COMPANY RESEARCH AND ANALYSIS REPORT

R&D COMPUTER CO., LTD.

3924

Tokyo Stock Exchange Prime Market

10-Feb.-2025

FISCO Ltd. Analyst

Hiroki Nagaoka

FISCO

FISCO Ltd.

https://www.fisco.co.jp

Contents

Summary

Concentrating on resolving issues, targeting earnings improvement in FY3/26

R&D COMPUTER CO., LTD. <3924> (hereafter, also "the Company") is an independent, medium-sized systems integrator that celebrated the 50th anniversary of its foundation in January 2021. The Company's proactive approach to M&A has prompted rapid expansion with respect to what it considers the growth area of package-based SI services, in addition to its stable business foundations of systems integration services and infrastructure solutions services. Although sales and profits have continued to head up so far, operating profit is expected to turn down in 1H FY3/25 since an unprofitable project for a certain customer arose, and whether the Company can wrap up that project by March 2025 will probably be a point to watch looking to a share price reversal.

1. Outline of consolidated results for 1H FY3/25

In 1H FY3/25 results, net sales rose 4.5% year on year (YoY) to ¥6,754mn, operating profit declined 37.1% to ¥479mn, ordinary profit decreased 36.2% to ¥495mn, and profit attributable to owners of parent declined 30.4% to ¥365mn. Net sales were broadly in line with the initially announced 1H forecast of ¥6,750mn. However, all profit items came in well below the initial outlook for operating profit of ¥806mn, ordinary profit of ¥815mn and profit attributable to owners of parent of ¥554mn. This reflects significant impact from a provision for loss on orders received that had to be posted at the time of 1Q results because an unprofitable project for a certain customer arose. As the Company is still in the midst of working towards the final handover of that project, whether it can deliver results within range of its downwardly revised forecasts appears to remain uncertain.

2. Consolidated results forecast for FY3/25 and status of medium-term management plan progress

On November 13, 2024, the Company revised down its FY3/25 consolidated results forecast for net sales from ¥14,420mn to ¥14,200mn (up 3.4% YoY), operating profit from ¥1,860mn to ¥1,230mn (down 28.9% YoY), ordinary profit from ¥1,900mn to ¥1,265mn (down 27.4% YoY), and profit attributable to owners of parent from ¥1,267mn to ¥840mn (down 31.9% YoY). The Company plans on net sales broadly in line with its initial outlook, but sharply cut its forecasts from the operating profit line down to reflect impact from an unprofitable project for a certain customer. That project is currently scheduled for final handover by March 2025. If it wraps up as planned, it should only result in the posting of a temporary loss and not impact results in FY3/26 beyond. However, whether margins similarly worsen for other projects continues to warrant attention. In addition, we think achieving the numerical management targets for FY3/26 set out in the medium-term management plan now looks slightly more challenging, considering that 1H FY3/25 results were much weaker than the initial outlook.

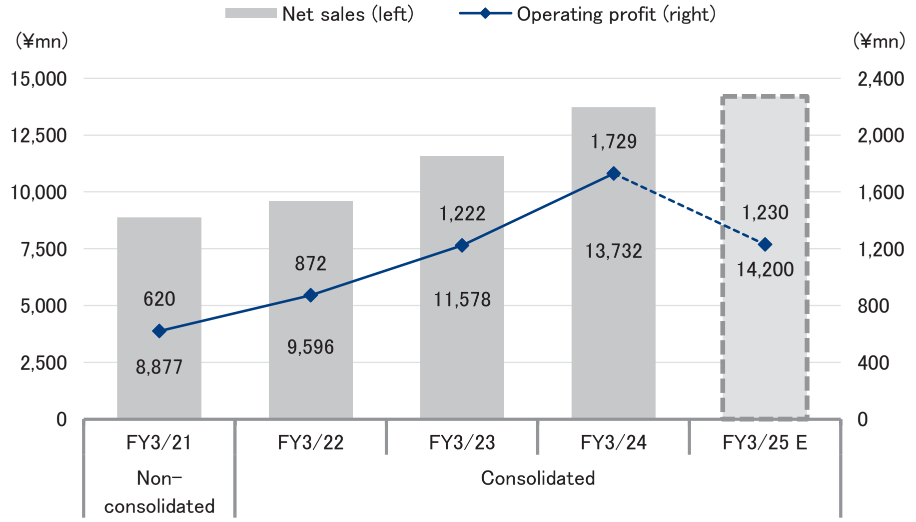
3. Dividend policy and steps to maintain listing on Tokyo Stock Exchange Prime Market

