

**T.D.I.CO.,LTD.**  
9638 TSE JASDAQ

16-Oct.-14

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and disclaimers appear  
at the end of this document.FISCO Ltd. Analyst  
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## ■ T.D.I. has made a strong start to FY3/15 and is taking a further leap forward by strengthening its solutions business

T.D.I. Co., Ltd (9638; hereafter “the Company”) is a medium-sized, independent software development company. Centered on its main businesses of software development and data-processing services, it provides its customers with embedded software, data center businesses and a variety of solution services. Based on its one-stop solution services and direct transactions with clients in a wide range of industries, it owns a solid customer base, a well-balanced business portfolio with its data-processing services serving as its main source of revenues, and excellent staff actively trained by the Company. Its results have been steadily increasing backed by the recovery of IT capital expenditures, particularly in the manufacturing industry, and the expansion of new IT markets, such as for mobile and Cloud services.

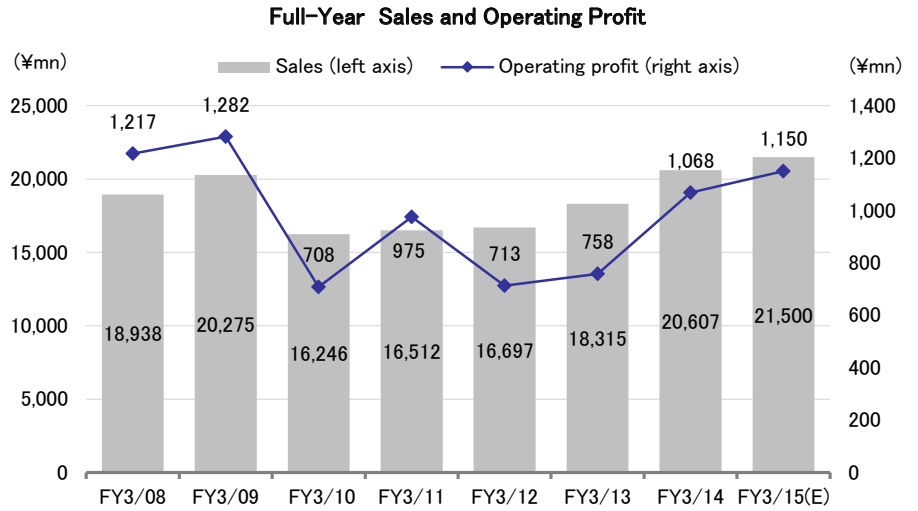
In the fiscal year ended March 2014 (FY3/14), the company recorded an increase in both sales and profits, with sales of ¥20,607mn, up 12.5% year-on-year (y-o-y) and operating profit of ¥1,068mn, an increase of 40.9%. The growth in orders from existing customers and the large-scale project orders contributed to the increase in sales and in addition, it was able to improve profitability by restricting unprofitable projects.

For FY3/15, the company is forecasting sales of ¥21,500mn, an increase of 4.3% y-o-y, and operating profit of ¥1,150mn, up 7.7%. Considering possible contributions from the second data center that opened in June of this year and the Company’s business environment, these forecasts might be conservative. It has made a solid start to FY3/15, as in Q1 its sales increased 22.3% y-o-y to ¥5,379mn and operating profit was up 39.8% to ¥237mn. If the Company performs well in the coming months, its results should surpass its forecasts.

The Company has positioned FY3/15 as the year it will “leap forward” into the future and it has drawn up a strategy to grow by strengthening its profitability and responding to opportunities for new businesses. In particular, it is aiming to bolster its ability to provide solutions to fields where demand is expected to grow, including digital advertising, home nursing care and medical systems, security and facial recognition systems, IT asset management, and automated inspection systems for factory lines, and it intends to make this solution business the driving force behind its growth. Its policy is also to utilize its solid financial base and abundant cash flow to actively carry out M&As.

