System Integrator

3826

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Summary

Against the backdrop of the abundant backlog of orders in the ERP/AI Business and the E-Commerce Business, the outlook is for sales and profits to continue to increase in FY2/21 also

System Integrator <3826> is an independent software developer that develops and sells software and services for improvement of corporate productivity with a slogan of "We consistently create software that creates time rather than consumes time." It operates the Object Browser Business, including the database development support tool SI Object Browser and integrated project management tool SI Object Browser PM (below, OBPM), the E-Commerce Business, and the ERP/AI Business. Furthermore, it actively promotes work- style reforms, child-rearing assistance, and other measures and has a low employee turnover rate in the IT industry at less than 5%. System Integrator has a reputation of being highly respected by employees.

1. FY2/20 results

In FY2/20, net sales increased 12.0% year-on-year (YoY) to ¥4,554mn and ordinary profit rose 19.2% to ¥664mn, which was once again a new record high. Against the backdrop of the expansion of the EC market, demand to build EC websites grew, so results were strong in the E-Commerce Business, while the ERP/AI Business benefited from companies' expansion of IT investment and achieved double-digit increases in sales and profits, and these businesses drove the favorable results. Compared to the Company forecasts (net sales of ¥4,600mn and ordinary profit of ¥603mn), net sales were basically as forecast, but ordinary profit was around 10% above forecast, mainly because productivity in the E-Commerce Business improved more than expected. Also, name awareness is increasing of TOPSIC, a programming skills evaluation service launched in 2018 as a tool to progress the efficient recruitment and training of engineers. Therefore, the number of companies deploying it rose from approximately 50 at the end of the previous fiscal period to around 80 companies, and its net sales also steadily increased, up 3.6 times YoY to ¥42mn.

2. FY2/21 forecasts

For the FY2/21 results, the Company has announced range forecasts on considering the impact of the spread of the novel coronavirus. The forecasts are for net sales to increase by 4.3% to 9.8% YoY, to from ¥4,750 to ¥5,000mn, and ordinary profit to rise by 2.8% to 13.3%, to from ¥683 to ¥753mn. The direct impact of the spread of the novel coronavirus is small and presently demand is trending solidly, but it is assumed that the economy will slow down more than after the Lehman shock, and the Company is expected to change its usual "offensive" management stance to a "defensive" stance and to keep down aspects such as human resources recruitment and development costs. But even if the market environment deteriorates even more, the outlook is that it will maintain increases in sales and profits by further keeping down costs. According to business, against the backdrop of the abundant backlog of orders, the ERP/AI Business is set to achieve double-digit increases in sales and profits, while results in the E-Commerce Business are also expected to grow. However, it is possible that results in the ERP/AI Business will slump in FY2/22, as it is likely that going forward, companies will reduce their IT investment.

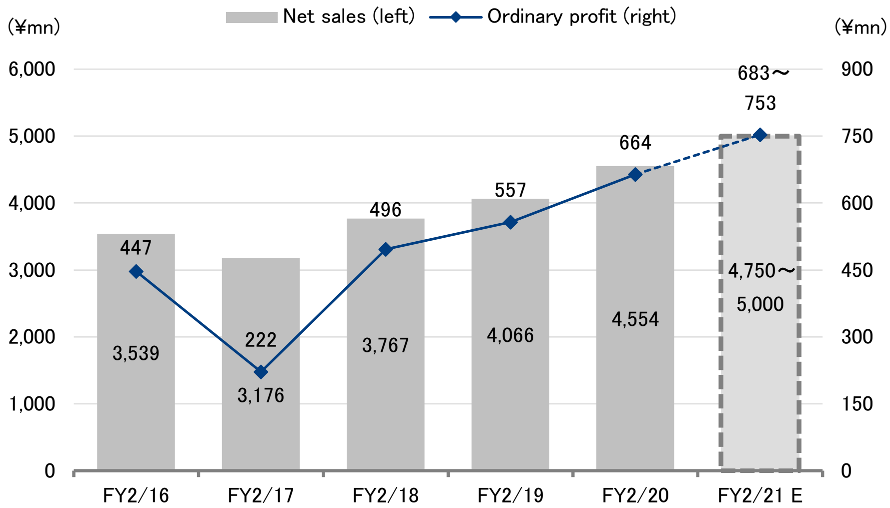
3. The growth strategy

As the growth strategy for the future, the Company's policy is to increase the stability of earnings by raising-up the percentage of total sales provided by the recurring-sales businesses, from the current level of 20% to around 40%, and also to work on measures including improving the profitability of the ERP Business and developing new businesses. In the recurring-sales businesses, it will unify sales of OBPM, which it currently sells as two types, of on-premises and Cloud-based, as a Cloud service from FY2/22, while in the ERP Business, it is expanding the scope of potential customers by providing a subscription model for GRANDIT. For new businesses, the policy is to enhance the TOPSIC service menu for further business expansion and to develop the AI business centered on AISI∀-AD (a system that uses image-recognition technologies to detect anomalies), for which sales negotiations have currently been placed on hold due to the spread of the novel coronavirus.

Key Points

- In FY2/20, achieved double-digit increases in sales and profits from the growth of the E-Commerce Business and the ERP/AI Business
- The forecasts are for higher sales and profits in FY2/21 as well, through "defensive" management
- Aiming to convert to a high-profit business structure by expanding the recurring-sales businesses and improving productivity

Results trends



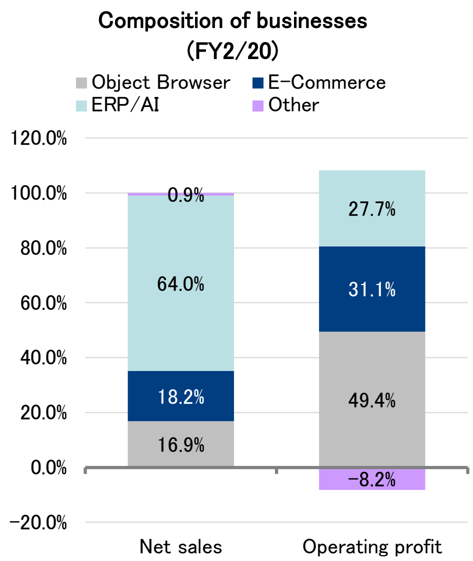
Source: Prepared by FISCO from the Company's financial results

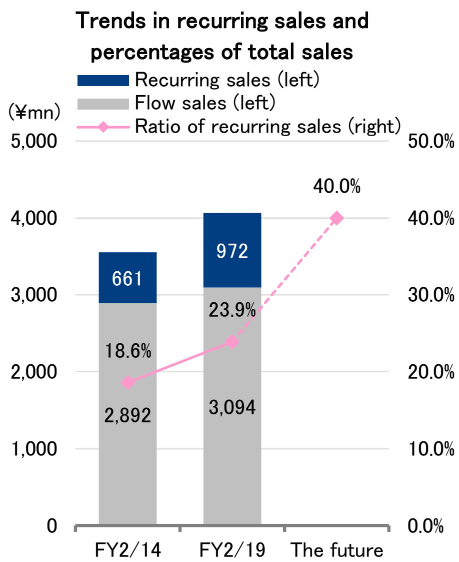
Business overview

An independent software development company that "consistently creates software that creates time rather than consumes time"

Founded in 1995, System Integrator is an independent software development company. In addition to the sales of packaged software developed in-house, the Company also provides maintenance service and cloud services (SaaS). 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 OBPM, and package software such as SI Web Shopping for constructing EC websites and GRANDIT Web-ERP package. Business segments are Object Browser Business, E-Commerce Business, ERP/AI Business, and Other Business for reporting the results of new businesses.

