increased to 140 at the end of FY2/17 from 120 a year earlier. The OBDZ has also gained greater market recognition as a tool that increases the productivity of software development by automating its design. More than ten companies now use this tool; however, there appears to be need for further performance improvements, which the Company is implementing based on customer feedback. The operating profit margin in the Object Browser Business fell to 64.1% in FY2/17 from 67.7% in FY2/16, mainly because of a deterioration of the sales mix and an increase in advertising and sales promotion costs for the OBPM and OBDZ.

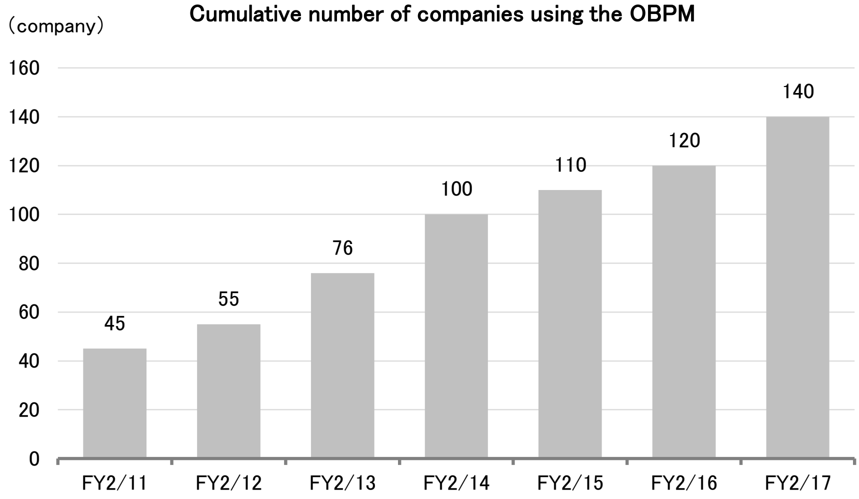
In May 2015, the Company formed an alliance with the Chinese company Chengdu Winnersoft CO., Ltd. (Winnersoft) for the development and sale of a Chinese version of the OBPM However, Winnersoft became involved in the development of custom-made tools for large projects and did not promote the sale of the Chinese version of the OBPM. Therefore, the Company will terminate its relationship with Winnersoft and plans to seek another Chinese partner to promote the sale of the Chinese version of the OBPM.

The Object Browser Business



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

Cumulative number of companies using the OBPM



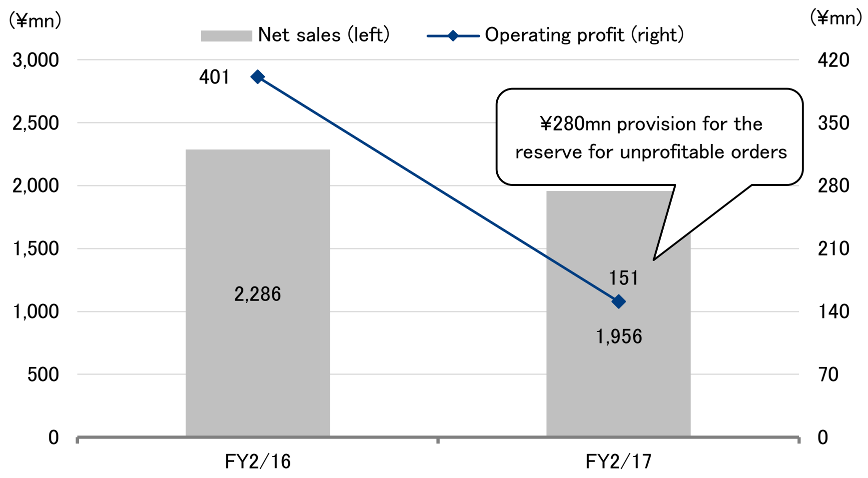
Source: Prepared by FISCO from the Company website

(2) The ERP Business

In the ERP Business, sales weakened 14.4% YoY to ¥1,956mn and operating profit dropped 62.4% to ¥151mn. Sales of the Company's proprietary Production Management Add-on Modules to manufacturers increased, as did introductory sales of its IT Template to IT companies in conjunction with sales of the OBPM. However, as noted previously, the business encountered an unprofitable project, the sales from which will not be recognized until FY2/18, and the Company made a ¥280mn provision to its reserve for unprofitable orders. Thus, its total sales and profits declined. The Company discovered that the large-scale problematic project was unprofitable because it had not assigned enough personnel to it. To prevent the recurrence of this problem, the ERP Business is building a more robust workforce of developers.