## ■ Check Point

- It has constructed a stable customer base through direct transactions
- It has forecast an increase in both sales and profits in FY3/15, but at conservative levels
- It is strengthening its solutions business by leveraging its diverse business skills



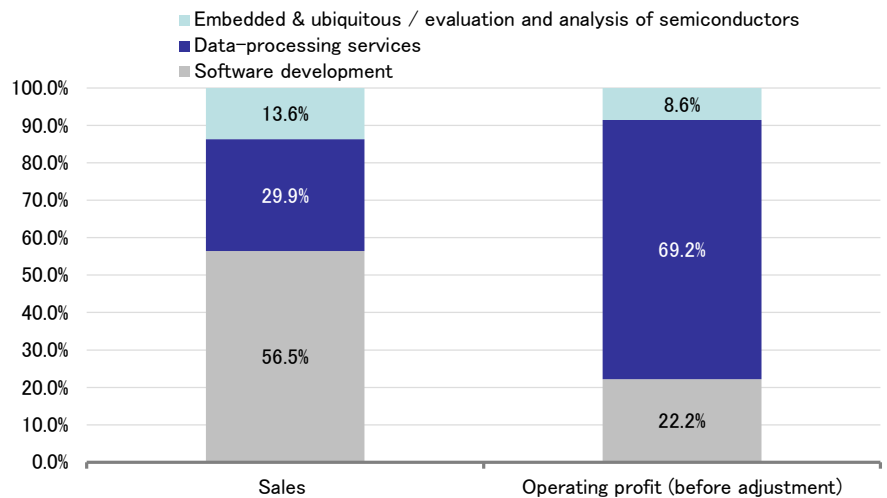
## ■ Business Overview

### An independent software development company with customers distributed in a wide range of businesses

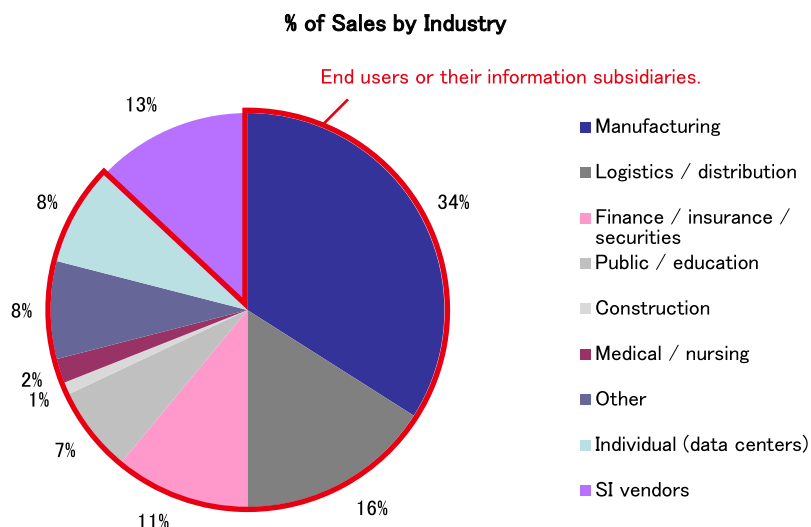
The Company is a medium-sized, independent software development company. Centered on its main businesses of software development and data-processing services, it provides its customers with embedded software, data center businesses and a variety of solution services. Its one-stop solution services and direct transactions with clients in a wide range of industries are the key features of its business.

It has three business segments; “software development,” “data-processing services” and “embedded & ubiquitous / evaluation and analysis of semiconductors”. Software development provides 56.5% of sales, but data-processing services generate 69.2% of operating profit (before adjustment; FY3/14 result).

#### % of sales and operating profit by business segment (FY3/14)



It has around 400 customers. In terms of percentages of sales by industry, a high percentage is provided by the manufacturing industry, as it includes its main customer, the Panasonic Group. However, if the influence of this factor is removed, then the Company can be described as having a well-balanced customer base with customers distributed across various industries. Also, it carries out direct transactions with approximately 90% of its end users or their information subsidiaries.



The Company categorizes its businesses into the following five areas.

**1. Software development**

In this area, it has customers in a diverse range of industries, but particularly in the logistics, manufacturing and insurance industries, and it offers these customers total services that provide consulting on backbone systems, business planning, design, development, and maintenance.

**2. Data-processing services**

In addition to administration and management services for information systems, including building infrastructures for customers’ information systems, server management, network monitoring, and help desks, it utilizes the Group’s remote centers to provide IT outsourcing services. The Company’s subsidiary, TDI Systems Service Co., Ltd., a wholly owned subsidiary) handles this area.

**3. Embedded & ubiquitous / evaluation and analysis of semiconductors**

In this area, the Company provides embedded software development services for in-vehicle equipment, home information appliances, and mobile and multimedia devices. It also provides design, evaluation, and analysis services for semiconductor products and various types of automated inspection services for production lines at factories and other facilities. Its subsidiary, TDI Product Solution Co., Ltd., a wholly owned subsidiary, handles this area.