Looking at FY2/20 sales composition, ERP/AI Business provided a majority of overall sales at 64.0% and Object Browser Business and E-Commerce Business split the remaining portion. In operating profit, meanwhile, Object Browser Business held the largest share at 49.4% followed by E-Commerce Business at 31.1% and EPR/AI Business at 27.7%. The Object Browser Business has a high segment profit margin of 42.6% and is the Company's cash cow, which is mainly because it has practically no competitors and stably maintains a high market share. The percentage of total sales providing by recurring sales, which includes monthly fee income from Cloud services and maintenance and support income, was 23.8% in FY2/20, but in the future, the Company is aiming to raise this up to around 40%. Descriptions of each business are provided below.



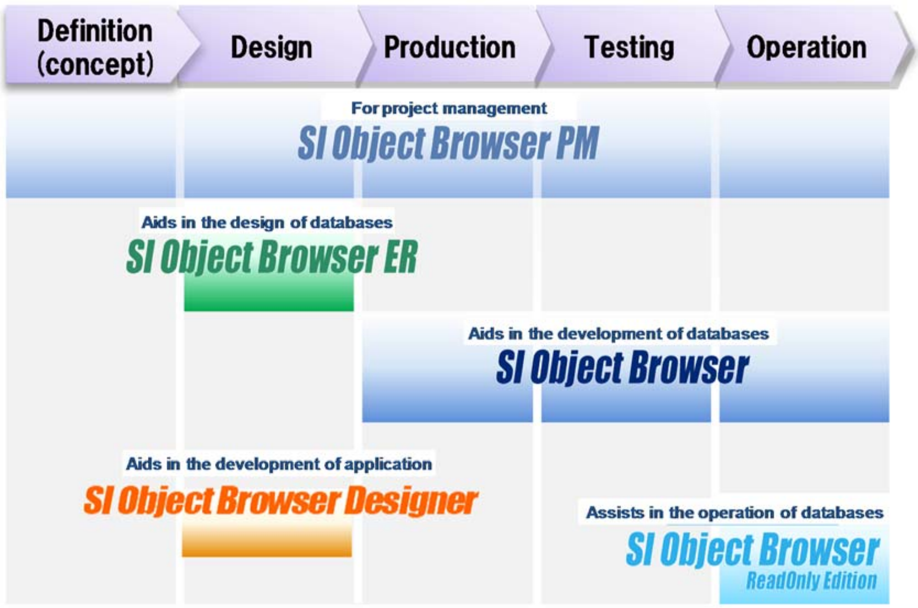


Source: Prepared by FISCO from the Company's financial results and results briefing materials

1. The Object Browser Business

Object Browser Business handles development and sales of software products, including the database development support tool SI Object Browser and database design support tool SI Object Browser ER (below, SI Object Browser series) as well as integrated project management tool OBPM and application design support tool SI Object Browser Designer (below, OBDZ). OBPM and OBDZ are available for either package sales or cloud services.

The software development process and SI products



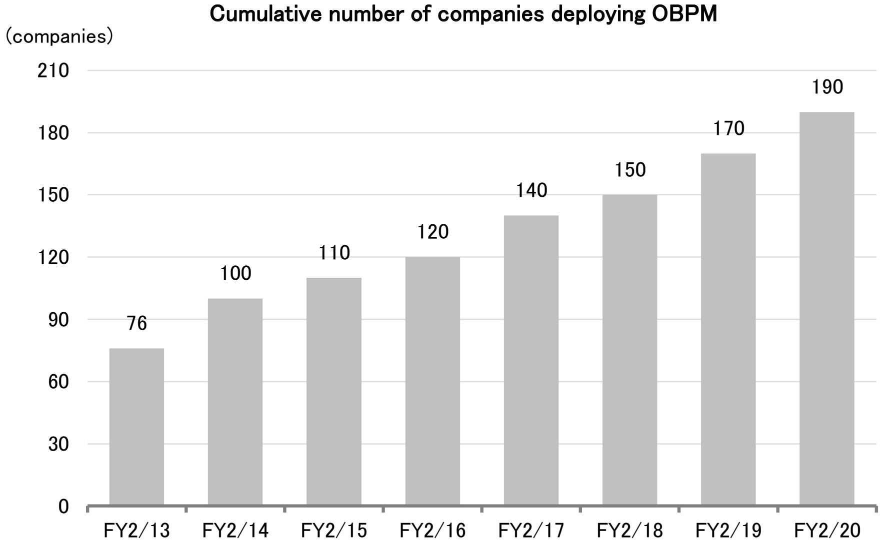
Source: The Company's website

In sales composition, the SI Object Browser series is 45% and OPBM is 55% and the OBPM share has been rising annually. The SI Object Browser series has deployments at 19,000 companies since its release in 1997 and is a de-facto standard in Japan. Maintenance and support and other recurring income currently stands at just under 30% of sales. This is a highly profitable product with gross margin at about 90% because of the prospect of stable annual sales and almost no sales costs.

OBPM, meanwhile, conducts integrated management of progress in development projects (managing the schedule, costs, human resource, quality, and profitability). This tool prevents occurrence of unprofitable projects ahead of time and supports higher productivity by the development division. It is the only product in Japan that complies with PMBOK*, and since its launch in 2008, the number of companies deploying it has steadily increased, to more than 190 companies as of the end of February 2020. Many of the companies deploying it are medium-sized IT companies. This is because in the majority of cases, major companies manage projects using products they develop in-house, while medium- and small-sized companies manage them using software on the market, such as Excel. However, the number of large companies considering deploying it is also rising, due to factors including its improved name awareness and high quality. Therefore, in FY2/17, the Company launched sales of a light version with limited functions to be deployed into the departments of major companies, while it also provides Cloud services, including an engineering version suitable for the manufacturing industry. More than 70% of the product's net sales are from recurring sales, such as from monthly fees and maintenance service fees, so it continues to grow stably. In addition, it has hardly any competitor products, so its gross profit margin is also high, at around 70%. However, because it incurs costs, like advertising costs and deployment-support costs, its operating profit margin is slightly lower than that of the SI Object Browser series.

* 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.

Cumulative number of companies deploying OBPM



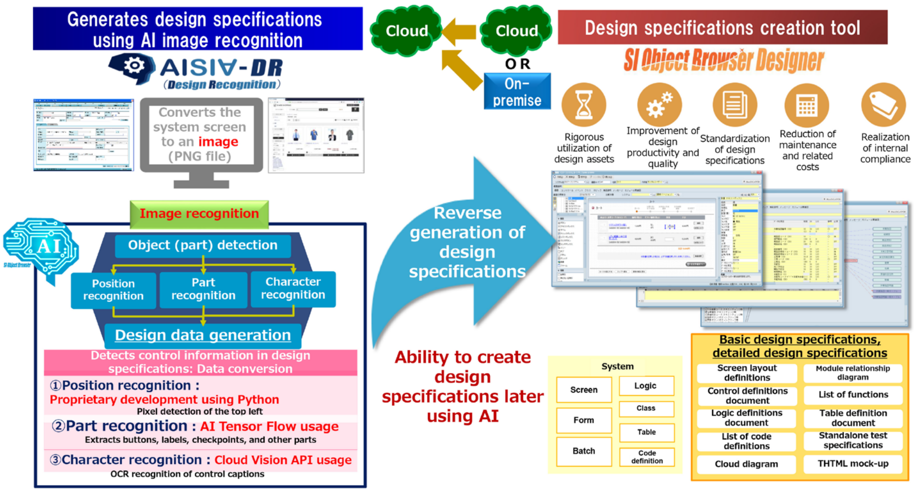
Source: Prepared by FISCO from the Company's website and results briefing materials

OBDZ is a support tool that enhances productivity and quality of the design process through systemization of basic design and detailed design, which are upstream processes in software development, and promoting of streamlining and standardization. It could be called CAD for the software development field (the Company already obtained a patent). Previously, engineers had to create design documents individually in Excel and Word, so when the specifications or other items were changed, maintenance and change management would become difficult, and development delays could occur due to human error. But OBDZ solves these problems by integrating the management of design documents. Therefore, in terms of how it is used, it can be said to be a product suitable for large-scale, waterfall-type system* development, including for mission-critical business systems. Since its release in 2013, the Company has repeatedly improved its functions, and in June 2019, it conducted a full model change to the new version in web-based technologies and released a greatly improved product whose performance speed is 1.5 times that of the previous version. The number of companies deploying it is still small, at around 60 companies, but it is being steadily deployed by companies ranging from small- and medium-sized companies through to major IT companies.

