System Integrator

3826

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Index

Summary

R&D investments in FY2/19 to set the stage for accelerated growth from FY2/20

System Integrator <3826> is an independent software development company. Its SI Object Browser software commands a large share of the database development support tool market in Japan and is highly profitable. The Company also sells packaged software including GRANDIT Web-ERP package for medium-sized companies and SI Web Shopping for construction EC (e-commerce) websites. As indicated by its corporate slogan, "We make software that saves you time, not takes it," System Integrator focuses on developing new products and services aimed at corporate users increase productivity. It also actively supports childcare assistance and other contributions to society.

1. FY2/18 results

For FY2/18, the Company reported sales of ¥3,767mn (+18.6% YoY) and a recurring profit of ¥496mn (+123.0%), both new record highs. Aided by growing business investment in IT, the Company's ERP business and EC and Omni Channel business saw strong double-digit growth in sales. On the earnings front, the company posted a ¥280mn provision for loss on orders received in the ERP business in FY2/17, but this was the increase in profit because it reversed all of this amount in FY2/18.

2. FY2/19 forecast

For FY2/19, the Company is forecasting sales of ¥4,000mn (+6.2% YoY) and a recurring profit of ¥503mn (+1.3%). The ERP business and the EC and Omni Channel business are again expected to be the main growth drivers. The outlook for sluggish earnings growth reflects plans for increased investment spending to support future growth, including R&D spending on new products and new AI technology-based services, as well as investments aimed at increasing productivity. The total for these strategic investments is expected to come to ¥430mn, or ¥280mn more than in FY2/18. With respect to new services, the Company noted that its new TOPSIC programming skill evaluation service has gotten off to a good start after its inaugural launch in January 2018, signing up a total of 16 companies by the end of April. Programming skills are hard to judge from an individual's resume, but with TOPSIC programming skills can be verified through online testing. The Company sees strong potential for growth in this area as TOPSIC can not only help client companies looking to hire top-class engineers, it also has applications in other areas, including use as an internal training aid in companies and also in schools.

3. Medium-term business plan: Break 2018

The Company has released its medium-term business plan that will take it through FY2/21. Dubbed Break 2018, the new plan lays out a five-part action plan under which the Company aims to expand existing businesses, establish offices overseas, establish an AI business, increase the skill level of employees, and streamline operations. In terms of numerical performance targets, the plan is targeting FY2/21 sales of ¥5,300mn and recurring profit of ¥684mn. Reaching these targets will require double-digit growth in sales and earnings from FY2/20; almost all of the growth in sales is expected to come from existing businesses and almost none from the new AI services that it plans to roll out. Among the new AI services under development is a company list search service that allows users to do detailed searches by industry and business line; this is expected to be launched in the fall of 2018. Another service expected to be completed and on the market before the end of 2018 is an anomaly detection service that uses AI image recognition technology.

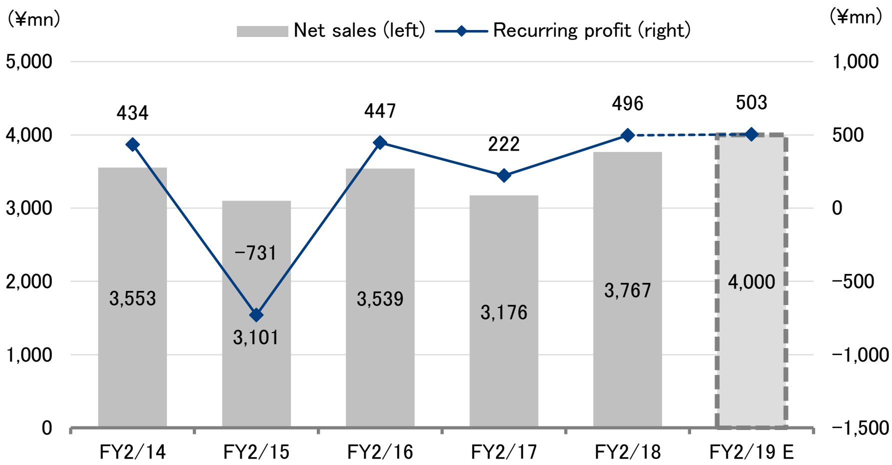
4. Shareholder return policy

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 FY2/19, the Company plans to pay dividends of ¥19.0 per share, the same as for FY2/18. This would result in a dividend payout ratio of 30.2%. 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
- Launching two new services, AI-based AISI∀ and TOPSIC programming skills evaluation service
- Aiming for double-digit growth in sales and earnings from FY2/20 based on growth at existing businesses

Results trends



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

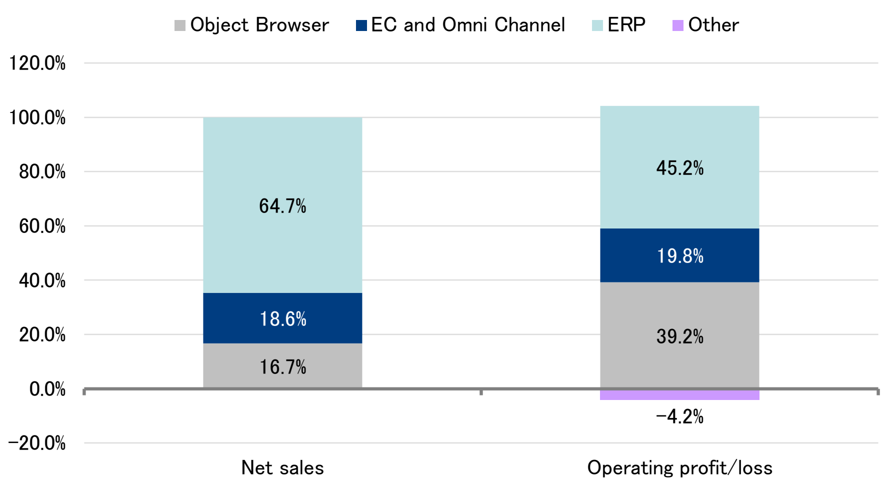
Business overview

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

Founded in 1995, System Integrator is an independent software development company. In addition to the development and sales of packaged software, the Company also has a maintenance service and consulting business. The Company is mainly looking to develop new products that can be offered as a cloud service. Mainstay existing products include database development support tool SI Object Browser and integrated project management tool SI Object Browser PM (OBPM), and package software such as SI Web Shopping for constructing EC websites and GRANDIT Web-ERP package. The Company breaks it business lines down into three main segments: the Object Browser business, the ERP business, and the EC and Omni Channel business. Starting in FY2/18, it also added an "Other business" segment for reporting the results of new businesses.

