COMPANY RESEARCH AND ANALYSIS REPORT

Tecnos Japan Inc.

3666

Tokyo Stock Exchange First Section

28-Aug.-2020

FISCO Ltd. Analyst

Ikuo Shibata

FISCO Ltd.

http://www.fisco.co.jp

Index

Summary

Despite concerns regarding the spread of COVID-19, TECNOS JAPAN predicts major recovery in FY03/21, and will also focus on DX promotion via collaborative-creation platforms.

1. Company overview

TECNOS JAPAN INCORPORATED <3666> (hereafter, "the Company") is an independent, ICT systems services company that provides a wide range of system services, including corporate digital transformation (DX)* consulting, system grand design assistance combining a mission-critical system (ERP), customer relationship management system (CRM), and its own service (CBP), business consulting, requirements definition, design, development, and maintenance, and is also focusing on expansion of global business. Its strengths include its high-quality consulting capabilities, technological capabilities, and the utilization of its proprietary templates. The Company has a track record of supporting the implementation of ERP, on the axis of SAP, for more than 220 companies, mainly in the manufacturing industries. Amid the acceleration of digitization, it is promoting DX business by combining ERP and CRM (company optimization) and industry-optimized, collaborative-creation platforms (CBP; inter-company collaborations) and utilizing the data accumulated from this to provide value (reforming customers' businesses).

* Refers to companies reforming products, services, and business models based on customer and societal needs using data and digital technologies in response to rapid changes in the business environment and also making changes in workflow, organization, processes, as well as corporate culture and atmosphere to establish competitive advantages.

2. FY3/20 consolidated results

In FY3/20 consolidated results, profits fell due to temporary special factors, despite increased sales, with net sales at ¥7,677mn (up 10.1% YoY) and operating income at ¥282mn (down 63.9%). Net sales rose at a double-digit pace, thanks to robust corporate system investments in ERP and CRM and full-year contribution by Lirik, Inc. added to the group in June 2018 (adding six months in FY3/20), and set an all-time high in a second straight year. Profits, however, dropped sharply due to losses incurred in certain projects (one-time factor). In activities, the Company bolstered CRM business with M&A deals and achieved progress by building a community aimed at establishing a collaborative-creation platform and conducting other activities.

3. FY3/21 consolidated results forecasts

In FY3/21 guidance, the Company expects higher sales and steep profit recovery with targets of ¥7,900mn in net sales (up 2.9% YoY) and ¥800mn in operating income (up 183.2%). It only expects moderate sales growth, despite continued improvement in ERP and CRM investment interest including business model reforms aimed at realizing DX, due to signs of cautious investment stances and curtailed investments due to the COVID-19 outbreak. In profits, meanwhile, the Company expects significantly stronger earnings on recovery from the previous year's result.

4. The growth strategy

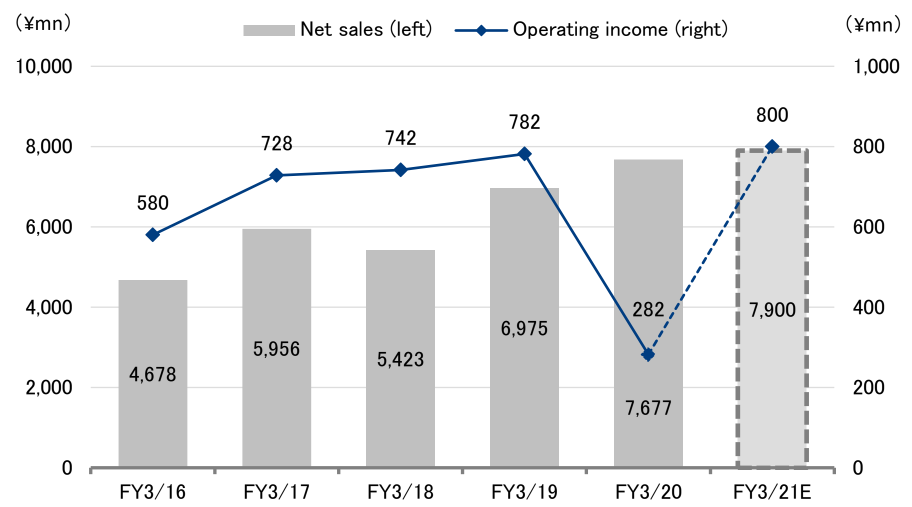
The Company's growth strategy has a direction (vision) of "LEAD THE CONNECTED SOCIETY TO THE FUTURE." based on a mission of "Contributing to the development of society by connecting organizations, people, and data." In other words, in addition to deployment and switching of ERP (optimization at the individual-company level) using knowhow accumulated since its founding, it is strongly advocating the concept of an industry optimization-type platform business (optimization of the entire supply chain) that connects companies via data through collaborative creation with partner companies that have various cutting-edge technologies and deploying companies. It has also set three points for the future investment areas towards growth: "platform business," the "global business" and "human resources and organizations."

FISCO thinks the Company is sufficiently capable of realizing sustainable growth, even with current uncertainty caused by the COVID-19 outbreak, through ERP and platform business targeting DX. Despite concerns about the COVID-19 situation temporarily having an adverse impact on earnings, structural reforms aimed at achieving DX have become an issue not only companies but for society as a whole, and the Company is capable of harnessing the resolution of societal issues for its own growth as a major opportunity. It needs to make progress in full-fledged operation of platform business as a first step and then focus on creation of new value including collaboration with partner companies and others.