Under its medium-term management plan, VISION 2025, the Company raised its dividend payout ratio standard from at least 40% previously to at least 50% for the three years until FY3/26. For FY3/25, the expected dividend payout ratio is 76.9% because the Company maintained its plan for an annual dividend of ¥36.0 per share despite announcing downward revisions to its full-year consolidated results forecast. FISCO believes that while there is not much room to raise the dividend payout ratio further in FY3/25, annual dividends per share will not fall below the ¥36.0 planned for FY3/25 in FY3/26 onwards, given the Company's solid financial standing and strong results. In addition, the Company has been working to stay listed on the Tokyo Stock Exchange (TSE) Prime Market, but its tradable share market capitalization has not reached ¥10.0bn or more, which is a standard for continued listing on the Prime Market.

Key Points

- In 1H FY3/25, net sales were broadly in line with the initial plan but profits trailed significantly since an unprofitable project arose. In FY3/25, profits are expected to turn down, interrupting the uptrend in sales and profits
- The Company had planned on higher sales and profits in FY3/25, the second year of its medium-term management plan, but sharply revised down its full-year consolidated results forecast on November 13. Whether it can promptly wrap up the unprofitable project and prevent such from spreading to other projects will be a focal point for FY3/26 onward to return to profit growth
- The Company's plan for dividends per share remains ¥36.0. Going forward, it intends to continue to pursue a shareholder returns policy of avoiding dividend cuts so as to maintain or increase dividends steadily

Results trends



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

Company profile

Expanding earnings via growth strategies. Profit margin temporarily fell sharply due to an unprofitable project

1. Company profile

The Company has a long history as an independent systems integrator, celebrating 50 years in January 2021. Unusual for the information services industry, it was established by an educational institute. "With all our heart" as the Company creed, and it conducts business based on its three corporate philosophies of 1) Create value for customers and pursue customer satisfaction to increase corporate value, 2) As a group of professionals, open up a path for the next generation and become a leading information technologies company, and 3) Always maintain and uphold an innovative corporate culture.

Since it was established by an educational institute, one of its features is its passion for educating employees. It encourages employees to acquire not only IT-related qualifications, but other business-related qualifications as well, and on average each employee holds four or more qualifications. Employees having skills and knowledge both in IT and customers' businesses makes it possible to develop systems that provide high levels of customer satisfaction.

2. History

At the time of its foundation in 1971, the Company began transactions with Fujitsu Limited <6702> in the development of a banking system, which led to expansion of its business scope centering around the outsourced development of financial systems for banks and insurance companies. In 2006, it started infrastructure-related services for systems integration services as the infrastructure solutions services. The Company began collaborating with Salesforce. com, Inc. (currently Salesforce Japan Co., Ltd.) in April 2010, and started providing cloud computing services. Furthermore, in systems integration services, it has started working on introducing package systems and developing add-ons as package-based SI services.

In April 2020, it carried out organizational restructuring in response to accelerating trends in DX. It established the DX Promotion Headquarters and made it directly responsible for the Salesforce Promotional Office (currently "Salesforce Business Promotional Office") and the newly established Cloud Strategy Office (currently "DX Technology Center"). Currently, the DX Promotion Headquarters is central to efforts to strengthen the Company's pool of employees proficient in new digital technologies, such as low-code and agile development, and the Company is shifting toward cloud-based business.

The Company was listed on the TSE Second Section in December 2015, and subsequently upgraded to the TSE First Section in May 2018. It then moved to the Prime Market following the TSE's restructuring of its market segments in April 2022.