The ERP business accounts for the majority of sales at 64.7% in FY2/18. Contributions are more balanced at the operating profit level, though, with the ERP business accounting for 45.2% of operating profit, the Object Browser business 39.2%, and the EC and Omni Channel business 19.8%. The Object Browser business in particular stands out as a stable source of revenues and earnings, as it consistently maintains a high market share and gets a relatively large portion of revenues from recurring monthly service fees. As for the Other business segment, because it consists of new businesses that are still in the investment phase, it is running a modest loss. The breakdown of sales and operating profit by segment are shown in the figure below.

Composition of businesses (FY2/18)

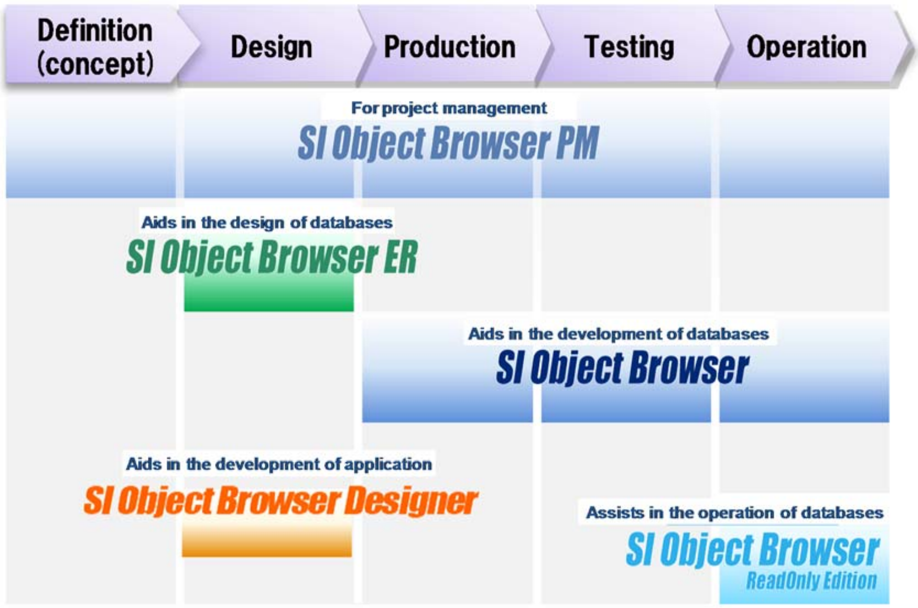


Source: Prepared by FISCO from the Company's financial results

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 SI Object Browser Designer (OBDZ) tool for the design of applications, which was released in June 2013. OBPM, OBDZ, and other in the SI Object Browser services are available for either on-premise installation or as cloud services. As for contributions to segment sales, the SI Object Browser series currently accounts for just under 50% of sales and OBPM just over 50%, these figures having reversed over the course of just the last year as number of OBPM contracts has continued to rise. As for OBDZ, with only a few dozen contracts, it does not have a material impact on segment results at this time.

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 in Japan. Maintenance fees comprise 29% 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 approximately 90% gross profit margin on sales of this series.

OBPM is an integrated project management tool. It helps prevent unprofitable projects by allowing careful tracking and management of the project's schedule, costs, work team, quality, and profitability, and also helps increase the productivity of software development departments. OBPM is the only such product in Japan that conforms to PMBOK* standards. Since OBPM was launched in 2008 it has been adopted for use by more 160 companies (as of May 2018). As there are no competing products on the Japanese market, it has a high 63% gross profit margin. Most of the companies that use OBPM are established, medium-sized IT companies. Larger companies usually use similar tools for project management they have developed in house while SMEs typically buy software on the market (such as Excel). However, as OBPM's reputation has grown and its quality has improved over the year, even some large IT companies have started to consider using it. The Company has also started to receive inquiries about OBPM from manufacturing companies. In response to this growing interest, in FY2/17 the Company came out with a cloud-based light version of OBPM with limited functions suitable for use by individual departments inside large companies, as well as a cloud-based engineering version designed for use by manufacturers.

* PMBOK (Project Management Body of Knowledge): A set of standard terminology and guidelines (i.e., a body of knowledge) for project management. "A Guide to the Project Management Body of Knowledge" was first published in 1987 by the non-profit Project Management Institute (PMI). PMBOK has evolved over time and is now accepted as the industry standard around the world.

OBDZ is a tool that helps improve productivity and quality in software development by streamlining, standardizing, and systemizing the upstream software development processes (the basic design phase and detailed design phase). In the past, engineers worked individually in Excel or Word, but changes in specifications made maintenance and change management difficult and could end up delaying development. By providing comprehensive management of the design specifications in the form of a database, labor efficiency can be increased as processes are standardized and automated, making a tool such as ideal for use in core systems development work and other large development projects. Since OBDZ was first released in 2013 its functionality has gradually been improved. There are a total 26 companies currently using OBDZ and that number is starting to increase bit by bit.

2. 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.

As for the Company's position in the market for packaged software for EC website construction, if we narrow the scope to packaged software for large-scale website operators we find the market dominated by three companies: System Integrator, ECBEING CORP. (subsidiary of SOFTCREATE HOLDINGS CORP. <3371>), and Commerce21 Corporation. However, as demands for additional functions (such as connectivity to other business systems) have become more varied in recent years, the value of individual orders has increased (from a few dozen million yen to more than ¥100mn), and this in turn has attracted more competition from systems integration companies.

With regard to SOCS, the omni-channel services, integrated management analysis cloud service released in 2015, the Company said that, after determining it would be difficult to make SOCS profitable, it terminated all related development work by 1H FY2/18, and by the end of FY2/17 had fully depreciated all related software assets.

3. The ERP Business

The ERP Business sells the GRANDIT of Web-ERP packaged software. This software is sold by a consortium of 13 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 950 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 of 13 companies, 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. In response to the growth in the market for cloud-based ERP software, the Company brought out GRANDIT on AWS for use on Amazon Web Services.

The Japanese market for ERP software was estimated to be worth about ¥90.3bn in 2017, and is forecasted to continue growing at the rate of roughly 10% as large companies move ahead with the rebuilding of core systems and more companies migrate to cloud-based systems. The business of ERP system vendors is largely split based on the size of their customers, with SAP and Oracle dominating the market for ERP systems for large corporations. The Company sells mainly to well-established, medium-sized companies, where it faces competition from the GLOVIA software of FUJITSU LIMITED. (6702) and the OBIC 7 from OBIC Co., Ltd. (4684). As the needs of client companies have grown more diverse in recent years the average value per order climbed well above the normal ¥100mn price-tag seen in the past; with more and more ERP systems now costing more than ¥500mn as a result of extensive customization. The gross profit margin on ERP system projects varies greatly depending on the applications in the system and technical specifications, making it difficult to generalize. However, the average gross margin appears to be in the 20%–30% range.