**4. Data centers**

In this area, it utilizes the Group’s Internet data centers to provide a variety of Internet-related services, including hosting and housing and rental servers. This business area includes its data-processing services. Its consolidated subsidiary, Kagoya Japan Inc., a 51% owned consolidated company acquired in April 2012, handles this area.

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**5. Solution services**

The Company provides a range of solutions tailored to its customer’s business environment, operations, and industry type, in order to help solve their business problems. This business area is included in each of its three business segments: for example, digital advertising, particularly for the retail industry; image recognition and automated inspection services to detect defective products, mixing of foreign substances, etc., through image recognition systems on factory production lines; remote management services for the outsourcing of IT operations; and shared information systems for home nursing care and medical care, particularly for regional medical facilities. It is estimated that this area currently provides only around 3% of total sales, but the Company has positioned it as its growth driver for the future.

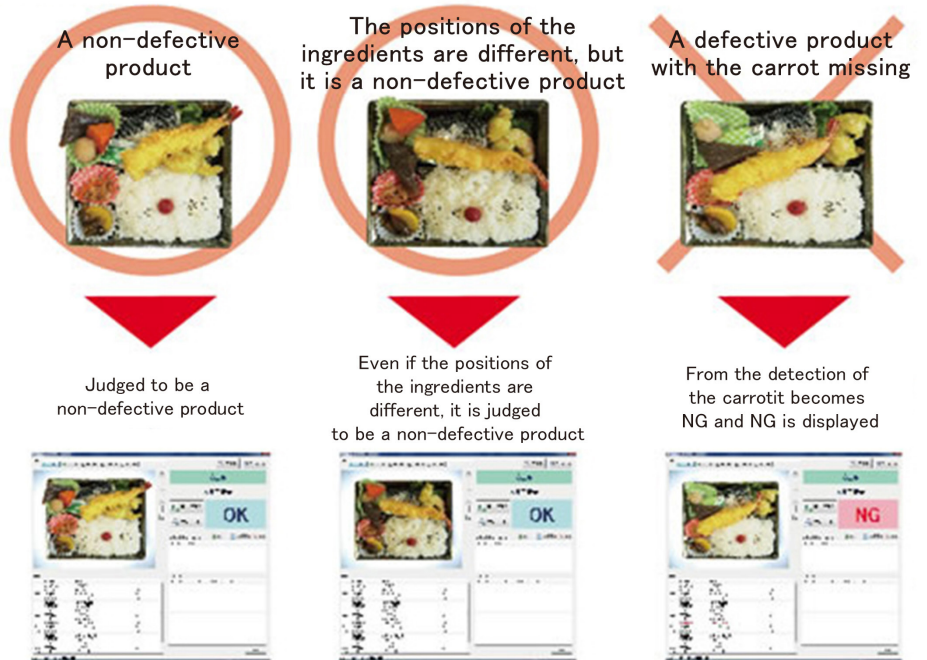
**Digital advertising solution  
(DAiS Promotion)**



Source: reproduced from Company materials

**Image recognition and automated inspection services**

\*The screen can be customized according to the customer’s preferences.



Source: reproduced from Company materials

## ■ Company history

### The Company has developed its business since the dawn of computer systems, including through a series of M&As

The Company can be traced back to the establishment in 1968 of its predecessor, Japan Computer Services Center Inc., which started outsourcing services for computer management operations and program development (head office, Chiyoda Ward, Tokyo).

In 1984, it changed its trading name to its current company name. During the very dawn of mainframe computer systems it steadily accumulated customers, mainly through providing maintenance and management services, and gradually expanded its business base. In 1993, it registered with the Japan Securities Dealers Association for OTC trading.

Backed by the increasing demand in IT systems, it has expanded its businesses with emphasis on mainframe machines for a wide range of companies, and also aimed to expand its business domain by developing solutions for customers in a variety of fields, in addition to its embedded software and semiconductor-related businesses.

The Company has been strengthening its management resources through active employee training programs, including establishing the “tdi Human Resources Development Center” in October 2007, and a series of M&As between 2008 and 2009. In February 2012, it established a subsidiary in China (Dalian). Then in April of the same year, with an eye to increasing the use of its Cloud services, it made Kagoya Japan Inc., operating data centers, a subsidiary, and opened its second data center in June 2014.