In recent years, the demand for products in the ERP Business has been strong. To expand this business, the Company has been strengthening its development organization and increasing the number of companies with which it cooperates in development. With regard to personnel, the number of employees has increased from 62 employees in the FY2/16 period due to mid-career hiring and transferring from other departments within the company. For partner companies as well, steadily increasing the number of companies has been under way, similarly developing a few companies. After training and other preparation, these new personnel are expected to contribute to sales growth in 2–3 years.

The ERP Business



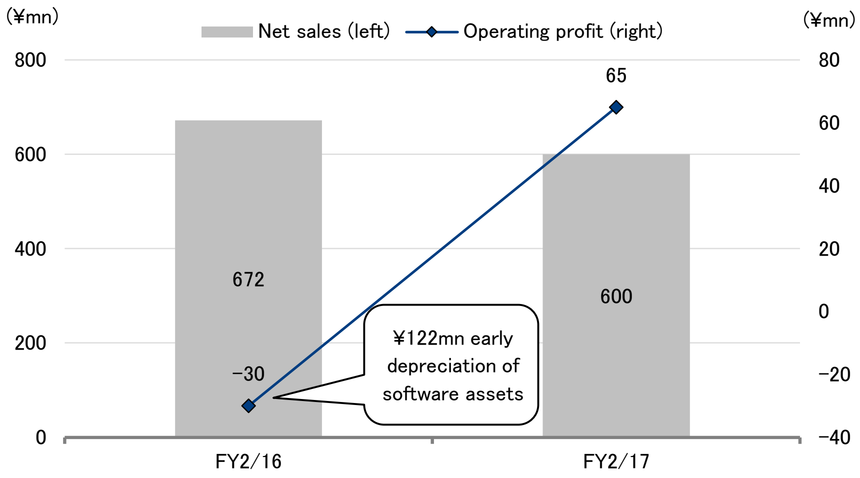
Source: Prepared by FISCO from the Company's financial results

(3) The EC and Omni Channel Business

In the EC and Omni Channel Business, sales decreased 10.7% YoY in FY2/17 to ¥600mn, but the business earned an operating profit of ¥65mn, reversing an operating loss of ¥30mn in FY2/16. Although the Japanese EC market continued to expand in FY2/17, the market targeted by the Company, the market for packaged software for large companies to build EC sites, has become saturated, and competition in this market has intensified. Thus, the Company's sales of this software continued to shrink YoY in FY2/17. Meanwhile, the main factor increasing profits was an ¥81mn YoY decrease in depreciation expense for FY2/17 following the recognition of additional depreciation of software assets for sale (¥122mn) in the previous fiscal year.

In January 2015, the Company released its omni-channel SOCS cloud service for integrated management analysis. In April 2016, it released its SOCS Version 2.0, which included the additional functions of data cleansing and name-based aggregation and a completely revised user interface that improved usability. The updated version meets the market need for unified management through the name-based aggregation of customer data dispersed throughout sales channels (EC sites and stores), thereby realizing an omni-channel approach. To date, only a few companies have purchased the SOCS cloud service, but in January 2017, the EC and Omni Channel Business placed a sales person with expertise in the sale of omni-channel cloud services, so the number of companies buying this service may increase.

The EC and Omni Channel Business



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

Company has repaid all of its interest-bearing debt, and its financial position is strong

3. Financial position and management indicators

At the end of FY2/17, the Company's assets totaled ¥3,210mn, which was ¥263mn more than its total assets at the end of FY2/16. Among current assets, cash and deposits decreased by ¥62mn YoY in FY2/17, and trade accounts receivable fell by ¥51mn, while inventories of goods in process increased by ¥257mn, and deferred tax assets grew by ¥81mn. The large increase in goods in process resulted from the unprofitable project in the ERP Business. Non-current assets, mainly software, increased by ¥28mn in FY2/17.