Results trends

Sales, operating profit, and recurring profit set new highs in FY2/18

1. Summary of the FY2/18 results

For FY2/18, the Company reported sales of ¥3,767mn (+18.6% YoY), an operating profit of ¥494mn (+126.0%), recurring profit of ¥496mn (+123.0%), and net profit of ¥345mn (+151.9%). Sales were slightly below the Company's initial forecast; earnings at all levels finished ahead of plan. Sales set a new record high for the first time in four fiscal years while operating profit and recurring profit set new highs for the first time in two fiscal years. (The previous high for net profit was ¥364mn, set in FY2/16.)

FY2/18 results

(¥mn)

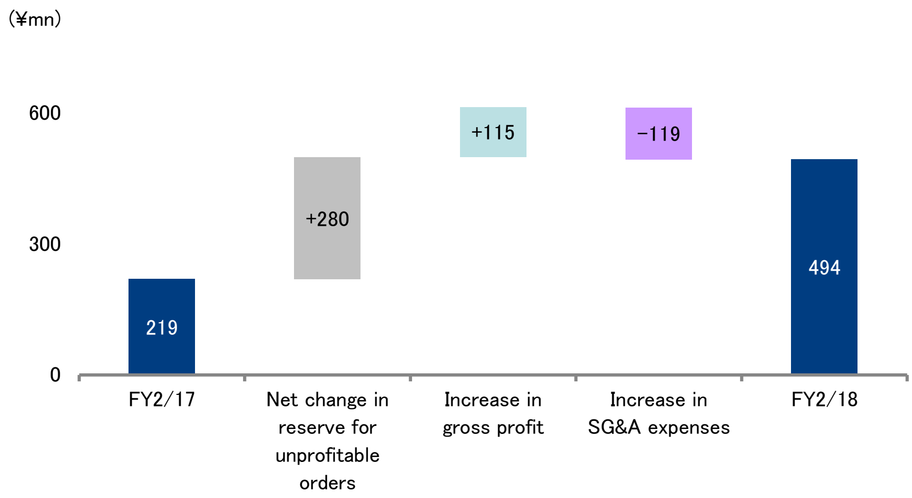
	FY2/17		FY2/18				
	Result	% of sales	Forecast	Result	% of sales	YoY	vs. forecast
Net sales	3,176	-	3,800	3,767	-	+18.6%	-0.9%
Cost of sales	2,296	72.3%	-	2,491	66.1%	+8.5%	-
SG&A expenses	660	20.8%	-	780	20.7%	+18.2%	-
Operating profit	219	6.9%	450	494	13.1%	+126.0%	+10.0%
Recurring profit	222	7.0%	453	496	13.2%	+123.0%	+9.6%
Net profit	137	4.3%	283	345	9.2%	+151.9%	+22.2%

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

Losses from an unprofitable project under the ERP business that started in FY2/17 continued to weigh on earnings in 1H FY2/18, but the pickup in Japanese IT investment spending along with big project wins at the EC and Omni Channel business and ERP business offset the drag and led to double-digit gains in both sales and earnings for the full year. On the plus side, operating profit got a large boost from the drawdown of the ¥280mn addition to reserve for unprofitable orders made the previous year to cover the losses on orders at the ERP business, and also the strong top-line growth at the EC and Omni Channel business. On the minus side, operating profit was hurt by an increase in strategic investment spending, including spending on new product development, spending aimed at increasing productivity, and the acquisition of marketing automation tools to help improve marketing. Under SG&A spending, the main increases were a ¥46mn increase in R&D spending and ¥33mn increase in personnel spending.

With regard to the money-losing project that started in FY2/15, the Company said it was currently in the adjustment phase that would lead to the final disposition of the contract, and that it did not expect any new expenses to push it over the roughly ¥900mn in provisioning for losses on orders already made to cover the losses on this project.

Factors contributing to changes in operating profit



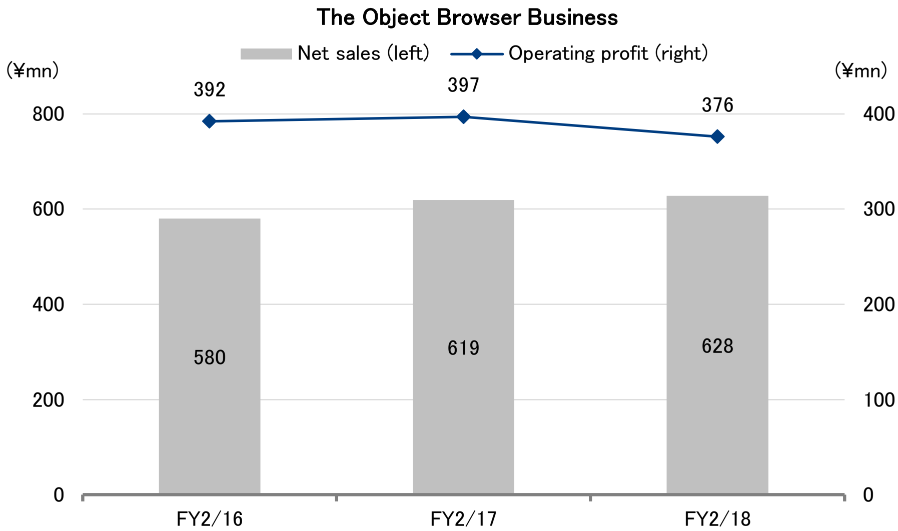
Source: Prepared by FISCO from the Company's financial results

Launching two new services, AI-based AISI∀ and TOPSIC programming skills verification service