#### Company history

September 1968	Founded as “Japan Computer Services Center,” an information services company, with its head office is in Chiyoda Ward, Tokyo. Established Osaka branch office in Higashi Ward, Osaka City. Started offering outsourcing services for computer operations management and program development.
June 1972	Started systems development.
September 1978	Started LSI development-related business.
October 1984	Changed its company name to T.D.I. Co., Ltd. (current name) and transferred its head office to Shinjuku Ward, Tokyo
December 1993	Registered for OTC trading with the Japan Securities Dealers Association
February 1995	Participated in the ITA (Information Technology Alliance), an alliance of 13 independent software companies
December 2004	Listed on the JASDAQ Stock Exchange (currently, the Tokyo Stock Exchange JASDAQ (standard))
October 2006	Won the Minister of Economy, Trade and Industry Award for a company having contributed to the progress of computerization in fiscal 2006
April 2007	Established a subsidiary, TDI Systems Service Co., Ltd.
October 2007	Established the tdi Human Resources Development Center
May 2008	Made Act City Co., Ltd. an affiliate (equity method affiliate)
April 2010	Established a subsidiary, TDI Production Solution Co., Ltd.
November 2011	Established Layers-TDI Solutions Co., Ltd. as a joint venture with Layers Consulting Co. Ltd
February 2012	Established a subsidiary, Dalian T.D.I. Co., Ltd.
April 2012	Made Kagoya Japan Inc. a subsidiary

## ■ Industry environment

### A recovery trend in IT system capital expenditure, particularly in the manufacturing industry

According to a survey by IDC Japan, the Japanese software market has grown significantly and by 2013, it was worth ¥2.4469 trillion yen (up 8.0% y-o-y). Moreover, the Bank of Japan in its Tankan business survey (released July 1, 2014), forecast that total software investment in fiscal year 2014 would increase by 4.8% y-o-y for all industries and 9.0% for the manufacturing industry, as it anticipated a trend toward the recovery of IT system capital expenditure particularly in the manufacturing industry. This trend is expected to continue. While the use of smartphones, tablet devices, and Cloud services will spread, corporate attitudes toward IT system investment are expected to shift from “defense (reducing costs and improving efficiency)” to “attack (creating businesses)” as observed in usage of big data in management strategies.

The Company’s industry has a multi-layered structure, with major SI companies at the top, below which are arranged medium- and small-sized subcontracting companies. The companies in its industry include manufacturing and communication companies (NEC<6701>, Fujitsu<6702>, Hitachi<6501>, NTT Data<9613>), independent companies (IT Holdings<3626>, SCSK<9719>, Fujisoft<9749>), and consulting companies (Nomura Research Institute<4307>). But there are only a few medium-sized enterprises that conduct transactions directly with customers as the Company does.

## ■ Features

### Building a stable customer base through direct transactions

The source of the Company’s corporate value is considered to be the following three strengths.

#### 1. A stable customer base centered on direct transactions

In an industry characterized by a multi-layered structure, with major SI companies at the top and subcontractor companies below them, the Company has been able to build a stable customer base centered on direct transactions with customers with whom it has built strong relations of trust through providing them with maintenance and management services for their information systems over many years. In addition to providing high quality services, its deep involvement in its customers’ information systems and operations works to increase switching costs (the costs of switching from one provider to another), which in turn results in stable transactions for the Company.

#### 2. A business portfolio with a good balance of growth and stability

In addition to its cash cow (source of revenues) business of data-processing services, which has a stable customer base, the Company is able to expand into new growth fields through utilizing its highly specialized technological capabilities and expertise that it has cultivated in areas such as software development and embedded software. Another major advantage is its strength in providing solutions to fields in which demand is expected to grow in the future, including digital advertising, home nursing care and medical systems, and security and facial recognition systems.

### 3. Human resource capabilities through active staff training

The Company also actively trains its employees. For example, PTA (Project TDI Academy) that it launched in 2006 provides specialized training in operational information and IT skill training, and each year it selects 10 of its employees to undergo 1 year of intensive engineer training. It also has a large-scale training facility, the tdi Human Resources Development Center, at Yugawara (Kanagawa Prefecture). The Company's policy is to carry out initiatives to further strengthen its technological capabilities so as to strongly differentiate itself from its competitors through these capabilities.