Liabilities at the end of FY2/17 totaled ¥1,958mn, which was ¥241mn more than the total a year earlier. Provision for loss on order received increased by ¥280mn, advances received grew by ¥88mn, and trade accounts payable rose by ¥76mn. On the other hand, income taxes payable fell by ¥27mn, and consumption taxes payable dropped by ¥133mn. Net assets at the end of FY2/17 totaled ¥1,251mn, which was ¥22mn more than the total at the end of FY2/16. The ¥137mn of net profit earned in FY2/17 accrued to retained earnings, but the Company paid ¥121mn of dividends.

Among key performance indicators, the Company's equity ratio was 39.0% at the end of FY2/17, which was 2.7 percentage points lower than its equity ratio at the end of FY2/16. The decline in this ratio was due mainly to the increase in a provision for loss on order received. The Company expects its equity ratio to rise as its profits recover. The Company has repaid all of its interest-bearing debt, and its financial position is sound. As profits fell due to the unprofitable project in FY2/17, the Company's ROE and operating profit margin declined YoY. However, the Company expects these ratios to rise from FY2/18 as its profits recover to high levels.

Balance sheet

(¥mn)

	FY2/14	FY2/15	FY2/16	FY2/17	Change
Current assets	2,212	2,497	2,520	2,761	241
(Cash and deposits)	1,130	401	788	725	-62
Non-current assets	323	456	426	448	22
Total assets	2,535	2,953	2,946	3,210	263
Total liabilities	693	2,102	1,717	1,958	241
(Interest-bearing debt)	-	353	20	-	-20
Net assets	1,841	850	1,229	1,251	22
(Retained earnings)	1,088	99	464	479	15
Financial indicators					
(Stability)					
Current ratio	323.8%	119.5%	146.8%	141.0%	
Equity ratio	72.6%	28.8%	41.7%	39.0%	
(Profitability)					
ROE (return on equity)	15.8%	-67.3%	35.1%	11.1%	
Operating profit margin	12.2%	-23.7%	12.6%	6.9%	

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

Business outlook

For FY2/18, the Company projects sharp rises in net sales and profits as it expects no provision for losses on unprofitable projects

1. Company forecast for FY2/18

For FY2/18, the Company forecasts a 19.6% YoY increase in net sales to ¥3,800mn, a 105.4% jump in operating profit to ¥450mn, a 103.4% surge in recurring profit to ¥453mn, and a 106.1% rise in net profit to ¥283mn. All these forecasts, except for net profit, would be record highs, eclipsing the previous highs of FY2/16. The Company expects its sales and profit growth to be driven by a brisk increase in sales of the OBPM, the realization in 2H of sales from the unprofitable project of FY2/17, and the absence of a provision for losses on unprofitable projects.

Forecast for FY2/18

(¥mn)

	FY2/17		FY2/18			
	Result	YoY	1H targets	YoY	Full-year targets	YoY
Net sales	3,176	-10.2%	1,550	-1.4%	3,800	19.6%
Operating profit	219	-50.8%	137	104.8%	450	105.4%
Recurring profit	222	-50.2%	138	100.7%	453	103.4%
Net profit	137	-62.3%	86	105.3%	283	106.1%

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

Company foresees double-digit increases in sales of the OBPM and the GRANDIT series

2. Outlook by business segment

(1) The Object Browser Business

For the Object Browser Business, the Company foresees sales growth of about 9% YoY in FY2/18. By continuing to promote sales of the SI Object Browser series as cloud services, the Company expects to increase sales of this series by 2% in FY2/18. On the other hand, the Company anticipates a 17% YoY rise in sales of the OBPM in FY2/18. In March 2017, it started selling a "light" version of its OBPM, with fewer functions than its standard tool, but priced at half the price of the standard version. It has received many inquiries about this "light" version from small, medium-sized and large companies, so it foresees a notable increase in sales of the OBPM in FY2/18. The Company also intends to develop versions of its OBPM for industries other than the IT industry. In March 2017, it started supplying the first such version, for engineering. It has not yet established a sales channel for this version, but it plans to market it intensively by demonstrating it at exhibitions and conducting seminars to explain the product. Through these efforts, it aims to obtain orders for the new version. Every industry in Japan has recently been plagued by a severe labor shortage, and they therefore require strict project management. Thus, there appears to be ample room for sales of the OBPM to grow.