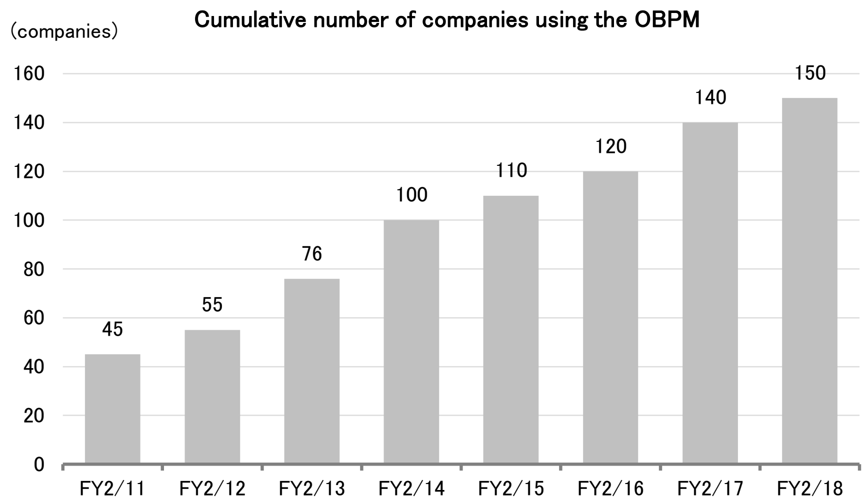
2. Earnings by business segment

(1) The Object Browser Business

The Object Browser business reported FY2/18 sales of ¥628mn (+1.4% YoY), a new record high, and an operating profit of ¥376mn (-5.1%). The SI Object Browser series of software development productivity enhancement tools saw basically flat sales as it is already the de facto industry standard and, as such, already widely in use. The main growth driver at the segment was the OBPM integrated project management tool, where the number of users rose from just over 140 companies at the end of FY2/17 to over 150. The Company attributed the growth in OBPM's user base to the new contract wins following the introduction of a "light" version and also a special "engineering" version designed to meet the needs of manufacturing companies. With regard to the OBDZ application design tool, the Company said the functional enhancements it made led to a steady increase in sales and now there are more than 20 companies using OBDZ. On the earnings front, segment operating profit was weighed down by increases in internet advertising and other marketing expenses (which had been held down last year) and increase in personnel spending. That said, with an operating profit margin still close to 60%, the Object Browser business remains a stable source of revenues and earnings for the Company.



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



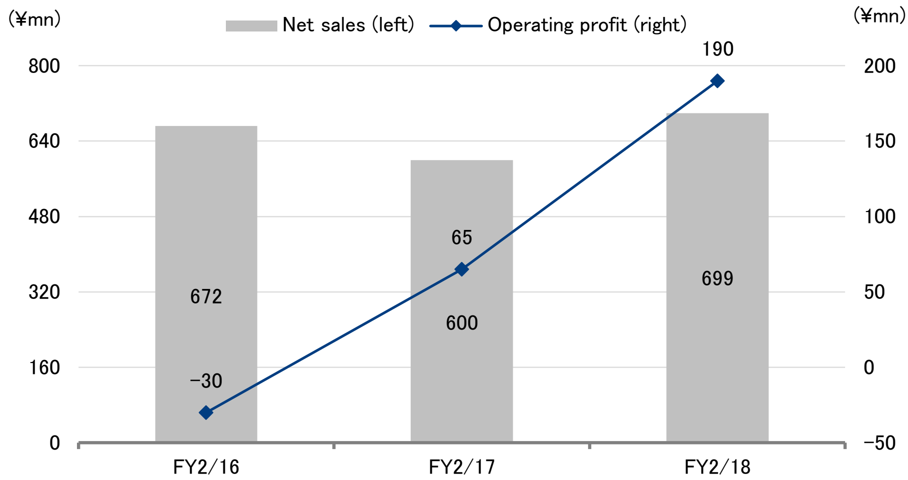
Source: Prepared by FISCO from the Company's website

(2) The EC and Omni Channel Business

The EC and Omni Channel business reported FY2/18 sales of ¥699mn (+16.5%) and an operating profit of ¥190mn (+189.4%). As the Japanese EC market has grown, so too has the number of software vendors. However, after years of seeing sales in this area decline, the Company saw sales in this area increase for the first time in four fiscal years. The top-line gains were due in large part to several large project wins, all of which came at the expense of competitors as the Company was asked to replace the systems that were put in place by other vendors. As EC websites grow larger and larger and include a broader range of functions, these project wins by the Company over the original vendor is an indication that client companies value its EC website development capabilities and more than 20 years of experience in this field.

On the earnings front, the EC and Omni Channel business benefited greatly from its careful screening of development projects from the order stage and its renewed focus on high value-added projects, both of which led to higher gross margins on projects. Additional help came from the termination of SOCS, its omni-channel services integrated management analysis cloud service, as eliminating the depreciation of R&D spending on SOCS accounted for most of ¥71mn reduction in depreciation at the segment.

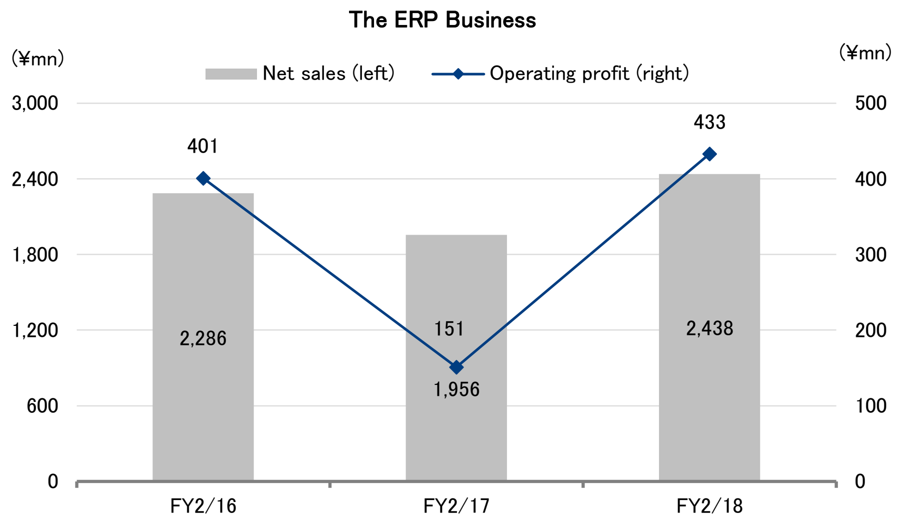
The EC and Omni Channel Business



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

(3) The ERP Business

The ERP business reported FY2/18 sales of ¥2,438mn (+24.6% YoY) and an operating profit of ¥433mn (+187.0%), with both sales and earnings hitting new highs for the first time in two years. The strong top-line gains reflected continued strong growth in investment spending by corporations on information technology and easy comparisons with the prior year, when sales were temporarily depressed by an unprofitable project. At the individual product level, the Company saw more orders for its proprietary Production Management Add-on Modules to manufacturers and increased sales of its IT Template (for IT companies) that works in conjunction with OBPM. Thanks to increasing demand for customized features, the average order value also rose. With regard to cloud-based GRANDIT on AWS, the Company noted that it is now up and running at several client companies and is generating a solid track record. On the earnings front, the sharp jump in operating profit was attributed to the dropout of the large addition to reserve for unprofitable orders that made the prior year in connection with an unprofitable project.