Key Points

- In FY3/20 profits fell sharply, despite higher sales, due to temporary special factors
- Achieved some progress toward building a collaborative-creation platform to realize DX
- In FY3/21, the Company expects significant earnings recovery despite concerns about the impact of the COVID-19 outbreak
- Pursuing a strategy that harnesses resolution of societal issues to drive its own growth by combining ERP (corporate optimization) and its proprietary collaborative-creation platform (optimization of the entire supply chain) with a goal of full-fledged development of DX

Results trends



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

Company overview

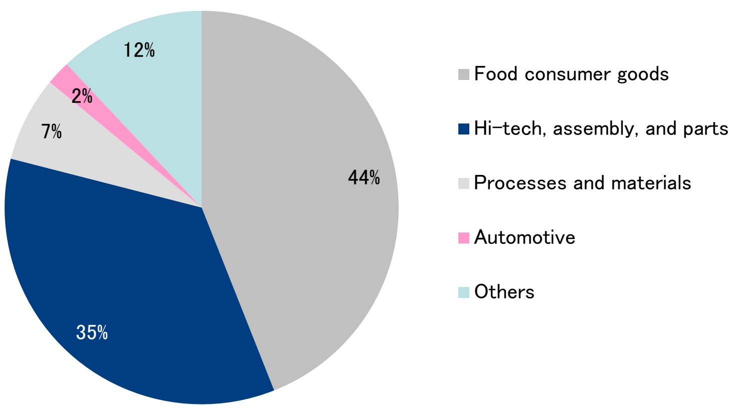
Mainly provides ERP and CRM implementation support and also focuses on DX promotion by building a collaborative-creation platform.

1. Business overview

The Company is an independent ICT systems services company that provides a wide range of system services, including corporate digital transformation (DX) consulting, system grand design assistance combining a mission-critical system (ERP), customer relationship management system (CRM), and its own service (CBP), business consulting, requirements definition, design, development, and maintenance. Its strengths include its high-quality consulting capabilities, technological capabilities, and the utilization of its proprietary templates, and the Company has a track record of supporting the implementation of ERP, on the axis of SAP, for more than 220 companies, mainly in the manufacturing industries. Amid the acceleration of digitization globally, it advocates a group mission of "LEAD THE CONNECTED SOCIETY TO THE FUTURE (Contributing to the development of society by connecting organizations, people, and data)" and is promoting DX business by combining ERP and CRM (company optimization) and industry-optimized, collaborative-creation platforms (CBP; inter-company collaborations) and utilizing the data accumulated from this to provide value (reforming customers' businesses).

The composition of total net sales by industry (FY3/20 results) was 44% for food consumer goods; 35% for high-tech, assembly, and parts; 7% for processes and materials; 2% for automotive; and 12% for others. At the current point in time, the Company is focusing on measures for major manufacturing industries revamping mission-critical systems using ERP. However, it might diversify to other industries, including logistics and retail, depending on progress in platform business that seeks to optimize the entire supply chain.

Composition of total net sales by industry (FY3/20)



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

The Company has only one business segment, “information systems solutions services,” but in terms of the content of the services provided, it is divided into “core work systems and peripheral solutions” and “others.” Moreover, the former is broadly divided into the mainstay ERP and CRM related business and the new focus field of the CBP promotion business. “Information systems solutions services” accounts for a high percentage of consolidated sales.

(1) The ERP and CRM related business

1) On the topic of ERP (Enterprise Resources Planning systems), which has been the Company’ core business since its founding, the Company supports the implementation of ERP packages provided by various ERP vendors that distribute on a global scale based on a Best of Breed* strategy to realize optimal solutions for customer companies. Specifically, it accurately ascertains in a timely manner the flow of goods in the logistics management work (purchasing, production, and sales) of customer companies, and also ascertains results in a timely manner and future forecasts for accounting management work (financial accounting and management accounting), and it provides integrated services for the results management of globalized corporate groups, from the upstream (consulting) through to the downstream (maintenance and improvements). The ERP packages which the Company handles are centered on SAP S/4HANA and also include mcframe by Business Engineering Corporation <4828>, which is strong in production management.

* An approach of selecting the best hardware and software in each field and constructing systems by combining them.

For SAP S/4HANA, which is the axis, in September 1996 the Company concluded a partner agreement with SAP Japan (started handling products at the time of establishment in 1994), and it has a track record of supporting its implementation into more than 220 companies. The Company is also focusing its efforts into overseas-related projects, supporting roll-in and roll-out (implementation to the overseas subsidiaries of Japanese companies and the Japanese subsidiaries of foreign companies). Furthermore, by using the templates* it has created based on its previous experience of implementation, it is able to complete an implementation with a short delivery time and low cost, and to provide new added value.

* Refers to new packages with settings and additional functions that other companies deem necessary being created by the Company based on its track record of implementing ERP packages and other software. By combining these settings and functions with the ERP package, it is possible to reduce the time required for implementation and costs when making new implementation.

Alongside the implementation of ERP packages, there is a growing need for even more evolved total solutions (demand forecasts, marketing related, etc.) through combining peripheral technologies. In response to this, the Company is working on products including EPM*1/BI*2, EAI*3, etc.