* Waterfall-type system refers to the development methodology of developing systems by moving through a series of processes – basic plan, external design, internal design, program design, programming, and tests. Since this assumes not returning to previous processes, it is similar to a "waterfall" in which water does not return from downstream to upstream.

In addition, as a new service that utilizes AI technology, in March 2018 the Company released AISI∀-DR (Design Recognition). This is a tool that uses deep learning technologies to reverse produce the design document from a systems screen. Currently, when upgrading an operating business system, there are cases in which the original design document does not exist. In such cases, normally it would be necessary to recreate the design document from scratch, but AISI∀-DR uses AI to recognize individual parts from the systems screen, making it possible to reverse produce the design document to a certain extent. It is considered effective to utilize it in a set with OBDZ, so the strategy is to first increases sales of the fully web-based version of OBDZ to around 100 companies, and after that, to propose AISI∀-DR to these customers.

Image of AISI∀-Design Recognition in use



Source: The Company's website

2. The E-Commerce Business

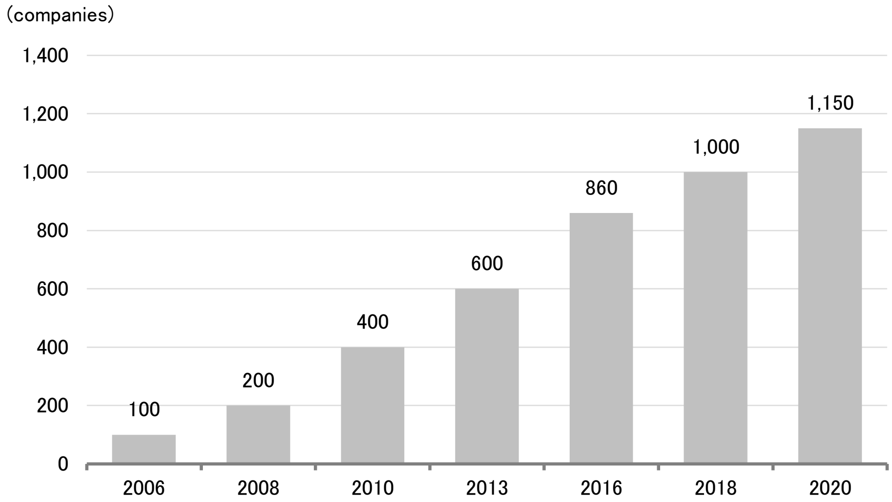
The E-Commerce Business mainly develops and sells the Company's mainstay product of SI Web Shopping, which is Japan's first EC sites construction package. A feature of SI Web Shopping is its strength in large-scale EC sites. More specifically, if possesses scalability, being able to process large-volume 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, while it is also possible to customize it by adding functions to meet the needs of other customers. The Company has built EC sites at more than 1,100 companies since the release in 1996 (active sites are just under 10%). It possesses robust development knowhow and advanced technology capabilities as strengths.

Looking at positions in the EC site-building package industry, while the Company, SOFTCREATE HOLDINGS CORP.<3371> subsidiary ecbeing Corp. (with a record of building for over 1,200 companies), and Commerce21 Corporation dominate products supplied to large operators, competition with system integrators (SIers) has been increasing recently. Needs are increasing to add to EC website-build packages functions to link with other business systems. So although the unit price per order was previously on a scale of several tens of millions of year, recently it has have grown in scale to around ¥100mn to ¥200mn. The percentage of total sales provided by recurring sales is 16%, which is relatively low within the Company, although it tends to fluctuate due to increases or decreases in development projects and the earnings period depending on productivity.

3. The ERP/AI Business

The ERP/AI Business develops and sells (installs) the GRANDIT full Web-based 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 Web-ERP packaged software is targeted to medium-sized companies with a few ten billion yen in annual sales, but recently deployments for major companies have also started to increase, and it has been sold to more than 1,150 companies by the consortium. A distinctive feature of the GRANDIT software is that it is an ERP that 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. It also steadily progresses, including addition of RPA to the line-up in GRANDIT 3.0, the latest version released in 2018.

Trends in the number of companies deploying GRANDIT



Source: Prepared by FISCO from the GRANDIT CORPORATION's materials

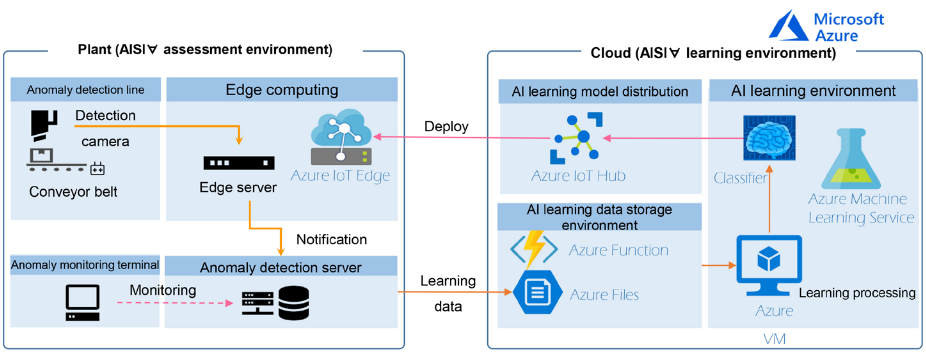
The Company has the leading track record of deployments among the members of the consortium, having deployed it into hundreds of companies, and it received the GRANDIT AWARD Prime Partner of the Year, as the leading sales company, 5 times during the 11 years that the Awards were held from 2008 to 2018. Its strengths include its in-house developments, including the "production management add-on module" as an add-on module to supplement GRANDIT's basic functions and the "continuous transaction management add-on module" for the manufacturing industry, and the "project management template (IT template)" that coordinates with OBPM for the software industry, and also that it has development capabilities enabling it to respond with a wide range of solutions. Its other strengths include that it is able to provide proposals for business automation through combining RPA and AI, and that it can provide integrated services based on the public Cloud, such as AWS and Microsoft Azure.

The scale of the domestic ERP market was more than ¥110bn in FY2019, which would seem to be growth of around 10% on the previous fiscal year. In the background to this growth is that, as part of their digital transformation measures, companies are continuously working to rebuild mission-critical systems, and also that the movement to migrate from on-premises to the Cloud is becoming increasing active. Going forward, SAP <SAP>, which is the largest ERP company, announced that it will end support for the maintenance of existing systems in FY2027, and companies, particularly major companies, are shifting from their existing systems to next-generation ERP. In addition, as it will become necessary to switch to other ERP, it is forecast that the market will continue to grow by close to 10% a year.

ERP vendors are being segregated according to the scale of their customers, and SAP and Oracle <ORCL> are strong for major companies. The Company's target customers are mainly medium-sized companies, which means that its competitor products include GLOVIA of Fujitsu <6702> and OBIC7 of OBIC <4684>. Also, alongside the diversification of customer needs in recent year, there has been a trend for ordered projects to become larger in scale, of around ¥300mn to ¥500mn per project. It is not possible to generalize about the gross profit margin as it varies depending on the product configuration and specifications, but on average, it ranges from 25% to 29%, while the operating profit margin trends at around 7%. Also, the percentage of recurring sales is around the 20% level.

As the AI business, the Company acts as a sales agency for Intelligent Automation Cloud Express (formerly, RPA Express), which is the RPA tool of Work Fusion of the US, selling it as a tool complementing the ERP business, while in October 2018, it released AISI∀-AD (Anomaly Detection), a deep learning anomaly detection system that it developed in-house. AISI∀-AD is a system that uses deep learning technologies to automate what were previously visual inspection processes conducted by people. The system configuration is that for the deep learning, it uses Microsoft's AzureCloud, which establishes the optimal environment for learning, and for anomaly detection processing, it uses an edge computer that is able to make high-speed determinations in real time. The targets of the detection and the required accuracy differ according to the customer, so it is necessary to establish specifications for each individual project, and currently the Company is at the stage of performing individual verification tests and measuring the effects for potential customers. On deploying a system, partner companies sell the hardware, like cameras and computers, while the Company incurs costs for the AISI∀-AD verification tests, and it records deployment and management-support fees in sales. For the deployment fees, it is targeting around ¥5mn per line.