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

(4) Other business

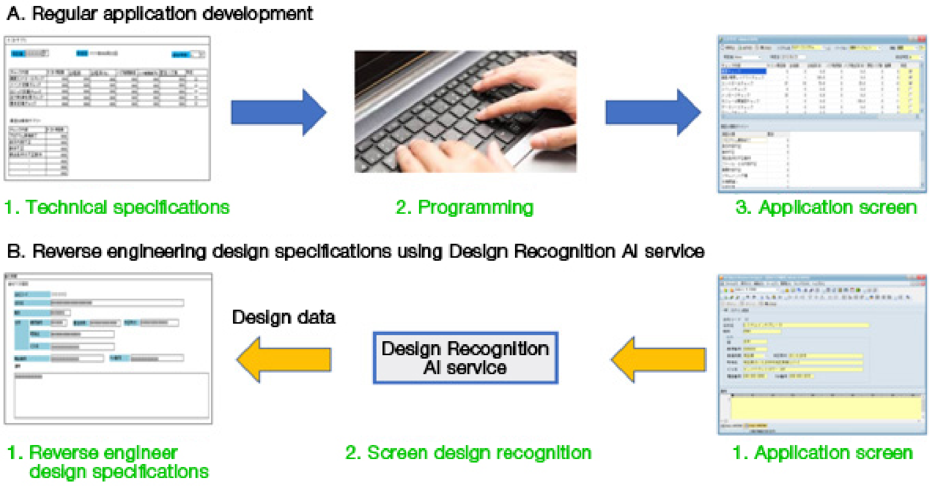
FY2/18 is the first year that new businesses are being reported under the Other business segment. Segment sales of ¥1.0mn were accompanied by a ¥40mn operating loss. The Company started two new businesses during the year, as detailed below.

a) AI service AISI∀

During FY2/18 the Company put together a dedicated team to start a full-fledged AI business. Going under the service name "AISI∀ (Aishia)," the first service created was AISI∀ -DR (DesignRecognition). Unveiled by the Company in October 2017, the AISI∀ DesignRecognition reverse engineers design specifications from a screen. In short, AISI∀ DesignRecognition is a kind reversing engineering software that creates design specifications based on real objects. As this is the first time someone in the software industry has created such a program, a patent application has also been filed. Sales of AISI∀ DesignRecognition began in March 2018 and the companies that are using the new service on a trial basis report good results and an image recognition rate that makes it suitable for practical use. AISI∀ DesignRecognition is meant to be used in conjunction with the Company's OBDZ software; ideally, users could use AISI∀ DesignRecognition to "reverse engineer design specifications from a screen and then the OBDZ could be used to efficiently handle the maintenance." The Company has set a sales target for AISI∀ DesignRecognition of approximately ¥300mn over the next three years (starting in FY2/19).

The second service developed by the new AI team was AISI∀ FlowerName, a service that uses AI image recognition technology to distinguish between different types of flowers based a photograph. AISI∀ FlowerName is available on the Company's website at no charge, as its main purpose is to increase public recognition of the Company's expertise in AI technology.

Image of AISI∀-Design Recognition in use



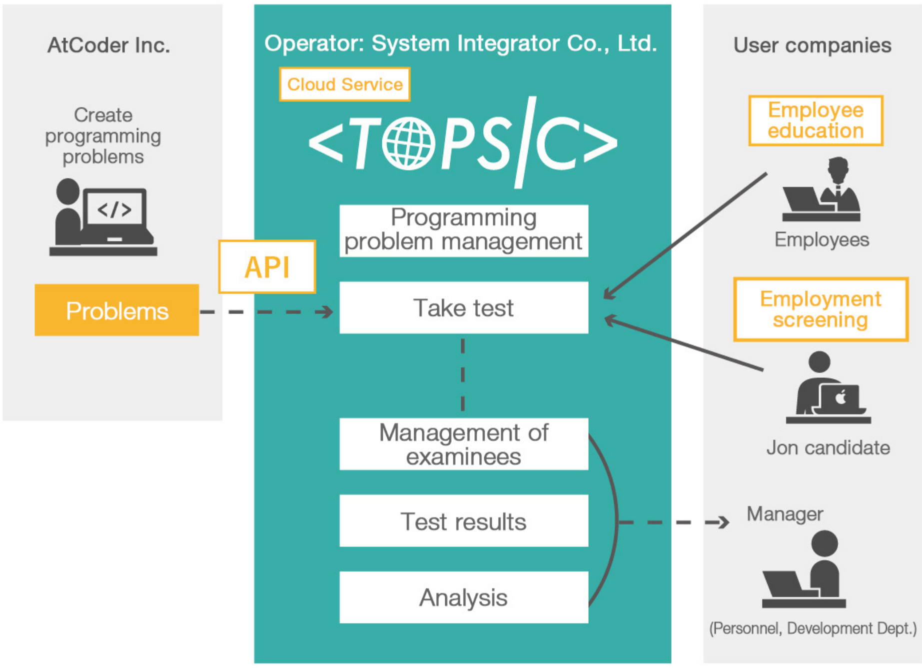
Source: The Company's website

b) Programming skill evaluation service TOPSIC

The Company's new TOPSIC programming skill evaluation service was launched in January 2018. Like TOEIC® (Test of English for International Communication), TOPSIC quantifies programming skills with a numerical score so it easy to see where individuals rank in terms of programming skills. As this gives companies that are looking to hire system engineers or select subcontractors a way to assess programming skills, it is a low-cost way of finding the right job candidate or the right subcontractor. And, because the TOPSIC test is also offered in English, it can also help companies when they are looking to hire non-Japanese system engineers. TOPSIC can also be used for in-house training of employees.

The Company also anticipates demand for use of TOPSIC at schools as interest in programming education is expected to continue to grow in the years ahead as Japanese schools make programming a required subject at the elementary school level starting in FY2020. Indeed, some private middle and high schools in Tokyo have already started using TOPSIC. Looking at just the potential in the education market, if TOPSIC can get the same type of market share that TOEIC® has, it could become a major source of revenues and earnings for System Integrator in the future. TOPSIC users pay either an annual fee of ¥300,000 plus ¥8,000 for each test taken or a fixed charge for individual users. The Company is targeting approximately ¥400mn in revenues from TOPSIC over the next three years (starting in FY2/19). The actual contents of the programming skills tests are put together by a partner company, AtCoder Inc.