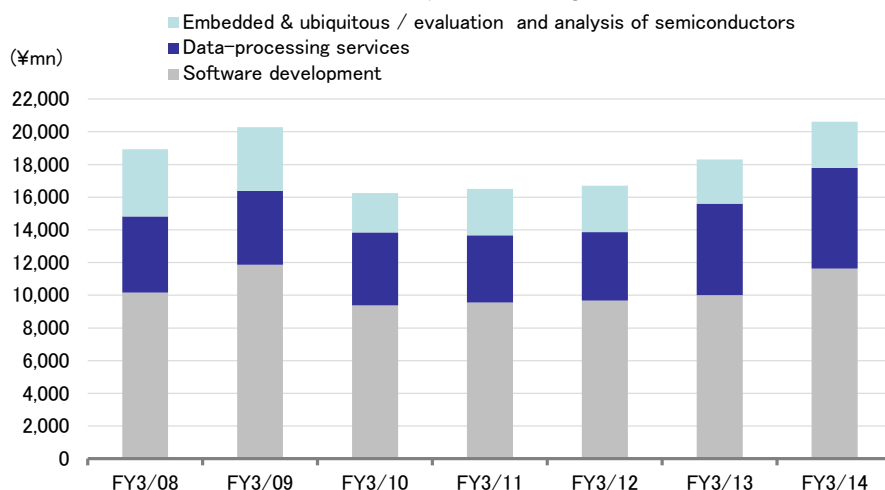
## ■ Financial Trends

### Results have been recovering since FY3/13

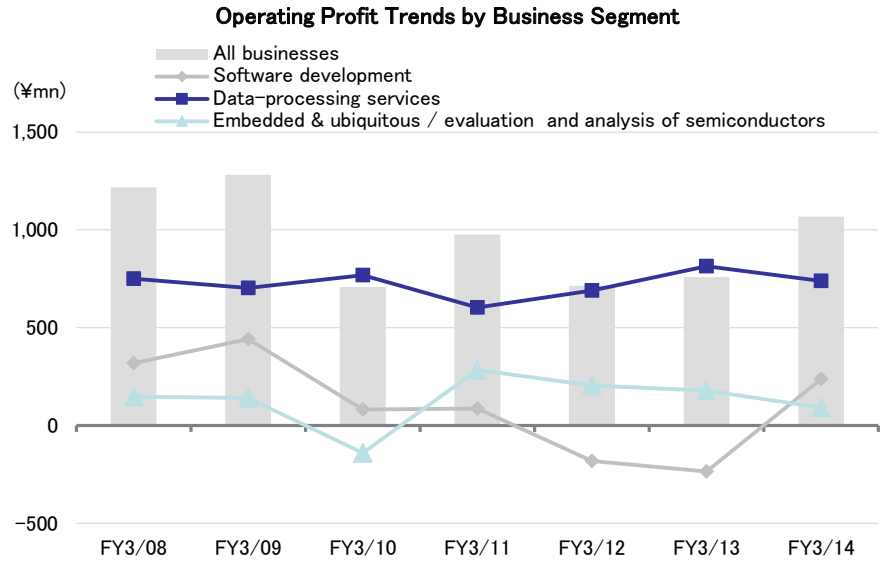
#### (1) Past trends

The Company's results significantly worsened due to the market downturn following the Lehman Shock in FY3/10. The slump continued for a few years after that, but the Company has been recovering since FY3/13, and in FY3/14 it recorded its highest ever sales. The unfavorable results from FY3/10 onwards were due to a fall in the number of orders as customers put on hold or postponed new software development projects, a decline in the number of orders in embedded & ubiquitous / evaluation and analysis of semiconductors, and customer requests for reductions to unit prices. On the other hand, the data-processing services have performed stably and have contributed to the overall performance of the Company. The main reasons for the recovery since FY3/13 are the increase in IT investment due to the effects of Abenomics, and in addition, the improved performance of data-processing services following the acquisition of Kagoya Japan Inc., which operates data centers.