*1 Abbreviation of Enterprise Performance Management (the management of a company’s results). It refers to concepts and tools that enable a company to manage its results and create initiatives based on a strategy.
*2 Abbreviation of Business Intelligence. It refers to concepts and tools for the accumulation, classification, search, analysis, and processing of data inside and outside of a company and making this useful for business decision making.
*3 Abbreviation of Enterprise Application Integration. It entails the coordination of multiple systems to integrate data and processes.

2) In CRM (customer relationship management systems), the "other mission-critical area" along with ERP, the Company fully entered the market with its addition of Lirik, which handles SI business mainly in the US, to the group in June 2018. Through collaboration with ERP, CRM facilitates integration of customer information, in addition to management information within the company, and thereby enhances the efficacy of big data and AI utilization. It also plays an important role in development of platform business (optimizing the entire supply chain across companies) promoted in DX realization. The Company added ACK Co., Ltd., which supplies CRM cloud-related services and other services in Japan, in January 2020 and announced a merger with ACK on July 10 that will take effect on October 1, 2020 with the Company as the surviving entity. The core CRM product handled by ACK is salesforce.com Ltd.'s CRM platform, and the Company aims to promote even faster reinforcement of CRM business via the merger.

(2) Digital transformation (DX) promotion business

Amid the acceleration of digitization on a global scale, the Company is responding to needs to switch to DX-compliant ERP*1 and is also promoting business for DX realization (optimization of the entire supply chain) by extending knowhow regarding standardization and overall optimization within corporate groups cultivated in ERP business to the entire supply chain and actively constructing its proprietary platform (CBP)*2 that utilizes CRM and cutting-edge digital technologies (including IoT and blockchain) and connects them seamlessly among companies. It will promote business reforms to its customers by using AI and other technologies to utilize to the greatest possible extent the big data accumulated on the platform, which will also enable the Company to secure a stable source of earnings as an asset business.

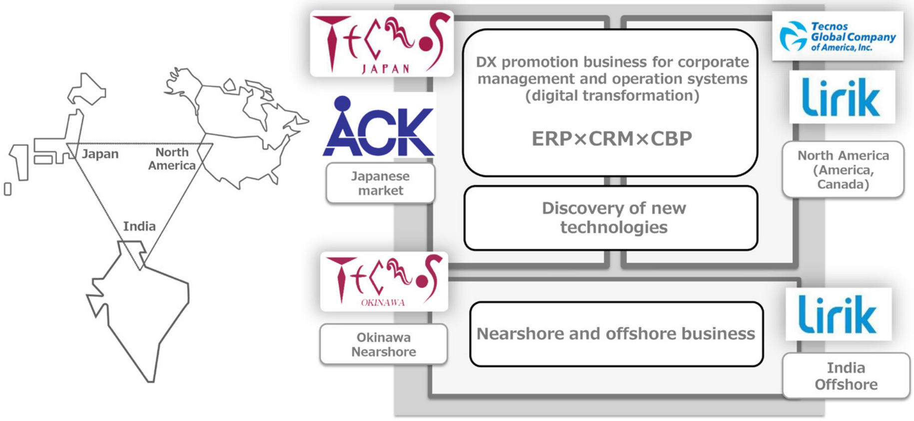
*1 SAP has shown a positive stance toward DX-compliant ERP and announced that it intends to discontinue support for conventional ERP by 2027 (it extended the deadline from the original plan for discontinuation in 2025).
*2 Abbreviation of Connected Business Platform. It is a new business platform that goes beyond inter-company frameworks and optimizes its entire business.

2. The Group's business structure

In addition to the Company, the Group is comprised of 6 consolidated subsidiaries (as of March 2020). The consolidated subsidiaries are Okinawa Tecnos Incorporated, established as a nearshore base; Tecnos Global Company of America, Inc. (TGCA)*, which is located in America's Silicon Valley, and also Lirik, which was acquired via TGCA in June 2018, and its subsidiaries, Lirik Infotech Private Limited (an Indian global delivery center) and Lirik Software Services Canada Ltd. The Company plans an absorption merger with ACK, which provides CRM cloud-related services and other services, in Japan in October 2020. Therefore, the Group's business structure is that it is developing businesses in the Japan and North America markets and also utilizing Okinawa (nearshore) and India (offshore) for IT human resources.

* The Company integrated Tecnos Global Company (TGC), which had been serving the command center for overseas sites, in parent operations.

Overview of the Tecnos Group



Source: The Company's financial results briefing materials

3. History

The Company was established in April 1994 with the aim of providing high-quality SI services using a small number of highly talented personnel. Since then, it has partnered with several ERP vendors, starting with SAP Japan but also including Business Engineering, Oracle Japan, and Infor Japan. It has expanded its business scale while establishing and enhancing its business to support the implementation of ERP. Based on a business management structure that does not rely on the products of specific vendors, it has acquired an excellent reputation among both vendors and users for its high-quality consulting capabilities, technological capabilities, and project-management capabilities, generating growth in results. It was listed on the Osaka Stock Exchange JASDAQ (standard) market in December 2012 (following the change of this market in June 2015 to the TSE 2nd Section, it was listed on this market, and its listing was then upgraded to the TSE 1st Section in September of the same year).