TOPSIC service



Source: The Company's website

Healthy financial conditions with debt-free operations

3. Financial position and management indicators

As of the end of FY2/18, the Company's balance sheet showed total assets of ¥3,189mn, down ¥20mn versus the end of FY2/17. Current assets of ¥2,789mn were up ¥27mn, with cash and deposits increasing by ¥192mn, inventories of goods in process declining by ¥107mn, and deferred taxes declining by ¥84mn. Non-current assets of ¥399mn were down ¥48mn, with ¥37mn of the decline accounted for by software assets.

Total liabilities at the end of FY2/18 came to ¥1,619mn, down ¥339mn versus the end of FY2/17. Most of the decline stemmed from a ¥273mn decline in reserve for unprofitable orders and ¥94mn decline in corporate taxes payable. Reserves for losses on orders totaled ¥982mn, most of which is related to a large order from a specific client that was received in FY2/15; this amount is expected to be completely drawn down during the course of FY2/19. Net assets of ¥1,570mn were up ¥318mn; most of the change stemmed from the ¥345mn in net profit booked for the year and the ¥44mn in dividends paid.

Looking at key performance indicators, we find an equity ratio of 49.2%, up 10.2ppts versus the end of FY2/17. If the ¥972mn in reserve for unprofitable orders were excluded, the equity ratio would top 70%. With no interest-bearing debt outstanding, the Company remains in a strong financial position. With respect to profitability ratios, we find both the operating profit margin and ROE rising sharply over the previous year, the operating profit margin hitting 13.1% and ROE 24.5%. With the unprofitable project that weighed on earnings in FY2/17 having now cleared the inspection phase and the Company having put in place to measure that will help it avoid similarly unprofitable projects in the future, we expect profit margins to remain high and stable going forward.

Balance sheet

(¥mn)

	FY2/15	FY2/16	FY2/17	FY2/18	Change
Current assets	2,497	2,520	2,761	2,789	27
(Cash and deposits)	401	788	725	917	192
Non-current assets	456	426	448	399	-48
Total assets	2,953	2,946	3,210	3,189	-20
Total liabilities	2,102	1,717	1,958	1,619	-339
(Interest-bearing debt)	353	20	0	0	0
Net assets	850	1,229	1,251	1,570	318
(Retained earnings)	99	464	479	781	301
Financial indicators					
(Stability)					
Current ratio	119.5%	146.8%	141.0%	174.4%	
Equity ratio	28.8%	41.7%	39.0%	49.2%	
(Profitability)					
ROE (return on equity)	-67.3%	35.1%	11.1%	24.5%	
Operating profit margin	-23.7%	12.6%	6.9%	13.1%	

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

Outlook

Investments in FY2/19 will set the stage for further growth in future years

1. FY2/19 forecast

For FY2/19 the Company is forecasting higher sales and higher earnings, with full-year sales hitting ¥4,000mn (+6.2% YoY), operating profit ¥500mn (+1.0%), recurring profit ¥503mn (+1.3%), and net profit ¥348mn (+0.6%). The modest growth projected for earnings reflects the Company's plan to boost strategic investment spending from ¥150mn last year to ¥430mn this year, with much of this going to develop new products that will drive growth in the future. On a half-year basis, the Company sees sales rising and earnings declining in the first half of FY2/19 followed by higher sales and higher earnings in the second half.

Forecast for FY2/19

(¥mn)

	FY2/18		FY2/19					
	Result	YoY	1H forecast	YoY	2H forecast	YoY	Full-year forecast	YoY
Net sales	3,767	+18.6%	1,680	+15.1%	2,320	+0.5%	4,000	+6.2%
Operating profit	494	+126.0%	140	-7.1%	360	+4.6%	500	+1.0%
Recurring profit	496	+123.0%	140	-8.0%	363	+5.4%	503	+1.3%
Net profit	345	+151.9%	97	-8.2%	251	+4.5%	348	+0.6%
Earnings per share (¥)	62.45		17.51		45.32		62.83	

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

The strategic investment spending planned for FY2/19 breaks down as follows: ¥60mn for AI-related investments, ¥300mn for product development, and ¥70mn for investments aimed at increasing productivity. See the figure below for further details.

Key initiatives planned for FY2/19

1. AI-related investments: ¥60mn in new investments	
(1) Search and knowledge AI	
(2) Anomaly detection AI	
2. Product development: ¥300mn in new investments	
(1) GRANDIT Add-on Module	
(2) Upgrades to existing products	
(3) Development of RPA-related services	
3. Productivity-oriented investments: ¥70mn in new investments	
(1) Employee training	Promote professional accumulative education
(2) In-house digital revolution	Enhance sales force automation, promote knowledge-sharing Marketing automation, restructuring of CRM
(3) Expand KPI management	Quickly acquire and analyze management data
(4) Utilize RPA	
(5) Improve business practices companywide to improve productivity	

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

(1) AI-related investments

The Company is planning to make a total of ¥60mn in AI-related investment in FY2/19 as it continues development work on its new search and knowledge AI service, AISI∀ CompanyList, and its new anomaly detection service, AISI∀ AnomalyDetection. AISI∀ CompanyList, schedule for launch in the fall of 2018, is a service that automatically create a database with the latest company information broken down by industry and business line; it does this by using an AI search engine that automatically searches the web with a 24-7 web crawler and scraps (extracts) the latest information from the text on corporate webpages, and automatically tags that information based on the industry or type of business. As this will give companies a low-cost and labor-free way of finding and sizing up potential customers, suppliers, and competitors—especially compared with traditional, high-cost corporate database service providers like Tokyo Shoko Research, Ltd.—the Company believes there is a great deal of latent demand for this service. The Company is looking for AISI∀ CompanyList to generate roughly ¥500mn in revenues in the first five years after its launch.

The Company is looking to complete AISI∀ AnomalyDetection by the end of 2018 and launch the new service before the end of FY2/19. The AI image recognition technology being used in AISI∀ AnomalyDetection is the same as that used in AISI∀ FlowerName. The Company has not detailed exactly what the AISI∀ AnomalyDetection service will entail however, since there are a number of other companies that are also developing and offering anomaly detection services based on image recognition technology, it will be interesting to see just how the Company will try to differentiate its service from competitors.