Image of AISI∀-Anomaly Detection in use



Source: The Company's results briefing materials

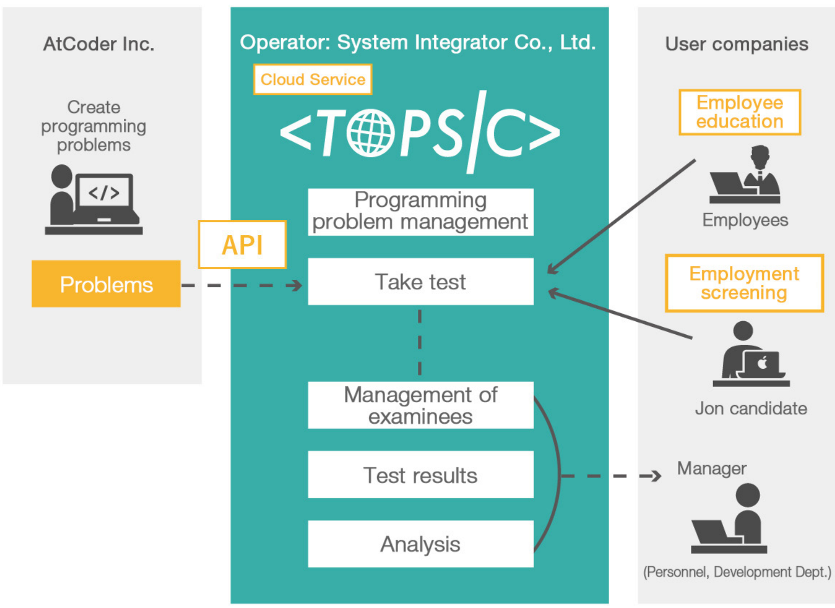
4. Other Business

The Other Business includes new businesses. TOPSIC, the programming skill evaluation service launched in January 2018, is a service that is already contributing to sales. This service checks the skill level of the test taker by issuing problems and evaluating the ability of the algorithm, a common skill that does not rely on the programming language, in an online format with a combination of six difficulty stages. Applications include screening in the process of hiring engineers, use as an educational and training tool for employees, and use as a skill check for selection of outsourcing companies. Furthermore, since it supports multiple languages, TOPSIC can be applied to hiring foreign engineers and selection of offshore companies. The Company provides this service to about 70 companies (including schools) as of end-February 2020 and business is steadily growing.

The fee plan is available on usage basis and on a fixed-fee basis of an annual contract. For the fixed-fee program with an ordinary company (standard plan), the annual basic fee is ¥300,000 and the annual usage charge is added based on the number of users (it provides the standard plan at a 10% discount for schools). Givery, Inc.'s "track" offering is a rival programming skill evaluation service. The main differences with the Company's service are a broader range that covers from the upstream design area to the programming area and slightly more expensive pricing, with a basic service fee that starts at ¥50,000 a month+ pay-per-use fees by user ID. The Company's service is considered to have superior ease of use when customers want to easily check the programming skills of engineers.

Alongside the improvement in the name awareness of TOPSIC, since 2018 the Company has been holding PG BATTLE, a tournament in which companies and schools compete against each other in programming battles using TOPSIC. One team is comprised of 3 people, and they write 4 programs in 90 minutes to solve the submitted problems and then submit their solutions online, and the teams compete on the basis of their total scores and the times required for the 3 team members. In the first tournament, a total of 260 teams, of both companies and schools, and 780 people participated, and by the second tournament, it had grown to 444 teams and 1,332 people and moreover there were 20 corporate sponsors, and in such ways the tournament is further growing in scale. It will continue to be held from 2020 onwards, and while growing in scale, it is thought that it will help to further spread the name awareness of TOPSIC.

TOPSIC service



Source: The Company's website

Trends

In FY2/20, achieved double-digit increases in sales and profits from the growth of the E-Commerce Business and the ERP/AI Business

1. Summary of the FY2/20 results

In the FY2/20 results, sales and profits increased by double digits, with net sales increasing 12.0% YoY to ¥4,554mn, operating profit rising 21.5% to ¥661mn, and ordinary profit growing 19.2% to ¥664mn. The only decline was in net profit, down 20.8% to ¥458mn. Benefitting from the expansion of IT investment, net sales increased in every business segment, but they grew particularly greatly in the ERP/AI Business. Profits declined in the Object Browser Business, but elsewhere they grew by double digits, driven by the performances of the E-Commerce Business and the ERP/AI Business, and apart from net profit, every profit item was a new record high for the second consecutive period. Net profit declined due to a special factor, of tax effects in the previous fiscal period.

Compared to the Company forecasts, net sales were basically as forecast, but the profit items were around 10% above forecast. This was mainly because in the E-Commerce Business, the productivity of development projects improved more than expected. Unprofitable projects were eliminated through the spread of the use of OBPM, while for other projects as well, the profit margins improved more than initially expected due to the smooth progress made for development. At the end of FY2/20, the number of employees had increased by 29 on the end of the previous fiscal period to 203 employees due to the active recruitment, mainly of engineers.

FY2/20 results

(¥mn)

	FY2/19		FY2/20				
	Result	% of sales	Company forecasts	Result	% of sales	YoY	Vs. forecast
Net sales	4,066	-	4,600	4,554	-	12.0%	-1.0%
Gross profit	1,516	37.3%	-	1,755	38.6%	15.7%	-
SG&A expenses	972	23.9%	-	1,094	24.0%	12.5%	-
Operating profit	544	13.4%	600	661	14.5%	21.5%	10.2%
Ordinary profit	557	13.7%	603	664	14.6%	19.2%	10.2%
Net profit	578	14.2%	422	458	10.1%	-20.8%	8.7%

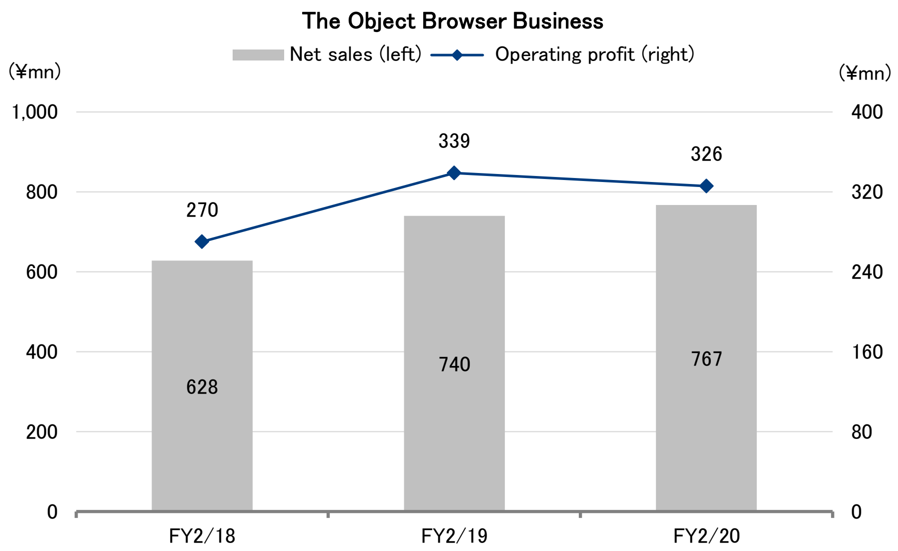
Source: Prepared by FISCO from the Company's financial results

The E-Commerce Business and the ERP/AI Business achieved double-digit increases in sales and profits, while TOPSIC is also growing steadily

2. Earnings by business segment

(1) The Object Browser Business

In the Object Browser Business, net sales increased 3.6% YoY to ¥767mn and operating profit decreased 3.6% to ¥326mn. Sales increased, mainly of OBPM, while the main reasons for the decline in profits was that the Company actively invested in advertising costs, which it had kept down in the previous fiscal period, and that it progressed measures to transition OBPM from the on-premises type to the Cloud-based service. When transitioning the business model from an on-premises type to a Cloud service, there is a period during which sales are temporarily pushed up, but profits are negatively affected.