Following its listing on JASDAQ in 2012, the Company developed a strategy to make the big data business its second business pillar after the ERP business. In September 2013, it established TGCA*1 with the aims of collecting information and discovering venture companies in the United States. Then in October of the same year, it established TDSE*2 (current name) as a group of data scientists responsible for the big data business and started to construct the foundations of a new business. In 2015, it launched sales of artificial intelligence products and also concluded a series of business partnership agreements with salesforce.com <CRM> and Microsoft Japan Co., Ltd., and it accelerated the strategy aimed at strengthening foundations toward expanding the big data business. Also, in 2018 it established a structure toward business expansion in the North America market through acquiring Lirik, a US company. Conversely, it sold some of its share in TDSE following this company's listing on the TSE Mothers Market, and as a result, it was removed from the scope of the Group. The Company added ACK (headquarters in Osaka), which provides CRM (salesforce) cloud-related services and other services in Japan, to its group (acquired as a wholly owned subsidiary) in January 2020 and is scheduled to conduct an absorption merger with it in October.

*1 The company name when it was first established was Tecnos Research of America, Inc. (TRA). It changed its name to its current name, TGCA, in April 2017.

*2 Its company name when it was first established was Tecnos Data Science Marketing Co., Ltd., (TDSM). It changed its name to its current name, TDSE, in April 2016.

The Company's features

Strengths include that it utilizes its proprietary templates and its consulting capabilities.
Also Promoting new value creation with platform business

1. The foresight to read the future

The sources of the Company's strength can be said to be its ability to forecast future trends and the foresight to act ahead of other companies. It predicted the future potential of ERP in the mid-1990s, when it was still not in widespread use. Within the industry, it was the first to quickly focus on establishing a foundation for and expanding ERP-related business, starting with SAP. Therefore, the Company has accumulated an abundance of results and expertise. For the DX promotion business, amid the acceleration of digitization and with an eye to companies' business reforms, the Company has also been working to construct a proprietary platform business by utilizing new technologies, including IoT, blockchain, and AI.

2. Utilizing its proprietary templates with an abundant track record of ERP implementation

As previously explained, the Company has accumulated a track record for many ERP implementations by acting ahead of other companies. It has implemented it into more than 220 companies, mainly in the manufacturing industries, such as electrical and electronic equipment, precision machining, machinery, and chemistry. It has also accumulated expertise from this abundant track record and experience, which it has consolidated into the Fact Series, its proprietary templates customized to industry and work task. It uses these templates to provide functions with no waste that are tailored to meet the needs of each industry at low risk, in a short period, and at low cost, which is a factor that significantly differentiates it from other companies. The templates also function as a bridge between ERP and big data for peripheral solutions, and they go beyond the boundaries of ERP and generate various effects, such as improving work efficiency, speeding up processes and reducing costs. It can be said that this has led to its excellent results. For example, the Company has continually received awards from major vendors.

3. A workforce that supports the high-quality consulting capabilities

For workforce that supports the Company's consulting capabilities, which is another of its strengths, it focuses on developing multitalented employees who are fluent in other languages, have a global mindset, and are able to multitask, as well as always keeping in mind global business development (supporting the overseas business development of customer companies) in addition to providing high-quality services. It is also maintaining the number of staff who hold certifications from various vendors* at an extremely high level.

* The Company has 202 SAP certified consultants (as of the end of June 2020). While it ranks 16th overall in Japan, it holds the top position among independent companies with 1,000 or fewer employees.

4. Realizing high profitability while also conducting upfront investment for the future

Utilization of proprietary templates and high-quality consulting capabilities mentioned above underpin the Company's robust productivity and added value, and the Company achieves profit margin exceeding the industry average while covering upfront costs that invest in the future, such as reinforcement of big data and related areas and construction of a proprietary platform. In other words, its high profitability is the source of the funds for the developments that will be the next earnings drivers, and it is establishing an ecosystem toward realizing sustainable growth.

5. Operations that comprehensively support corporate digital transformation

It is said that the key to the successful digital transformation, which will determine the success or failure of companies in the future, is linking it to ERP and CRM. Therefore, the Company's many achievements and expertise in the ERP and CRM fields are considered to be a major advantage for it in terms of the utilization of big data and the development of the DX promotion business. In particular, the Company is one of only a select few companies in the industry in Japan to have established a comprehensive support structure by integrating the ERP and CRM and big data fields. Starting with industry-optimization platforms (CBP), it is highly likely that this will be a differentiation factor toward business expansion for the Company in the future.

Results trends

In FY3/20 profits fell sharply due to one-time factors, despite higher sales
Investments in corporate ERM and CRM continue to be strong

1. Overview of FY3/20 consolidated results

In FY3/20 consolidated results, profits declined due to temporary special factors, despite increased sales, with net sales at ¥7,677mn (up 10.1% YoY), operating income at ¥282mn (down 63.9%), ordinary income at ¥307mn (down 63.7%), and net income attributable to owners of the parent at ¥130mn (down 90.8%). Sales and profits missed initial period targets (though they met the revised forecast).

Net sales rose at a double-digit pace, thanks to strong corporate system investments in ERP and CRM and full-year contribution by Lirik, Inc. added to the group in June 2018 (adding six months in FY3/20), and set an all-time high in a second straight year. Reasons for missing the initial period targets were occurrence of opportunity losses in a certain project due to responses to the need for extension of the project period and increases in personnel and non-recognition of some sales that had been anticipated*. Result contributions from ACK, which the Company added to the Group in January 2020, appear to be minimal (covering three months).