The Company considers the Chinese market attractive, as the demand for its products in China could be much larger than the demand in Japan. The Chinese market for software development is more than ten times the size of the Japanese market. Thus, if the OBPM were to be widely adopted in China, the Company's sales and profits could rise notably. China has become increasingly aware of the importance of project management, as indicated by the rapid rise in the number of project management professionals (PMPs) in that country. In order to obtain the international PMP certification, an engineer must demonstrate mastery of the project management body of knowledge (PMBOK)* specified by the Project Management Institute of the US. A few years ago, China had about 30,000 certified PMPs, the same number as in Japan. Now, China has about 100,000 certified PMPs, or more than three times the number in Japan. Chinese PMPs use the Excel program for project management, and there is no software tool for integrated project management available on the Chinese market. Labor costs have risen notably in China in recent years, and the country's software developers are therefore seeking to improve their productivity. They would probably adopt a high-performance project management software tool if it were available. The Company is now seeking a new Chinese business partner. After finding one, the partner will start selling the OBPM. Some time will be required to generate significant sales in China, but given the huge potential demand in China, the Company's progress in selling there should be monitored. The Company is also considering the development of an English-language version of its OBPM for sale overseas.

* PMBOK is the abbreviation of Project Management Body of Knowledge created by the Project management Institute in the United States. PMBOK systematically summarizes process-based approaches applicable to a wide range of projects, including construction, manufacturing and software development. As an approach to effectively achieving project management, it summarizes the processes required, dividing them into five basic process groups and 10 management areas.

(2) The ERP Business

The Company projects a 28% YoY increase in sales for its ERP Business in FY2/18. Most of the increase will reflect the recording of the sales from the majority of unprofitable projects in 2H, with an order of about ¥500mn. However, the Company also anticipates continued increases in demand for its Production Management Add-on Module and its IT Template, the latter sold as a package including the OBPM. The Company plans to modify its GRANDIT to satisfy diverse customer needs. For example, it has made this series usable with Amazon Web Service, thereby making the series attractive to companies which are converting their administrative systems to a cloud base. Because the Company does not produce hardware, in the past, it has been unable to supply its ERP software to some companies that wanted both software and hardware. For cloud services, however, the cloud operator supplies both the hardware and network needed for the services. The spread of cloud services is therefore increasing the opportunities for the Company to obtain orders. The Company has not altered its fee schedule for the GRANDIT, but it is including services, such as operation and maintenance, in more of its contracts for the construction of systems. This tactic increases the proportion of the Company's sales accounted for by stable fees for regular services and raises the reliance of its customers on the Company. In FY2/17, the Company concluded such all-encompassing contracts with a few companies. It aims to conclude more such contracts by adjusting its products to customer needs.

Since additional development personnel will be needed to address the unprofitable project in FY2/18, the Company projects continued low profitability for the ERP Business in FY2/18. The Company does not expect this business to regain its FY2/16 operating profit margin of 17.6% until FY2/19 or later.

(3) The EC and Omni Channel Business

For the EC and Omni Channel Business, the Company forecasts a 5% YoY increase in sales in FY2/18. Although it expects competition to remain challenging for its SI Web Shopping product, it foresees an increase in sales of this product. Stressing its experience in building large EC websites and its ability to provide solutions for these websites, the Company has been marketing this product aggressively, and orders for the product have been growing, mainly repeat orders from existing customers, including orders for some relatively large projects.

As mentioned above, the EC and Omni Channel Business has recently assigned a sales person specialized in omni-channel products and is concentrating on expanding the number of potential customers for its SOCS. In April 2016, the business added the name-based aggregation capability to this tool, thereby distinguishing it from competing products. Hereafter, the business plans to increase the name recognition of the tool through seminars while obtaining more orders for it. Omni-channel products are just beginning to be adopted in Japan. Some Japanese companies appear to have developed internal solutions for integrated management of customer data from each sales channel, such as stores and EC websites, while others appear to not to have taken any measures. However, a growing number of companies appears to be concluding that the integrated management of omni-channel customer information is needed for effective marketing. Thus, the Company foresees an increase in the use of omni-channel services that offer attractive performance, functions, and prices. From FY2/18 through FY2/20, the Company targets aggregate sales of ¥500mn for its SOCS.