(2) Investment spending on product development

Plans call for a total of ¥300mn in investment spending on product development in FY2/19, around ¥50mn the Company has typically been spending on product development in past years. About half of the spending this year will go towards enhancements of Production Management Add-on Modules for GRANDIT. Manufacturing companies have been the main market for these add-on modules thus far, but as additional functions have been added the Company has seen more inquiries from companies in construction and other areas in recent years, leading to increases in the number of custom orders. This prompted the Company to include the features that were in high demand as standard features and upgrade the packaged version to make it suitable for construction companies, thereby increasing both the product's competitiveness and the productivity gains that could be realized.

Investments in product development in others areas include upgrades to existing products in the SI Object Browser series and the development of RPA-related services. The Company is looking at developing an educational support service for technicians working in RPA development. Towards this end, it plans to work with a partner company* that is already offering RPA services to provide solutions services for users of GRANDIT.

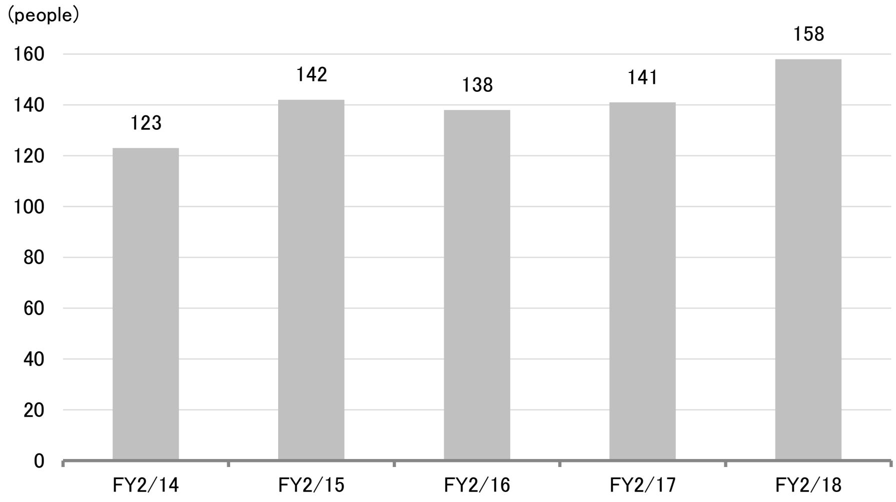
* On April 18, 2018, GRANDIT and Toshiba Information Systems (Japan) Corp. signed a business sales partnership agreement under which the two companies agreed to work together to develop a solutions service combining the Company's GRANDIT with the RPA tool from Toshiba Information Systems.

(3) Productivity improvements

In FY2/19 the Company also plans to make ¥70mn in IT investments aimed at increasing productivity. The investments will be aimed at augmenting employee training, management functions, and sales functions, and will also make use of RPA to help increase operational efficiency.

Hiring plans call for increasing staffing levels by about 20 employees by the end of FY2/19. This includes seven new graduates came on board in April 2018 and mid-career hires.

Number of employees at end of fiscal year



Source: Prepared by FISCO from the Company's securities report

OBPM and EC and Omni Channel business expected to drive growth in FY2/19

2. Outlook by business segment

(1) The Object Browser Business

At the Object Browser Business, the Company sees both sales and operating profit growing by roughly 10% YoY in FY2/19. Only a modest increase is expected in sales of the SI Object Browser series but sales of OBPM are expected to accelerate and advance by double-digits as the sales staff hired last year gets up to speed. The Company reports that contract numbers have recently picked up and additional demand is also expected for the limited-feature "light" version of OBPM.

OBDZ is in the process of being upgraded to address performance problems in the current version. The upgrade, which is expected to be completed by the end of FY2/19, is aimed at realizing a major improvement in performance over the current version and also making OBDZ more user-friendly. Accordingly, the Company anticipates almost no sales of OBDZ this year. Sales are expected to pick up again in earnest from FY2/20 as AISI∀ -DR will be out by then and the two products can be marketed together.

(2) The EC and Omni Channel Business

For the EC and Omni Channel Business, the Company is forecasting sales and operating profit growth of 7% to 8%. The Company has been seeing a lot of inquiries for constructing EC websites and orders have continued coming in at a steady pace. The growth reflects more than just demand from large companies. As dedicated online sellers and the value of goods sold through the internet has growth, constructing EC websites with a higher level of security and the ability to process even larger transactions has become necessary. By reliably addressing these needs, the Company is aiming for sales in this area of ¥1,000mn in the near future.

(3) The ERP Business

For the ERP business, the Company is forecasting a 3% rise in sales and flat operating profit. As discussed previously, the Company plans to invest heavily in product development during FY2/19 (including Production Management Add-on Modules). Because the in-house product development team will take priority in terms of human resources, sales growth is expected to slow temporarily. The Company also plans to continue expanding its development team and training employees at partner companies and, as product development is completed, expects to get back into double-digit growth territory starting in FY2/20.

(4) Other Business

As for new businesses, the Company says that since AISI∀ -CompanyList will not be on the market until in fall of 2018, that it has included almost no sales from it in its forecast for FY2/19. In contrast, the Company is expecting sales from TOPSIC of the tens of millions of yen. Neither of these new services is expected to be profitable, though, as the heavy upfront investment spending will keep both in the red. The Company reports that it has been receiving many inquiries about TOPSIC since it was launched in January this year, including some requests for trial-runs from companies where no interest had been expected, and by the end of April had already signed up 16 companies, a rate of a little over five per month. At this rate it looks like the Company will easily meet its target for TOPSIC of 60 companies by the end of FY2/19.

With respect to TOPSIC, it is important to note that the Company's sales force has thus far not been involved in selling this new service, as users are able to complete the order process online through the Company's website. Some sales promotion will be done going forward, though, including issuing press releases about the results that the companies have achieved by using TOPSIC as a means of increase name recognition. Starting in May 2018, TOPSIC will also get some support from the OBPM sales team, since there is a lot of overlap between the potential client base for OBPM and TOPSIC. A full-scale marketing campaign is also planned to help promote TOPSIC to existing users of SI Object Browser series products and OBPM.

The chronic shortage of systems engineers in the Japanese IT industry has made hiring highly qualified system developers (both Japanese and foreign) and in-house training of employees a pressing management issue. The move by the Japanese government to make programming classes mandatory at the elementary school level starting in FY2020 will add further to the demand for programming education in the years to come. As the current market environment suggests there is a great deal of latent demand for a service like TOPSIC, we believe this service may enjoy rapid growth going forward.