* These sales were related to peripheral systems, not mainstay ERP and CRM systems. Since the Company already completed the projects, the subject cases will not affect future results. The Company is narrowing involvement in peripheral areas and taking steps to avoid recurrence, such as 1) bolstering project promotion and management operations (adding people and revamping workflow) and 2) enhancing employee education (review of project management methods).

In profits, the cost of sales ratio temporarily rose substantially to 79.2% (vs. 74.6% in FY3/19) because of booking losses on the above-mentioned project (¥584mn) in unit costs. SG&A expenses increased too due to upfront spending on platform business. These items resulted in steep profit decline. Nevertheless, upfront spending on platform business was within the anticipated range, and losses from a certain project were responsible for the large miss of the initial period target. Meanwhile, the decline in net income, which is even larger, reflects non-recurrence of profits from a gain on sales of shares of an affiliate (¥989mn; *) booked in the previous fiscal year (FY3/19). This is also a temporary item.

* The Company sold a portion of shares it owned in TDSE, which had been an equity-method affiliate, when this company listed on the TSE Mothers market in December 2018.

For the Company's financial condition, the equity ratio was roughly flat at 72.6% (vs. 72.2% at the end of FY3/19), based on a decline in total assets by 18.9% YoY to ¥5,990mn due to downturns in work in process (current assets) and investment securities (non-current assets) and a decline in shareholders' equity by 18.4% to ¥4,348mn due to dividend from retained profits and negative valuation difference on available-for-sale securities. ROE, which indicates capital efficiency, meanwhile, dropped sharply to 2.7% (vs. 33.1%). However, the real level seems to be above 10% after taking into account inflated ROE in FY3/19 from recording of a gain on the sales of the shares of an affiliate and a temporary setback from losses on a certain project.

Overview of FY3/20 consolidated results

(¥mn)

	FY3/19 results		FY3/20 results		Change		FY3/20 Period-start estimate		FY3/20 revised estimate (2019/10/31)		FY3/20 revised estimate (2020/5/8)	
	Amount	Composition ratio	Amount	Composition ratio	Amount	Change in %	Amount	Composition ratio	Amount	Composition ratio	Amount	Composition ratio
Net sales	6,975		7,677		702	10.1%	8,200		7,351		7,675	
Cost of sales	5,203	74.6%	6,081	79.2%	877	16.9%	-	-	-	-	-	-
SG&A expenses	988	14.2%	1,313	17.1%	324	32.9%	-	-	-	-	-	-
Operating income	782	11.2%	282	3.7%	-500	-63.9%	830	10.1%	102	1.4%	280	3.7%
Ordinary income	848	12.2%	307	4.0%	-541	-63.7%	850	10.4%	112	1.5%	305	4.0%
Net income attributable to owners of the parent	1,411	20.2%	130	1.7%	-1,281	-90.8%	560	6.8%	70	1.0%	128	1.7%
Total assets	7,383		5,990		-1,393	-18.9%						
Shareholders' equity	5,329		4,348		-981	-18.4%						
Equity ratio	72.2%		72.6%			0.4%						

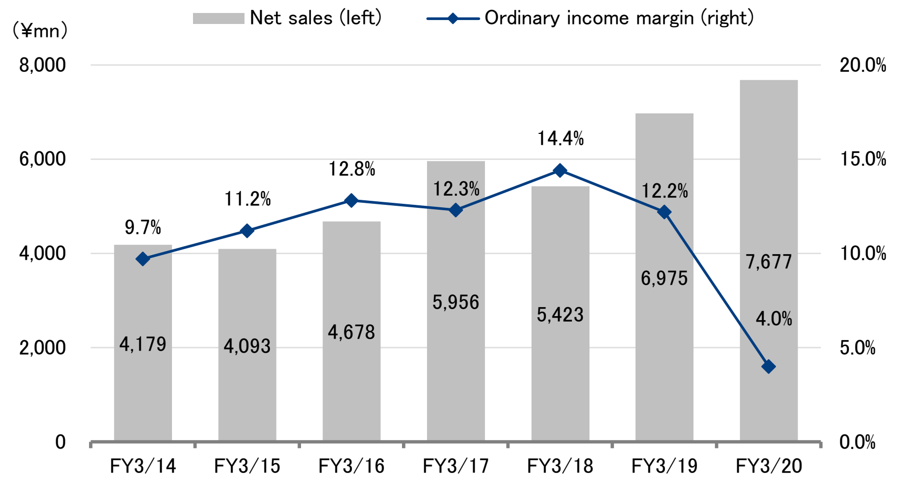
Source: Prepared by FISCO from the Company's financial results report, financial results briefing materials, and press releases

Sales and profits steadily improved in FY3/20 excluding special factors

2. Past results trends

Looking back on how the consolidated results have trended in the past, the Company prioritized establishing a structure for the future from FY3/14 to FY3/15. Although sales growth came to a standstill, sales have grown since FY3/16 due to the launch of the big data business and the expansion of overseas sales. As previously mentioned, sales declined temporarily in FY3/18 because TDSE was removed from the scope of consolidation. But sales started to increase significantly in FY3/19 due to the expansion of the ERP and CRM businesses on the back of the Company's strong willingness to invest. So, the Company's results can be evaluated as steadily growing. In profits also, both operating income and ordinary income were new record highs in five consecutive fiscal periods through FY3/19, while the profit margins are also being maintained at levels greatly above industry standards (profit temporarily fell in FY3/20 due to temporary special factors as explained above).