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

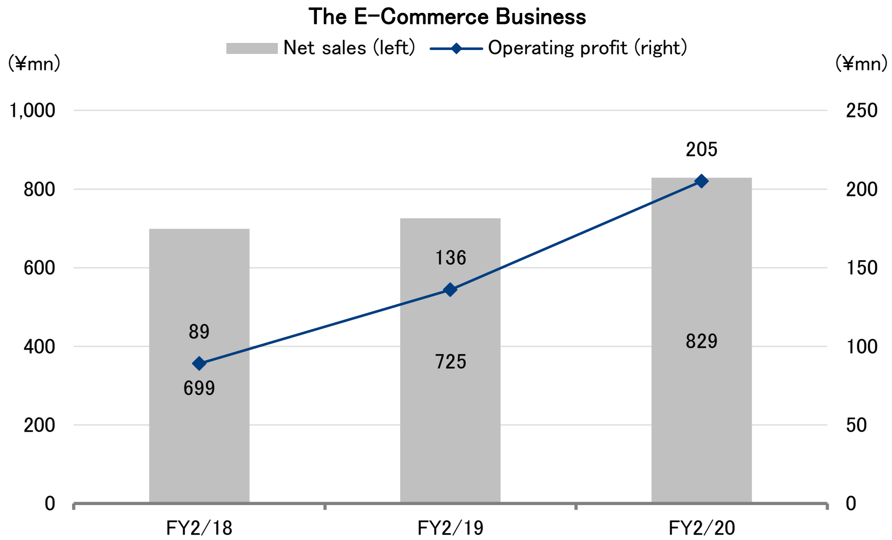
The number of companies deploying OBPM increased from more than 170 companies at the end of the previous fiscal period to more than 190 companies, and net sales increased 5.7% YoY. On the one hand, conditions in the IT industry have been busy in the last few years, but on the other hand, the risk of project development delays has also increased. This would seem to be leading to a rise in demand for OBPM, which can manage an entire project. An increasing number of companies are selecting the Cloud service rather than the on-premises type, and although the growth rate has slowed from the previous double-digit growth, the Company has been working to expand its recurring-sales business, and it can be highly evaluated for adopting a strategy that matches the above development.

Also, the SI Object Browser series has been deployed by new customers, while there is also renewal demand from existing customers, so its sales increased slightly YoY. The number of companies deploying it increased from more than 17,000 companies at the end of the previous fiscal period (390,000 licenses) to 19,000 companies (430,000 licenses), and it continues to steadily grow as the industry de-facto standard product.

For OBDZ, which is an application design support tool, the Company released a wholly web-based version with greatly improved performance in June 2019 and worked on sales promotion activities, including holding seminars. Therefore, the number of companies deploying it increased from around 40 companies at the end of the previous fiscal period to 60 companies. While its sales scale is still small, going forward the policy is to grow sales, while improving functions, as a tool to improve productivity in the software development field.

(2) The E-Commerce Business

In the E-Commerce Business, sale and profits increased significantly, with net sales rising 14.4% YoY to ¥829mn and operating profit growing 50.5% to ¥205mn. Alongside the expansion of the EC market, the number of companies entering this market is increasing and competition is intensifying. But the Company has strengths, of its development track record and expertise accumulated over more than 20 years, and the orders it received to build large-scale EC websites and for projects with a high degree of difficulty increased. A recent trend is that cases are increasing requiring cooperation with other systems, including ERP, and the ability to respond to diverse business forms (B-to-C/ mall /B-to-B/ omni-channel), and therefore the tendency has also been for the order amount per project to increase to around ¥100mn to ¥200mn (the standard package is about ¥10mn). In addition, the operating profit margin rose greatly, from 18.9% in the previous fiscal period to 24.8%, which was due to the thorough project management and the contribution of the improvement in productivity from the review of the development methods.

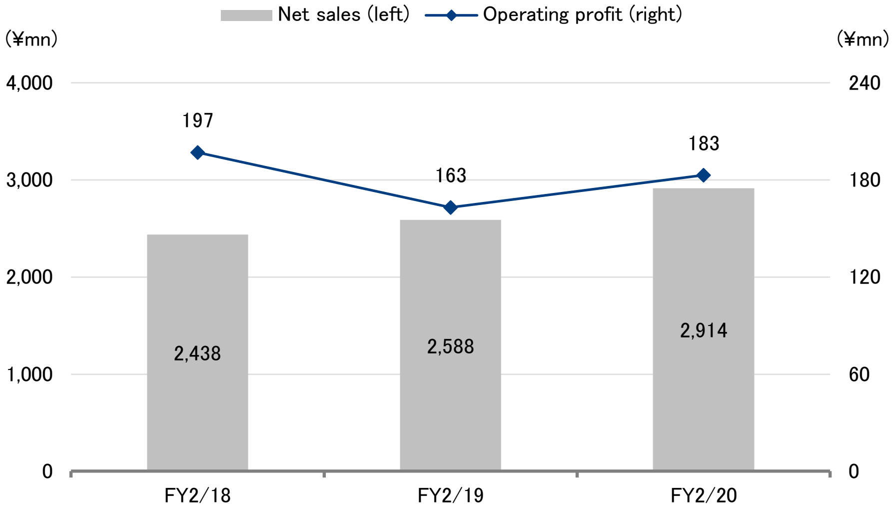


Source: Prepared by FISCO from the Company's financial results

(3) The ERP/AI Business

In the ERP/AI Business, net sales increased 12.6% YoY to ¥2,914mn and operating profit rose 11.7% to ¥183mn. In August 2019, orders from this industry were strong due to the effects of the improved versions and new releases of various types of add-on modules (production management, construction management, and cost management) that enable a response as a one-stop solution for the production, sales, installation and set-up, and after services according to the business form in the manufacturing industry. In addition, through linking the Company's own GRANDIT and OBPM and also using the “continuous transaction add-on module,” it is realizing an ideal, rational model in IT companies and creating a product from this linked model as an IT template, so the number of IT companies deploying it is increasing.

The ERP/AI Business



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

Needs are also increasing to build GRANDIT on the public Cloud, such as AWS and Microsoft Azure. From March 2019, the Company started providing a subscription model for GRANDIT. Providing it as a Cloud service enables customer companies to introduce it at low cost and in a short period of time. Therefore, it has become easier for medium- and small-sized companies to use GRANDIT, and we will be paying attention to this measure that will lead to an increase in the number of customers.

For AISI∀-AD (a deep learning anomaly detection system), which has been launched as a new business, there have been many inquiries for its use for visual inspection processes in factories. The verification targets are various and diverse, including transportation-equipment parts, PET bottle caps, and electrical-equipment materials, and among the potential customers, the Company is progressing verification tests at 2 or 3 companies. It has been receiving requests even while progressing these tests, and it is currently at the stage of accumulating expertise and results, increasing the level of completeness, and improving the ability to provide solutions. As net sales, it recorded around ¥9mn as verification-test costs. Some projects currently remain on hold, including due to the impact of the spread of the novel coronavirus, but it seems that they will start once conditions return to normal in the future.