There is a competing programming skill evluation service from Givery, Inc. that goes by the name of Track. Track has been on the market for about two years but differs significantly from TOPSIC in that it covers a broader range of subjects, going all the way from upstream design work down to programming. At ¥600,000 a year, Track is also twice as expensive. This being the case, it fair to say that TOPSIC has the advantage of being both cheaper and more focused on programming skills.

Aiming for double-digit growth in sales and earnings from FY2/20 based on growth at existing businesses

3. The medium-term business plan

The Break 2018 medium-term business plan will take the Company through the next three years to the end of FY2/21. In its policy statement, the Company says it wants to make the people of the world happy through the power of software and, towards this end, has dedicated itself to “make software that saves you time” as its management mission. Looking ten years out, the Company says it wants to be creating software that is used not only in Japan but by users all around the world. The new medium-term business plan that covers the coming three years is aimed at helping the Company reach this goal, as it outlines a basic action plan with five specific steps that will help establish a solid foundation that will allow the Company’s business to continue growing over the long term.

(1) Increase market share of existing businesses

Of its three main current businesses, the Company is looking at the EC and Omni Channel business to increase its market share by using an EC ecosystem strategy that will put its SI Web Shopping software at the center as the core system. At its ERP business, this year the Company is aiming to increase its market share by enhancing the functionality of its add-on modules in FY2/19 and offering new value-added solutions services that make use of RPA tools, both of these moves being aimed primarily at manufacturing and construction companies. And at its Object Browser business, the Company will continue looking to its SI Object Browser product series as a steady source of revenues and earnings while working to increase OBPM’s market share in the IT industry, uncover latent demand for OBPM in manufacturing and other industries, and reinforce its market position and grow sales with other products such as OBDZ and AISI∀ -DR.

(2) Establish bases overseas

To help increase its development capabilities, the Company is actively looking make use of more overseas engineers. In 2017 it began working together with the University of Danang in Vietnam, and to hire two Vietnamese employees a year to train and work in Japan. And it also help develop partnerships with local Vietnamese companies. With this initiative, the Company said that it might be able to establish an offshore development base in Vietnam as early as 2019. The Company is also establishing a new business division that will be in charge of adapting current products to other languages and opening up sales channels overseas. In the past, the Company was looking to market its products in China and, towards this end, entered into partnership agreements with several local companies. The results of this effort have been disappointing, though, and so the Company is now also looking to grow sales in the rest of Asia.

(3) Establish AI business

Since 2017 System Integrator been doing AI R&D and working on developing AI technology-based services, and has already developed two such services. As discussed previously, the Company is preparing to launch new AI-based products in two different areas, one in “search and knowledge AI” and one in “image recognition AI.” It is looking to make these new AI businesses profitable in a relative short period of time.

(4) Raise skill level of employees

In keeping with its policy that all employees must be first-class engineers, the Company plans to invest more in various kinds of education and training that will increase employee skill levels. As part of this effort, the Company plans to use its new TOPSIC programming skill evaluation service in-house as well.

(5) A leading Japanese "streamlined company"

Going forward, the Company is looking to established itself an a leading "streamlined company" by further improving operational efficiency through the use of RPA and various system tools to better utilize data. In the process, the Company aims to establish itself as a model for what can be achieved through process streamlining and offer its expertise in this area to client companies.

With respect to performance targets under its medium-term business plan, the Company is targeting sales of ¥5,300mn and a recurring profit of ¥684mn in FY2/21, with sales and earnings both growth at a double-digit pace from FY2/20. After making ¥430mn worth of strategic investments in FY2/19, the Company plans to let investment spending return to the normal range of ¥100–¥150mn seen in past years, providing a substantial boost to earnings from FY2/20. With regard to new businesses, the Company said the sales generated by new business account of only a small percent of the sales targeted under the medium-term business plan and that the vast majority of the growth is expected to come from existing businesses.

Targets

(¥mn)

	FY2/18 results	FY2/19		FY2/20		FY2/21	
		Forecast	YoY	Target	YoY	Target	YoY
Net sales	3,767	4,000	+6.2%	4,800	+20.0%	5,300	+10.4%
Recurring profit	496	503	+1.3%	578	+14.9%	684	+18.3%
Recurring profit margin	13.2%	12.6%	-	12.0%	-	12.9%	-

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

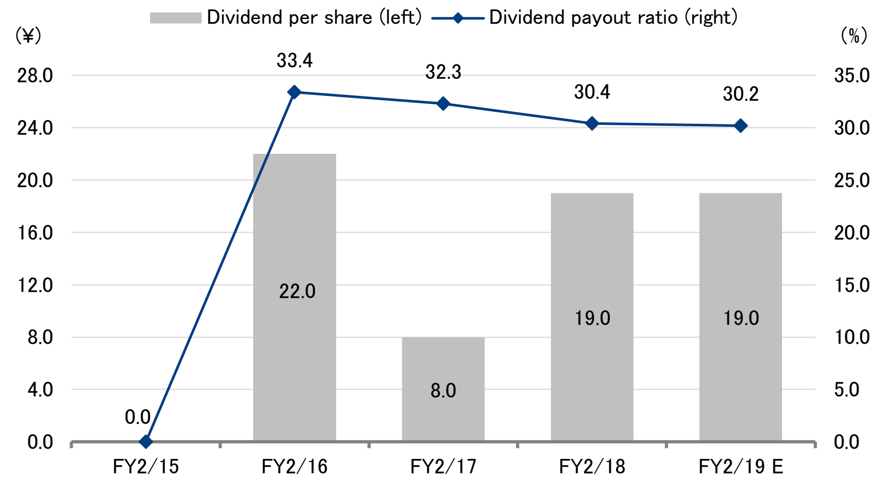
Shareholder return policy

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

In order to increase its enterprise value, the Company plans to take a more proactive approach towards returning profits to shareholders. Its current dividend policy ties dividends to earnings with a standard a dividend payout ratio of 30%. The ¥19.0 dividend it expects to pay in FY2/19 is unchanged from the previous year and represents a dividend payout ratio of 30.2%. However, investors can expect the dividend to increase in future years if sales and earnings continue to grow.

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 rewards newly harvested Koshihikari rice grown in Niigata, using reduced levels of fertilizers and agrochemicals. The Company announced a revision on November 16, 2017, and starting FY2/18, shareholders holding from 100 to 499 shares receive a 1kg bag, those holding 500 to 1,999 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

Information security policy

Cybersecurity measures undertaken by the Company include the creation of an information security committee and a manual, constant monitoring of cybersecurity risks, and rapid response to any incidents.

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