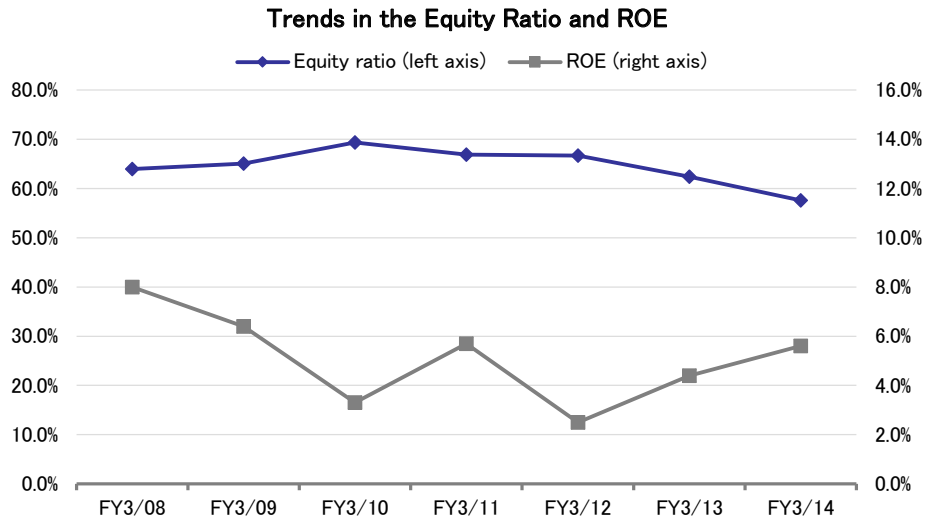
Sales Trends by Business Segment



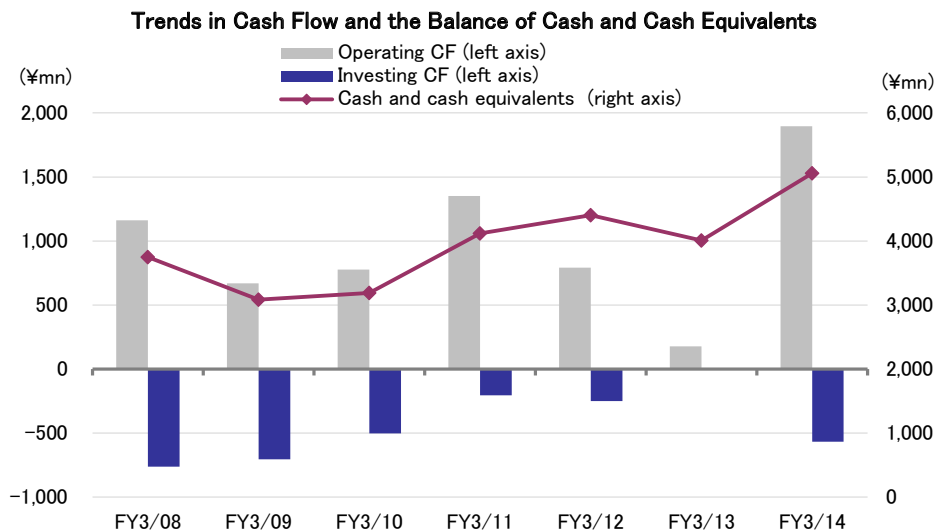
Profitability slumped from FY3/10 to FY3/13. This was mainly because of unprofitable projects, in addition to a fall in the utilization of its software development capacity. However, data-processing services maintained a high level of profitability. Since FY3/14, profitability has greatly improved due to measures to restrict unprofitable projects in software development.



The Company has a stable financial base and its equity ratio has trended stably in a range of 55% to 70%. Also, its current ratio, which indicates its short-term payment capability, was 261.0% (at the end of June 2014), reflecting a healthy balance of cash and cash equivalents being maintained at a high level. However, there is room for improvement in ROE and capital efficiency. The Company can improve its capital efficiency through raising the profitability of its existing businesses and also utilizing its stable financial base and surplus cash to invest in highly profitable fields (including through M&As).







**Software development contributed greatly in FY3/14, with a double-digit increase in sales and profits**

**(2) FY3/14 results**

The Company’s sales and profits both increased in FY3/14. It recorded sales of ¥20,607mn, up 12.5% y-o-y, operating profit of ¥1,068mn, a rise of 40.9%, ordinary profit of ¥1,142mn, an increase of 37.2%, and net income of ¥545mn, up 32.2%.

By business segment, revenues from software development grew thanks to increased orders from existing customers and the acquisition of large-scale projects. The performance of data-processing services also steadily improved, primarily from an increase in orders for new projects and the favorable performance of the data centers.

The improvement in profits in software development, which were achieved by restricting unprofitable projects, contributed greatly to the overall increase in profits and the operating profit ratio rose to 5.2% (compared to 4.1% in the previous fiscal year). However, there was an increase in SG&A costs in data-processing services (to strengthen sales and for employee training) and a fall in the number of highly profitable embedded software projects in embedded & ubiquitous / evaluation and analysis of semiconductors. Consequently, profitability in both these segments declined.