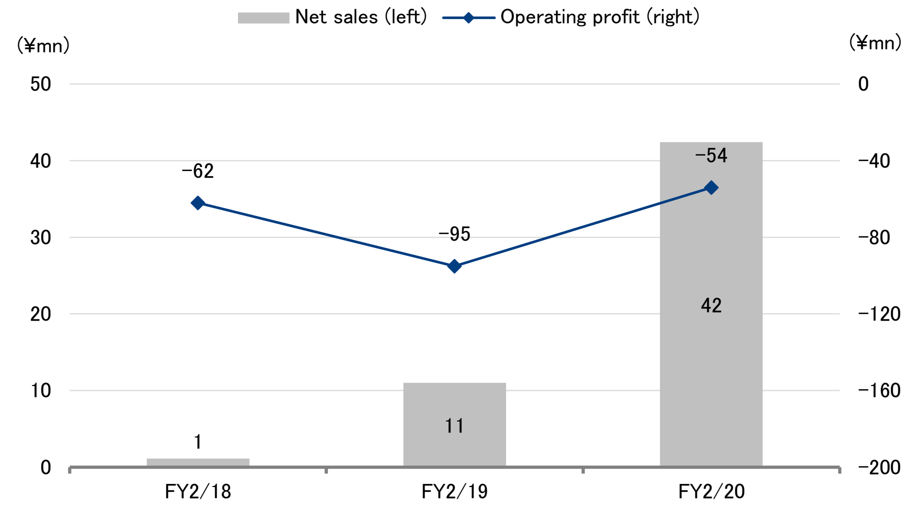
(4) Other Business

Other Business includes the TOPSIC programming skill evaluation service and other R&D investment. TOPSIC sales steadily increased, from ¥11mn in the previous fiscal period to ¥42mn. The main reasons for the higher sales were that, alongside the improvement in its name awareness, the number of companies deploying it also increased, mainly IT companies, rising from around 50 companies at the end of the previous fiscal period to 70 companies. Sales also grew due to the recording of sponsor income of ¥8mn from holding the PG BATTLE tournament, in which companies and schools compete against each other in a programming battle.

For AISI∀-CL (Company List)*, which the Company had been developing as an AI service, it has explained that it has decided to discontinue its development from the fact that there was a pioneering company and that there were little prospects of it being monetized. The operating loss amount from the other departments was reduced from ¥95mn in the previous fiscal period to ¥54mn from the effects of the increase in sales of TOPSIC and also the reduction in R&D investment.

* An information collection automation service that performs crawling and scraping (information extraction) of the homepages of companies established on the Internet; uses natural language processing technologies to read the extracted information, such as company outlines and on product and services; and then automatically tags the information, including by business category and industry.

Other Business



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

Has an excellent financial position with debt-free management and is maintaining high levels of profitability

3. Financial position and management indicators

At the end of FY2/20, total assets were up ¥522mn on the end of the previous fiscal period to ¥3,288mn. Looking at the main change factors, in current assets, cash and deposits decreased ¥22mn, while accounts receivable increased ¥384mn and work in process rose ¥85mn. In non-current assets, the main changes were that software (including the work-in process software account) increased 105mn and deferred tax assets decreased ¥89mn.

Total liabilities were up ¥289mn on the end of the previous fiscal period to ¥1,024mn. Income taxes payable increased ¥141mn and accounts payable rose ¥81mn. Also, net assets grew ¥232mn to ¥2,264mn, with the main increase factor being the recording of net profit ¥458mn, and the decrease factors being ¥177mn for dividend payments and ¥49mn to acquire treasury shares.

Looking at the management indicators, the equity ratio declined from 73.4% at the end of the previous fiscal period to 68.9%, but it was still maintained at a high level, while the current ratio is over 200% and moreover the Company has no interest bearing debt. It can be judged to have an excellent financial position. On the other hand, in the profitability indicators, ROE was down 10.9 percentage points (pp) YoY to 21.3% due to the decline in net profit. But this was due to a special factor of tax effects, and there has been no change to the fact that it continues to trend at a high level. Also, the operating profit margin rose 1.1pp to 14.5% and double-digit profitability was maintained, positioning the Company as both highly financially sound and highly profitable.

Balance sheet and financial indicators

(¥mn)

	FY2/17	FY2/18	FY2/19	FY2/20	Change
Current assets	2,761	2,789	2,094	2,589	495
(Cash and deposits)	725	917	1,319	1,296	-22
(Work in process)	1,211	1,104	49	134	85
Non-current assets	448	399	672	698	26
Total assets	3,210	3,189	2,766	3,288	522
Total liabilities	1,958	1,619	734	1,024	289
(provision for loss on order received)	1,256	982	6	0	-6
(Interest-bearing debt)	-	-	-	-	-
Net assets	1,251	1,570	2,031	2,264	232
(Retained earnings)	479	781	1,255	1,536	281
Financial indicators					
(Stability)					
Current ratio	141.0%	174.4%	285.0%	255.7%	-29.3pt
Equity ratio	39.0%	49.2%	73.4%	68.9%	-4.5pt
(Profitability)					
ROE (return on equity)	11.1%	24.5%	32.2%	21.3%	-10.9pt
Operating profit margin	6.9%	13.1%	13.4%	14.5%	1.1pt

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

Outlook

The forecasts are for higher sales and profits in FY2/21 as well, through "defensive" management

1. FY2/21 forecasts

For the FY2/21 results, the Company has announced range forecasts on considering the impact of the spread of the novel coronavirus. The forecasts are for net sales to increase by 4.3 to 9.8% YoY, to from ¥4,750 to ¥5,000mn; operating profit to grow by 2.8% to 13.3%, to from ¥680 to ¥750mn; ordinary profit to rise by 2.8% to 13.3%, to from ¥683 to ¥753mn; and net profit to climb by 4.0% to 14.5%, to from ¥477 to ¥525mn.

Forecasts for FY2/21

(¥mn)

	FY2/20		FY2/21			
	Full-year result	YoY	1H forecast	YoY	Full-year forecast	YoY
Net sales	4,554	12.0%	2,150	10.2%	4,750~5,000	4.3~9.8%
Operating profit	661	21.5%	300	7.6%	680~750	2.8~13.3%
Ordinary profit	664	19.2%	303	7.9%	683~753	2.8~13.3%
Net profit	458	-20.8%	212	10.1%	477~525	4.0~14.5%
Earnings per share (¥)	41.62		19.26		43.33~47.69	

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

The direct impact of the spread of the novel coronavirus is small and presently demand is trending solidly, but it is assumed that the economy will slow down more than after the Lehman shock, and the Company is expected to change its usual "offensive" management stance to a "defensive" stance and to keep down aspects such as human resources recruitment and development costs. For personnel, in the previous fiscal year, it increased the number of personnel by 29 people, but its policy for this fiscal period is to keep down the increase to around 15 to 20 people. Similarly, it will reduce R&D costs from ¥47mn in the previous fiscal period. Also, it had planned to open a development base in Vietnam in the spring of 2021, but this has been postponed until 2022 or after. While personnel costs will increase, even if the market environment further deteriorates, the Company is still aiming for higher sales and profits through keeping down other costs. The ranges of the forecasts are about at the same levels as the numerical results targets set in Break 2018, the medium-term business plan (net sales of ¥5,200mn and ordinary profit of ¥753mn).

Outlook is for the ERP/AI Business and the E-Commerce Business to continue to grow

2. Outlook by business segment

Outlook by business segment

(¥mn)

	FY2/18	FY2/19	FY2/20	FY2/21 E	Growth rate
Net sales	3,767	4,066	4,554	5,000	9.8%
The Object Browser Business	628	740	767	810	5.6%
The E-Commerce Business	699	725	829	900	8.6%
The ERP/AI Business	2,438	2,588	2,914	3,225	10.7%
Other Business	1	11	42	65	54.8%
Operating profit	494	544	661	750	13.3%
The Object Browser Business	270	339	326	322	-1.2%
The E-Commerce Business	89	136	205	211	2.9%
The ERP/AI Business	197	163	183	241	31.7%
Other Business	-62	-95	-54	-24	-
Operating profit margin	13.1%	13.4%	14.5%	15.0%	
The Object Browser Business	43.0%	45.8%	42.6%	39.8%	
The E-Commerce Business	12.8%	18.9%	24.8%	23.4%	
The ERP/AI Business	8.1%	6.3%	6.3%	7.5%	
Other Business	-	-	-	-	

Note: the FY2/21 results forecasts are the upper limits of the Company's range forecasts
Source: Prepared by FISCO from the Company's financial results

(1) The Object Browser Business

In the Object Browser Business, the forecasts are for net sales to increase 5.6% YoY to ¥810mn and operating profit to decrease 1.2% to ¥322mn (which are the upper limit values of the Company's range forecasts, same below). It is aiming to increase net sales through growing sales of OBPM, the SI Object Browser series, and OBDZ. Of these, it is clear that its sales strategy for OBPM is to shift it to the Cloud. As for the sales of fewer than 200 licenses, the Company has sold only for the Cloud since FY2/21, while it has also been progressing contracts for Cloud services for the more than 200 license users. For the light version, as there are some products it competes with, the Company is reviewing its price strategy. It is in a transition period, from the on-premises type to a Cloud service, which will have a temporarily negative impact on profits.