Medium- to long-term growth strategy

By promoting new products that are likely to become de facto industry standards, the Company aims for double-digit annual growth in sales and profits

1. Growth strategy

The Company does not intend to rely on a single product for sales and profit growth over the medium-to-long term. Rather, its strategy is to plan, develop, and make profitable new products for which the Company anticipates market growth, thereby strengthening its profit base and achieving growth. Its basic concept is to develop software products that are likely to become the de facto standards in their fields and to provide services continuously as cloud services, rather than as one-off sales. By providing cloud services, the Company aims to grow and to stabilize its profits. The main sources of the Company's sales and profits are now established products, such as the SI Object Browser series, the OBPM, GRANDIT and SI Web Shopping products. Newer products, such as the OBDZ and the SOCS, are being nourished as the next main sources of sales and profits.

2. Management issue

From FY2/14 through FY2/17, two large projects undertaken by the Company became unprofitable. Using its OBPM, it has reduced the number of unprofitable projects in recent years, but it did not prevent two large projects from becoming unprofitable. In both cases, the projects became unprofitable because the Company failed to recognize risks to profitability early enough to prevent red ink. However, the Company has recently introduced means to recognize and respond to risks to profitability quickly. By properly applying this capability, the Company intends to prevent unprofitable projects in the future. If it succeeds, FISCO believes that its sales and profits will probably grow briskly.

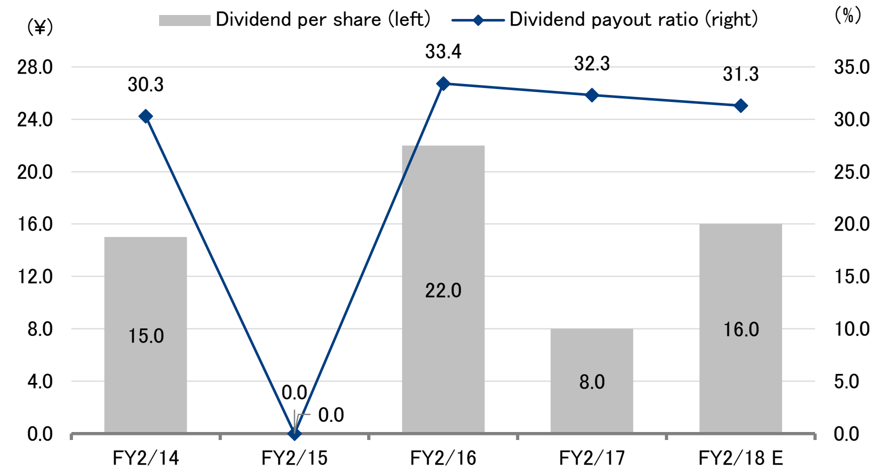
Shareholder return policy

The policy is to pay dividends based on performance and its standard dividend payout ratio is 30%

To increase its enterprise value, the Company provides comfortable returns to its shareholders. It maintains a standard dividend payout ratio of at least 30%, thereby tying its dividends to its profits. Because its profits declined in FY2/17, the Company lowered its dividends to ¥8.0 per share for FY2/17 from ¥22.0 for FY2/16. However, the Company plans to lift its dividends to ¥16.0 per share for FY2/18, which implies a dividend payout ratio of 31.3% based on the Company's EPS forecast for FY2/18. If Company profits continue to grow in coming years, its dividends should also increase.

The Company has also introduced a shareholder rewards program with the objective of creating stable shareholders who hold their shares for the medium- to long-term. The program is for shareholders who hold at least 100 shares and who held the same share number listed in the current list of shareholders at the end of August as they did at the end of February in each year. The company awards newly harvested Koshihikari rice grown in Niigata, using reduced levels of fertilizers and agrochemicals. Shareholders holding from 100 to 1,999 shares receive a 2kg bag, those holding 2,000 to 7,999 receive a 5kg bag, and those holding 8,000 shares or more receive a 10kg bag, with the gift being delivered each fall after the harvest.

Dividend per share and dividend payout ratio



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

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FISCO Ltd.