## FY3/14 results and FY3/15 forecasts

(¥mn)

	FY3/13 results		FY3/14 results		Change		FY3/15 forecast		Change	
		% of sales		% of sales		% change		% of sales		% change
Sales	18,315	100.0%	20,607	100.0%	2,292	12.5%	21,500	100.0%	892	4.3%
Software Development	10,005	54.6%	11,636	56.5%	1,631	16.3%	-	-	-	-
Data-processing services	5,605	30.6%	6,163	29.9%	557	10.0%	-	-	-	-
Embedded & ubiquitous / evaluation and analysis of semiconductors	2,704	14.8%	2,807	13.6%	102	3.8%	-	-	-	-
Sales costs	14,502	79.2%	16,267	78.9%	1,764	12.2%	-	-	-	-
SG&A costs	3,054	16.7%	3,272	15.9%	217	7.1%	-	-	-	-
Operating profit	758	4.1%	1,068	5.2%	310	40.9%	1,150	5.3%	81	7.7%
Software development	-236	-	237	2.0%	473	-	-	-	-	-
Data-processing services	815	14.5%	739	12.0%	-76	-9.3%	-	-	-	-
Embedded & ubiquitous / evaluation and analysis of semiconductors	178	6.6%	91	3.3%	-87	-48.9%	-	-	-	-
Current profit	832	4.5%	1,142	5.5%	309	37.2%	1,200	5.6%	57	5.0%
Net income	412	2.3%	545	2.6%	132	32.2%	580	2.7%	34	6.3%

## The Company is forecasting an increase in both sales and profits in FY3/15, although its forecasts are somewhat conservative

### (3) FY3/15 forecasts

In FY3/15, the Company is forecasting that sales will increase 4.3% y-o-y to ¥21,500mn, operating profit will rise 7.7% to ¥1,150mn, current profit will grow 5.0% to ¥1,200mn, and net income will increase 6.3% to ¥580mn. However, judged from factors such as its favorable business environment, these forecasts might be conservative.

The Company does not disclose forecasts for individual business segments, but software development is likely to record higher sales due to a favorable business environment and the promotion of a proposal-type business. Data-processing services are expected to achieve steady sales growth, including from the contribution to sales of the second data center opened in June.

On the one hand the Company is aiming to strengthen profitability by thoroughly monitoring software development projects, but on the other hand its forward investment costs, including training expenses to expand solution business, will increase. Therefore, while the operating profit ratio is expected to remain unchanged, it is forecasting increased profits resulting from higher sales.

## A smooth start to the fiscal year, with operating profits in Q1 increasing 39.8% y-o-y

### (4) Progress made in Q1 FY3/15

The Company has made a smooth start to FY3/15 and in Q1 sales increased 22.3% y-o-y to ¥5,379mn, operating profit rose 39.8% to ¥237mn, current profit grew 6.6% to ¥261mn, and net income climbed 36.1% to ¥127mn.

All of the three businesses segments performed strongly, but in particular software development contributed greatly to the increase in sales and profits, thanks to an increase in orders from existing customers and large-scale projects.

Business performance of the Company tends to pick up in second half of a fiscal year. In the previous fiscal year (FY3/14), Q1 sales provided 21.3% of full-year sales. Yet in the current fiscal year (FY3/15), Q1 sales have already achieved 25.0% of the forecast for the full fiscal year. As such, the Company's full year results might exceed forecasts.

#### Q1 FY3/15 results

(¥mn)

	Q1 FY3/14		Q1 FY3/15		Change	
		% of sales		% of sales		% change
Sales	4,399	100.0%	5,379	100.0%	980	22.3%
Software development	2,388	54.3%	3,119	58.0%	731	30.6%
Data-processing services	1,441	32.8%	1,611	29.9%	170	11.8%
Embedded & ubiquitous / evaluation and analysis of semiconductors	569	12.9%	649	12.1%	80	14.0%
Sales costs	3,431	78.0%	4,245	78.9%	814	23.7%
SG&A costs	798	78.0%	897	16.7%	98	12.4%
Operating profit	169	3.9%	237	4.4%	67	39.8%
Software development	-7	-	39	1.3%	46	-
Data-processing services	171	11.9%	183	11.4%	12	7.1%
Embedded & ubiquitous / evaluation and analysis of semiconductors	5	0.9%	14	2.2%	9	172.6%
Current profit	191	4.3%	261	4.9%	70	36.6%
Net income	93	2.1%	127	2.4%	33	36.1%