The Company is aiming to increase the number of companies deploying OBDZ by using feedback from users to work to improve its functions at any time and thereby further bolster its strength as a product. The impact of the spread of the novel coronavirus has not yet appeared, but if a movement appears among customer companies to reduce investment in the future, this may have an impact on sales.

(2) The E-Commerce Business

In the E-Commerce Business, the forecasts are for net sales to increase 8.6% YoY to ¥900mn and operating profit to rise 2.9% to ¥211mn. The EC market continues to expand, while it seems that the spread of the novel coronavirus has not yet had an impact on activities for the Company's receipt of orders. The forecast of a fall in the operating profit margin is as reaction to the fact that there were many highly profitable projects in the previous fiscal period. The policy is to aim for higher sales and profits through acquiring orders, mainly for renewal projects for EC websites that continue to become larger in scale.

(3) The ERP/AI Business

In the ERP/AI Business, the forecasts are for net sales to increase 10.7% YoY to ¥3,225mn and operating profit to grow 31.7% to ¥241mn. For ERP, as around a year and a half is required from an order to a delivery, the outlook is that sales in FY2/21 will continue to be strong against the backdrop of the abundant backlog of orders. Conversely, for the receipt of orders, there is the concern that cases will appear of customer companies postponing investment due to the impact of the spread of the novel coronavirus, and if the situation becomes more serious, this may have a negative effect on results from FY2/22 onwards. In the year after the Lehman Shock in 2008, sales fell by around 20% to 30%, so it is necessary to be aware of the risk that earnings may temporarily decline in FY2/22 also. However, as previously stated, companies' measures for digital transformation will continue in the future, so when looking to the medium term, there is no change to the fact that we can expect ERP demand to grow by around 10% a year.

Sales negotiations and other activities for AISI∀-AD have been temporarily halted due to the impact of the spread of the novel coronavirus. But the potential demand for it appears to be large because, by automating external-appearance visual inspection processes, it not only eliminates the labor-shortage problem, it also eliminates the risk of defective products due to human error. It is possible that its sales will grow from the movement for a recovery in the domestic manufacturing industry due to the spread of the novel coronavirus, so we will be paying attention to developments in the future.

(4) Other Business

The outlook is for TOPSIC net sales to increase 54.8% YoY to ¥65mn and for the operating loss to shrink to ¥24mn, including as other development costs will be kept down. For TOPSIC, the plan is to spend on development costs and to work on enhancing the service menu. So from around 2022, the number of companies deploying it is set to further increase and it is expected to start making a fully-fledged contribution to results at this time. Also, the Company has decided to hold the third PG BATTLE tournament in October 2020, and because it is an online tournament, it is expected that it will not be affected by the spread of the novel coronavirus and that it will be even bigger than in previous years.

Currently, the shortage of engineers, particularly in the IT industry, is continuing, and recruitment costs are increasing. In this situation, the potential demand for TOPSIC, which can be used to judge a person's programming skills quickly and easily, would seem to be large. On the point that TOPSIC can be utilized greatly when recruiting overseas engineers, which is expected to increase in the future, and for determining skills, such as of subcontractor companies, it is expected to grow to become the fourth pillar of earnings in the future. The Company is working on measures for the major market of schools and other education facilities with a partner, of a trading company with a sales network. But there are also cases of IT literacy being insufficient on the schools' side, so the Company considers it to be premature for its use to spread.

Aiming to convert to a high-profit business structure by expanding the recurring-sales businesses and improving productivity

3. Growth strategy

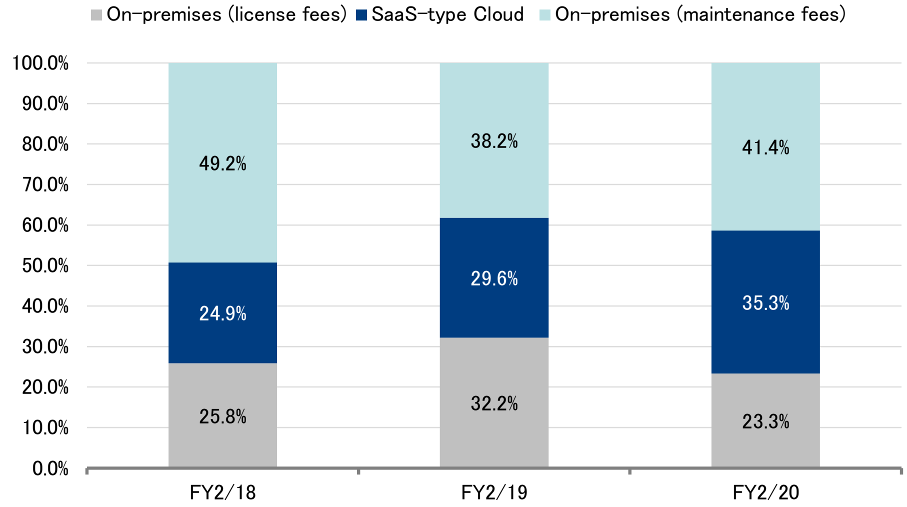
As its growth strategy for the future, the Company is aiming to convert to a high-profit business structure by working to expand the recurring-sales businesses and improve productivity.

(1) Expanding the recurring-sales businesses

It is aiming to increase the percentage of total sales provided by the recurring-sales businesses from the current level of the 20% range to around 40% in the future. In these businesses, it is increasing the percentage of recurring sales by shifting to a Cloud service for OBPM, developing the newly launched subscription model for GRANDIT in the ERP Business, and working to increase sales of TOPSIC.

Looking at the percentages of total OBPM sales by product in FY2/20, the Cloud service provided 35.3% and on-premises (maintenance fees) 41.4%, so the recurring-sales businesses already contribute 76.7% of the total. But the Company plans to fully transition to a Cloud service-only sales structure in FY2/22. This shift from on-premises to a Cloud service will have a negative impact on profits up to FY2/21, but from FY2/22 onwards, the outlook is that profits will also grow from the proportional increase in recurring sales. Although the scale of sales is still small, at slightly more than ¥400mn a year, the profit margin is high and it is expected to become a stable earnings base for the Company's results.