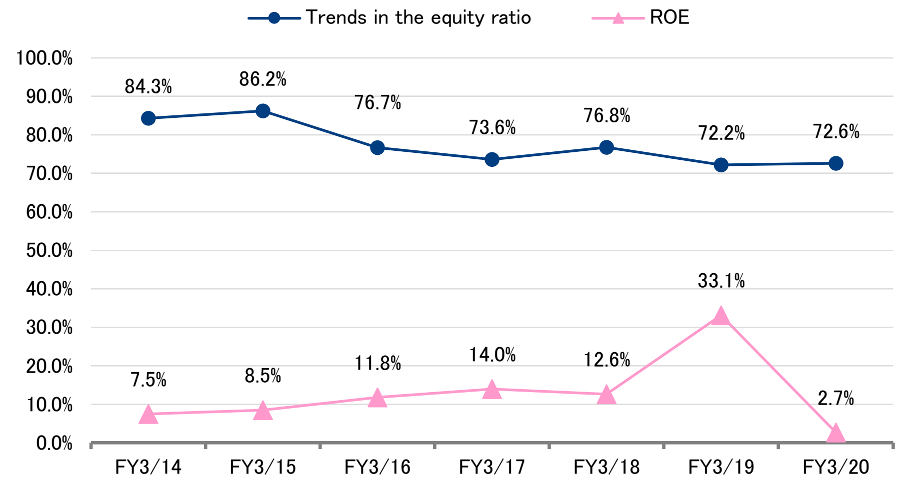
Trends in consolidated net sales and the ordinary income margin



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

In financial conditions, the equity ratio, which reflects soundness of the financial base, remained at a high level and ROE, an indicator of capital efficiency, was above 10%. These levels demonstrate very healthy financial conditions. The large shift in ROE from 33.1% in FY3/19 to 2.7% in FY3/20, as already mentioned, reflected a variety of temporary special factors and does not constitute a change in fundamental profitability (capital efficiency). (The real level is over 10%.)

Trends in the equity ratio and ROE



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

Results of the main activities

Strengthening CRM and building a community aimed at realizing innovation

1. Absorption merger with ACK

The Company added ACK, which provides cloud-related services and other services for US-based salesforce.com, the global standard in CRM, to its group (acquired as a wholly owned subsidiary) in January 2020 and is scheduled to merge with it in October*. CRM is becoming increasingly important as digital transformation of companies takes hold as a major management issue. The Company's move aims to bolster its CRM-related business in Japan. Management also hopes to create group synergies, including Lirik that handles CRM-related business in North America (added to the group in June 2018), in Japan and globally, including cultivation of IT engineers, improved efficiency in sales activities, and reinforcement of service provision operations.

* Recent (FY9/19) results are healthy at ¥594mn in sales and ¥55mn in operating income.

2. Building a community for the connected society

The Company launched the Tecnos Japan Innovation Bridge (TJIB), a community that it sponsors, in January 2020 for the purpose of bringing together companies to participate in collaborative creation of the "connected society" it envisions. Specifically, this involves cooperation with companies that support the CBP (its proprietary platform business) currently being promoted and contributions to realization of a connected society, formation of a user community and partner community to strengthen relevance and quality, and collaboration with the CBP's API and technology underlying IoT to deliver innovations. Success in platform business, a strategic area, also has significant societal implications through creation of new value and realization of innovations.

3. Transition to a corporate organization with an auditing committee

The Company moved to a corporate organization with an auditing committee for the purpose of further acceleration of the decision-making process amid growing changes in the environment for the information services industry and reinforcement of auditing and supervision function and establishment of better corporate governance. The auditing committee consists of three members (including two outside directors) out of a board with 10 directors (including four outside directors).

Results outlook

In FY3/21 headed for significant earnings recovery (vs. FY3/20), despite concerns about impact from COVID-19 outbreak

In FY3/21 guidance, the Company targets higher sales and steep profit recovery with targets of ¥7,900mn in net sales (up 2.9% YoY), ¥800mn in operating income (up 183.2%), ¥820mn in ordinary income (up 166.4%), and ¥554mn in net income attributable to owners of the parent (up 324.9%).

It only expects moderate sales growth, despite continued improvement in ERP and CRM investment interest including business model reforms aimed at realizing DX, due to signs of cautious investment stances and curtailed investments as the result of impact from the COVID-19 outbreak.

In profits, meanwhile, the Company expects significantly stronger earnings on recovery from the previous year's result that slumped due to project losses. It forecasts operating margin above 10% even with continued upfront spending on platform business (CBP).

While FISCO also thinks it is necessary to closely monitor the possibility of diminished investment sentiment due to impact by the COVID-19 outbreak, the Company's guidance seems reasonable, suitably factoring in anticipated impact at this point. In particular, the Company does not face much downside risk because of its many projects continuing from the previous fiscal year. A key point is the extent to which it can promote activities that address changes in the industry environment after COVID-19 and future DX, leveraging the opportunity provided by current conditions. FISCO intends to follow progress in platform business, including alliances with various partner companies, and detailed results from these efforts.