## ■ Growth strategy

### Leveraging its diverse business skills to strengthen solutions business

FY3/15 is the final year of the Company's medium-term management plan titled "Rising to the Future". The company positioned this fiscal year as "The First Year of Challenge" and aimed for a leap forward into the future. It will cultivate a corporate culture of continuous challenges and is striving to improve its technological capabilities and organizational strength. The Company is aiming to grow by strengthening profitability and taking opportunities to enter new businesses fields. Its goals are to maintain and improve the quality and motivation of employees and to be the winner in a very competitive industry experiencing intense changes. To achieve these goals, the Company must become an enterprise with a strong presence achieved by differentiating its solution business from its competitors and securing a large business volume. In the medium-to-long term, it is targeting sales of ¥50,000mn (of which, around 20% are to be provided by its solution business). For its solution business that utilizes a diverse range of business skills, the Company is targeting areas where it can utilize its technological capabilities and expertise, including security and face recognition, energy smart meters and agriculture robots, as well as fields where increased demand is forecast in the future, such as digital advertising and the home nursing care and medical business. By strengthening its solutions business, it is aiming to strengthen its capabilities to propose to its existing customers and to increase transactions with them, which the Company believes to be the key to obtain new customers. The Company's policy is also to utilize its solid financial base and surplus cash to proactively carry out M&As.

## ■ Share price valuation

### Room to reconsider valuation through improvements in ROE

When analyzing the valuation of the Company's share price, it can be compared to the share prices of peer companies such as Information Services International-Dentsu, Ltd. (ISID) <4812>, Nippon Systemware Co., Ltd. <9739>, INES <9742>, and Fujisoft <9749>. The Company's PER and PBR are not at low levels compared to its peer companies and there is room for improvement. Compared to the average PER of 15.7 times and PBR of 1.34 times of Nikkei, and the JASDAQ averages of PER of 16.5 times and PBR of 1.39 times, the Company is slightly lagging behind the market.

The key to improving the valuation is thought to be its ROE (capital efficiency). Currently, the ROE remains at 5.6%, but if the Company improves its capital efficiency by expanding its business through an aggressive investment strategy while increasing profit levels, there should be sufficient room for a change in valuation.

Comparison of share price valuations

Securities code	9638	4812	9739	9742	9749
Company name	T.D.I.	ISID	Nippon Systemware	INES	Fujisoft
Share price (¥)	892	1,123	566	860	2,408
Market capitalization (¥mn)	7,946	36,600	8,433	41,280	81,150
EPS (forecast, ¥)	69.66	90.85	60.40	35.30	154.15
BPS (result, ¥)	1,174.78	1,191.99	846.03	1,345.69	2,723.46
Dividend (forecast, ¥)	21.00	24.00	15.00	21.00	28.00
PER (forecast, times)	12.81	12.36	9.37	24.36	15.62
PBR (result, times)	0.76	0.94	0.67	0.64	0.88
Dividend yield (forecast)	2.4%	2.1%	2.7%	2.4%	1.2%
Sales growth rate	8.8%	6.1%	4.6%	-	3.7%
Operating profit growth rate	17.3%	24.2%	14.0%	-	18.4%
Operating profit ratio (result)	5.2%	5.8%	5.2%	5.4%	5.4%
ROE (results)	5.6%	7.5%	7.4%	2.4%	4.5%
Equity ratio	57.6%	66.0%	64.0%	72.8%	54.9%

\* Share price is the closing price on October 16. The growth rate is the rate for the three fiscal periods, including the forecast for the current fiscal period.

## ■ Returns to Shareholders

### A dividend payment policy of stable and performance-linked dividend payments

The Company pays an interim dividend and a year-end dividend. It has three basic dividend policies: (1) to link dividends to performance, (2) to target a consolidated dividend payout ratio of 30% at the present, and (3) to maintain a stable dividend payment of at least ¥12 per share after considering its profit level. As such, the Company's dividend policy is to both stably pay dividends and to link dividends to performance. In FY3/14, it revised its initial dividend forecast (an annual dividend of ¥20) and paid a dividend of ¥25 (interim ¥10, year-end ¥15), an increase of ¥5 from the previous year, and achieved a dividend payout ratio of 38.1%. In FY3/15, it plans to pay a dividend of ¥21 (interim ¥10, year-end ¥11) for a dividend payout ratio of 30.1%, but it may again be upwardly revised.

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