Percentages of OBPM sales



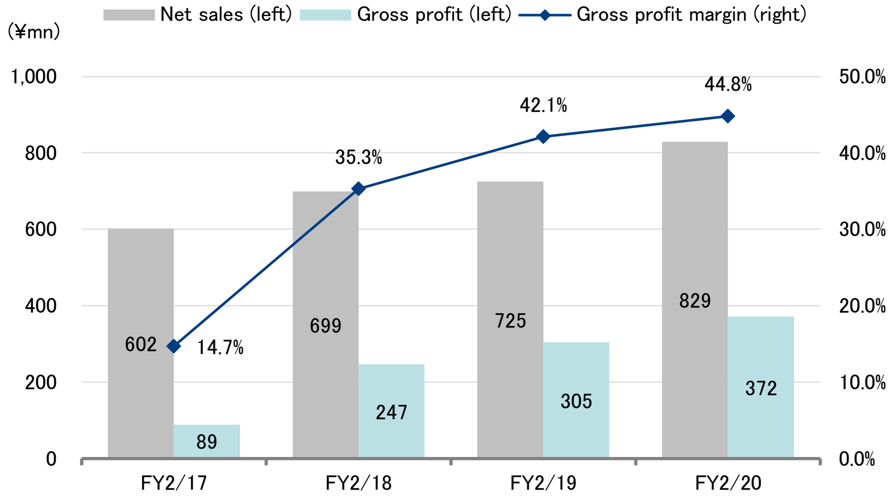
Source: Prepared by FISCO from the Company's results briefing materials

(2) Measures to improve productivity

In software development, whether or not projects can be completed in line with the plan affects profitability. The larger in scale the project, the more difficult it becomes to manage the schedule. Also, if there are changes to specifications during the project, it becomes necessary to rework it, so the development period may be significantly pushed back compared to the initial plan, and as a result, in many cases it becomes an unprofitable project. The Company has had cases like this in the past, of projects for which it was forced to record a significant loss.

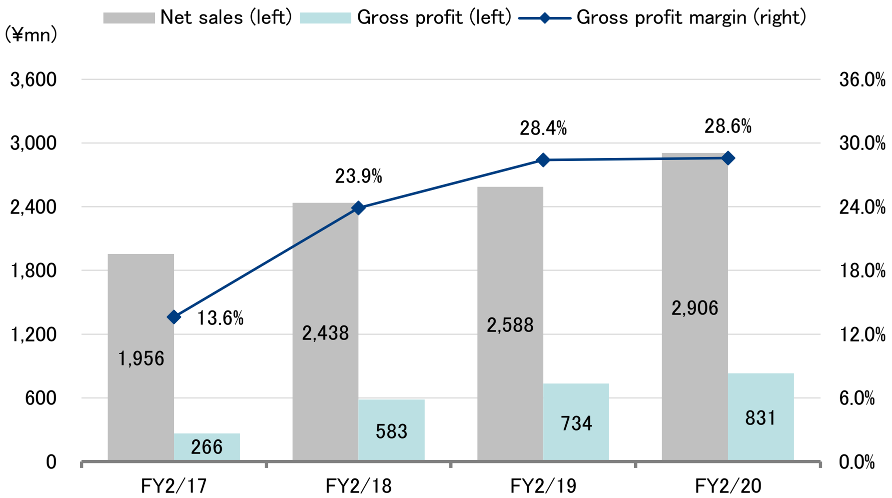
In order to mitigate the risk of this, the Company deploys OBPM, a product it developed in-house, into all companies, with the aim of thoroughly managing projects. In the E-Commerce Business, the gross profit margin has improved rapidly, from 14.7% in FY2/17 to 44.8% in FY2/20, with the main reasons for this being the thorough management of projects through the use of OBPM, and also the greatly improved productivity due to the review of development methods and the improvements to work efficiency. In the ERP Business as well, the Company is aiming to improve the gross profit margin, which is currently only in the 20% range, through progressing these measures.

Trends in the E-Commerce Business' results



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

Trends in the ERP Business' results



Note: does not include the AI business
Source: Prepared by FISCO from the Company's results briefing materials

Attracting attention as a pioneering company for “work style reforms”

4. Initiatives for the work environment

Toward improving the work environment for employees, the Company is actively working to promote diversity, including building a system in which it is easier for women to work and recruiting people with disabilities and overseas workers. In 2007, it introduced a work-at-home system for employees requiring child care and nursing care, and it is also encouraging male employees to take child care leave and to work from home for child care. The Company’s return-to-work rate for women after taking child care leave is 100%, the rate of taking paid holidays is 79.2%, and the average number of non-statutory overtime hours is 5.9 hours a month, all of which are at levels better than the industry averages (FY2/20). It has been highly evaluated for these efforts, and in 2012 it acquired the gold certification as a “company practicing diverse work styles” from Saitama Prefecture; in 2017, it was certified by the Ministry of Health, Labour and Welfare as a “company realizing both work and nursing care (Tomonin)” and then in 2019, as a “company supporting parenting (Platinum Kurumin).” Also, in 2017 it was selected as one of the “100 Teleworking Pioneers” by the Ministry of Internal Affairs and Communication, as a company that is actively promoting teleworking.

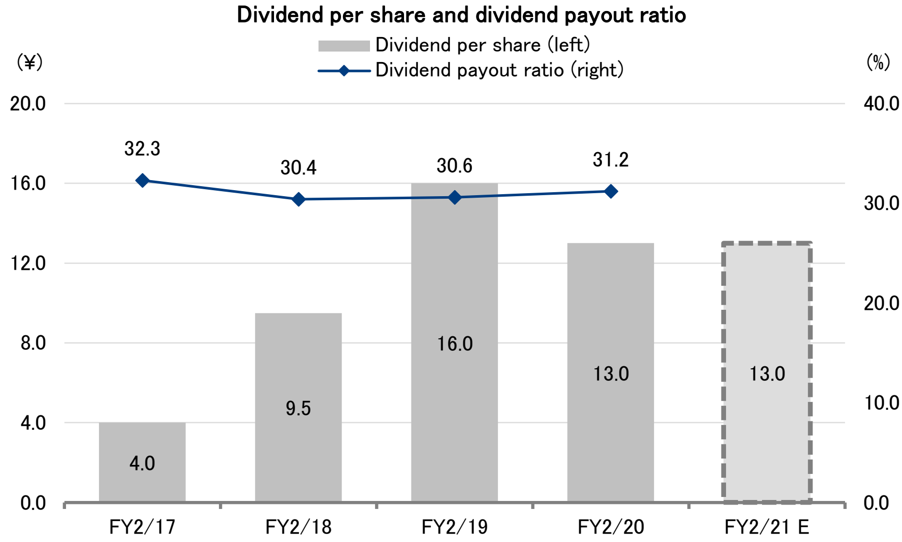
It would appear that the Company has also been highly evaluated by students and others for these efforts, and within the IT industry, where the labor shortage has become serious, it is able to recruit excellent human resources comparatively smoothly. In addition, its employee turnover rate is less than 5%, and it has a high employee retention rate within the IT industry. It recruited 7 new graduates in the spring of 2018, which it increased to 12 new graduates in both the spring of 2019 and the spring of 2020.

Shareholder return policy

Standard dividend payout ratio is 30% based on performance and a gift of Koshihikari rice through shareholder rewards program

The Company actively works to return profits to shareholders in order to improve its enterprise value. Its dividend policy is to link the dividend to results, with a dividend payout ratio of 30% as the standard. In FY2/20, net profit declined due to the normalization of the tax burden, so it decreased the dividend per share by ¥3.0 YoY to ¥13.0 (dividend payout ratio, 31.2%). In FY2/21, it plans to pay a dividend of ¥13.0, for a dividend payout ratio at the 30% level when calculated from the lower-range value of the Company’s forecast. However, if it achieves the upper range forecast value, the dividend payout ratio will be around 27%, in which case we can expect it to increase the dividend.

The Company has also introduced a shareholder rewards program with the objective of cultivating stable shareholders who hold their shares for the medium-to long-term. The program is for shareholders who hold at least 200 shares and who are listed under the same shareholder number in the shareholder ledger at the end of August and end of February in each year. The Company rewards newly harvested Koshihikari rice grown in Niigata, using reduced levels of fertilizers and agrochemicals. Shareholders holding from 200 to 999 shares receive a 1kg bag, those holding 1,000 to 3,999 receive a 2kg bag, those holding 4,000 to 15,999 receive a 5kg bag, and those holding 16,000 shares or more receive a 10kg bag, with the gift being delivered each fall after the harvest.



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

Information security policy

As information security measures, the Company assigns an officer to oversee information security, appoints information security managers in each organizational unit, and has formed an information security committee. These actions support safe management of information throughout the company. Additionally, the Company conducts education and training on information security for directors and employees and formulates and complies with internal operational rules to maintain information safeness.

Disclaimer

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