FY3/21 forecast

(¥mn)

	FY3/20 Results		FY3/21 Forecast		Change	
	Amount	Ratio	Amount	Ratio	Amount	Change rate
Net sales	7,677		7,900		223	2.9%
Operating income	282	3.7%	800	10.1%	518	183.7%
Ordinary income	307	4.0%	820	10.4%	513	167.1%
Net income attributable to owners of the parent	130	1.7%	554	7.0%	424	326.2%

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

The industry environment

Anticipating full-fledged progress in DX, though watch out for adverse impact on investment appetite by COVID-19

1. ERP and CRM business trends

According to a market research company, the ERP market in Japan is expanding robustly on the back of steady investment in core systems, mainly by major companies. Investment in ERP continues to be stable. In particular, Cloud ERP, which entails provision on the Cloud (SaaS) or package operations (IaaS), is on a rapid growth trajectory. A focal point in the future, meanwhile, is the 2025 problem. In other words, while the shortage in IT human resources in Japan will increase to approximately 430,000 people, full-scale development of DX is expected alongside the acceleration of digitalization, and ERP will also shift to comply with DX, including utilization of big data. ERP switching needs might occur later than initially expected (or proceed at a more moderate pace), alongside COVID-19 measures, following the decision by SAP, which is the largest ERP company, to delay its end of support for conventional ERP from 2025 to 2027. Nevertheless, interest in DX realization has risen and there is considerable focus on creating added value for the future.

2. Impact of the COVID-19 outbreak

There are concerns that the COVID-19 outbreak might weaken investment appetite or trigger cautious stances due to potential earnings downturn. Nevertheless, demand for digitalization is growing, including support for remote work (at home), and a key point is whether necessary investments are capable of being implemented, along with COVID-19 measures. Going further, some observers see a surge in reforms to social structure (such as changing workstyles and business models) aimed at bringing COVID-19 under control spurring a digitalization (DX) trend. This environment requires suitable management decisions that factor in positive and negative aspects.

The growth strategy

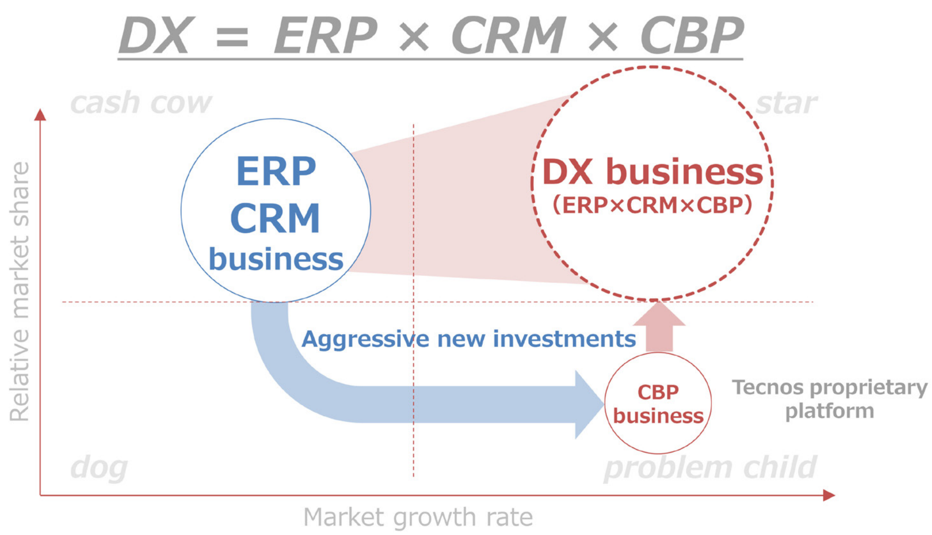
Aims to realize DX by building a platform for collaborative creation Promoting global business and investing in human resources

The Company's growth strategy has a direction (vision) of "LEAD THE CONNECTED SOCIETY TO THE FUTURE." Based on a mission of "Contributing to the development of society by connecting organizations, people, and data." In other words, in addition to deployment and switching of ERP (optimization at the individual-company level) using knowhow accumulated since its founding, it is strongly advocating the concept of an industry optimization-type platform business (optimization of the entire supply chain) that connects data among companies through collaborative creation with partner companies that have various cutting-edge technologies and deploying companies. It will combine ERP and CRM with its proprietary platform, and this will be the form of the digital transformation that the Company will progress. It has also set three points for the future investment areas towards growth, of "the platform business," "the global business," and "human resources and organizations."

1. Constructing a platform business

The Company is actively investing in constructing its proprietary platform (CBP), and also developing various services on this platform through collaborative creation, including with customer companies. Furthermore, it plans to promote business reforms at its customers by using AI and other technologies to utilize to the greatest possible extent the big data accumulated on this platform. First of all, the Company plans to provide a B-to-B orders and payment service, through which participating companies can expect effects including the simplification of work from ordering through to billing, improved supply chain efficiency, and flexible responses to payment methods. Furthermore, the Company can steadily add new participants from a base of those who are connected and also benefits from acquisition of a recurring-type stable income source. While it is likely to continue in a phase of upfront costs for the time being, FISCO expects profitability in annual income within the next 2-3 years.

Overall image of business policy for realizing DX



Source: The Company's financial results briefing materials

2. Progressing the global business

The Company will accelerate business development for the North America market, based on the recently acquired business of Lirik. In particular, it intends to expand the commercial zone of this business from the current zone, which is focused on the West Coast of the United States. Conversely, it has established the Global Promotion Headquarters as the promotion organization at the Japanese base for the global business. Its intention is to bring together the Company's and Lirik's strengths to expand the ERP x CRM x CBP business, while coordinating between Japan and North America. It will also acquire IT and AI human resources through strengthening Lirik's offshore base (India), while aiming to continue to discover and develop Silicon Valley's latest technologies.

3. Investment in human resources and organizations

The problem of the shortage of human resources in its industry is become increasingly severe, and in this situation the Company intends to actively recruit overseas human resources. The Company aims to accumulate a track record of recruitment results, while utilizing the Group's networks and various cultures in India and the North America. On the other hand, it is also focusing on training employees. In particular, it is working to develop global human resources, including sending its Japanese employees to the overseas bases it has acquired (in the US and India). In April 2019, it newly established the Innovation Center in Tokyo (Nihonbashi). In addition to securing excellent human resources, its aims include developing human resources, establishing an environment to promote innovation, and making advances in telework. It is also recruiting partners that include venture companies with the latest technologies.

FISCO also acknowledges uncertainty about the impact of the COVID-19 at this point. Excluding this fact, however, our assessment is that the Company possesses latent growth potential of over 10% just in ERP business, including DX response. A longer-term point hence is how much the Company is capable of adding to this growth through platform business, a strategic area. In particular, platform business faces less constraint (human resources, etc.) on expansion than ERP and CRM businesses up to now and offers potential for a positive cycle in which rising recruitment of participants further enhances platform value (network externality). It is necessary to evaluate growth curve and income structure changes in a few years considering sudden increase in profitability when sales exceed the breakeven point and collaboration upside in ERP and CRM business (joint deployments). Despite concerns about the COVID-19 situation temporarily having adverse impact on earnings, structural reforms aimed at achieving DX have become an issue for society as a whole, not only companies, and the Company is capable of harnessing the resolution of societal issues for its own growth as a major opportunity. FISCO intends to focus on progress in full-fledged operation of platform business and also creation of new value, including collaboration with partner companies and others. Furthermore, the Company's promotion of global business is sufficiently attainable given its track record with global standard systems (SAP and salesforce) and utilization of human resources obtained through the Lirik acquisition (including the development site in India) and sales channels (in North America). The extent to which the Company can horizontally apply knowhow and human resources accumulated in domestic platform business to global activities is likely to dictate future potential. The largest bottleneck, meanwhile, is securing personnel, a common issue for the industry. From this perspective too, development of platform business with few personnel constraints, related creation of knowledge-intensive business, and recruitment of overseas human resources are important strategies for the Company.

Shareholder returns policy

Paid a ¥12 dividend per share in FY3/20
Has not decided the FY3/21 dividend target at this point due to the COVID-19 outbreak

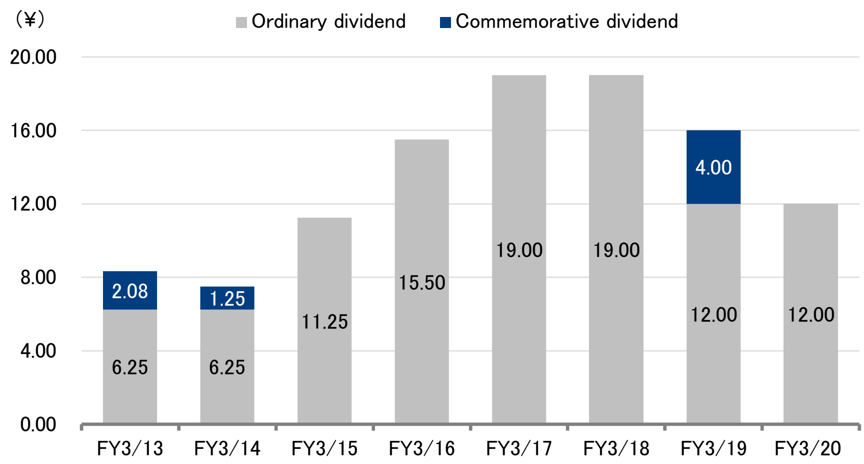
The environment surrounding the Company's industry is changing greatly. In such a situation, its policy for the future is to increase the allocation of funds to growth investment while also returning profits to shareholders by considering profits-linked factors. Specifically, as the dividend to return profits to shareholders, it has set a target of 35% or above of the "deemed dividend resource (deemed net income)" of consolidated ordinary income adjusted by the effective tax rate. In addition, it has positioned the acquisition of treasury shares as a measure to supplement the dividend to return profits to shareholders, and it is flexibly acquiring them according to cash flow conditions and other factors.

* The deemed dividend resource (deemed net income) = consolidated ordinary income x (1–effective tax rate).

For the FY3/20 dividend per share, the Company paid a ¥12 ordinary dividend. Despite sharply lower profits due to temporary special factors, it sustained the period-start target and kept the ordinary dividend on par with the previous year*. The Company has not decided the FY3/21 dividend target at this point because of uncertainty about impact of the COVID-19 outbreak on the economic.

* For the FY3/19 dividend per share, the Company paid a total dividend of ¥16, which was comprised of an ordinary dividend of ¥12 and a commemorative dividend of ¥4 for the 25th anniversary of its establishment and the listing of an affiliate.

Trend in the dividend per share



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

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■ For inquiry, please contact: ■
FISCO Ltd.
5-11-9 Minami Aoyama, Minato-ku, Tokyo, Japan 107-0062
Phone: 03-5774-2443 (Financial information Dept.)
Email: support@fisco.co.jp