In April 2021, in the Company's first-ever M&A acquisition, it acquired all the shares of infree Corp., which handles the enterprise resource planning (ERP) of German-based SAP <SAP>, and made it a wholly-owned subsidiary. In April 2022, the Company acquired NESCO SUPER SOLUTION Co., Ltd. (currently Technigate Co., Ltd.), a specialist company of the SuperStream accounting package, and made it a wholly-owned subsidiary. These subsidiaries are included in the consolidation of the financial statements and have been part of the consolidated financial statements since FY3/22.

3. Business description

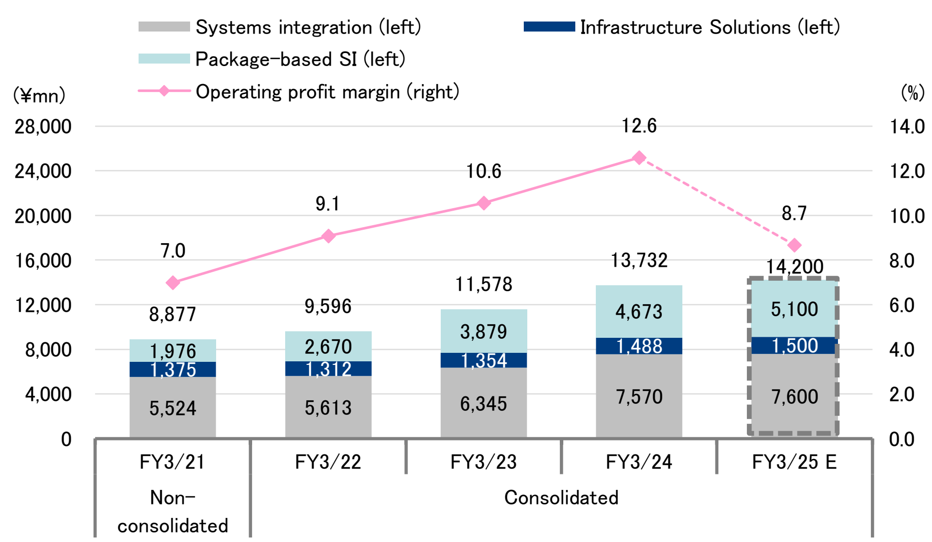
The Company operates the three service lines of systems integration services, infrastructure solutions services, and package-based SI services, and is structured to provide total system support to resolve business issues. According to the composition of consolidated net sales by service line in 1H FY3/25, systems integration services provided 54.9%, infrastructure solutions services 9.2%, and package-based SI services 36.0%.

Regarding annual average sales growth rates for the three fiscal years up to FY3/24, the overall rate was 15.7%, the rate for systems integration services was 11.1%, the rate for infrastructure solutions services was 2.7%, and the rate for package-based SI services was 33.2%. Sales growth has been much faster for package-based SI services than other services, with their share of consolidated net sales continuing to rise sharply from just 18.0% in FY3/20 to 36.0% in 1H FY3/25.

With respect to the Company's results, sales are concentrated mainly in 2Q (July–September) and 4Q (January–March) due to the balance between the timing of budget execution by client companies and work periods on development systems, and operating profit tends to be weighted mainly towards the fiscal year-end in 4Q. The 1Q operating profit margin was extremely low at 1–2%, however, from FY3/22 onward, profitability has improved significantly, partly due to the increase in net sales of package-based SI services, and the seasonality of the Company's revenues appears to be easing somewhat.

The Company has positioned systems integration services and infrastructure solutions services as steady growth businesses and package-based SI services as a high growth business. In April 2020, the Company established the Salesforce Business Promotional Office to expand Salesforce-related business throughout the entire Company. The results appeared as early as FY3/21. infree, which was made a subsidiary in April 2021, has an excellent internal education system, and the Company has also utilized employees who are involved with its SAP-related business. As a result, net sales of the SAP-related business have realized sustainable growth. Furthermore, having a subsidiary that is high level and provides highly paid services has also had a beneficial impact on the Company's corporate culture, such as inspiring employee motivation to take on higher-added-value work. With the added impact of a difference in sales composition due to the expansion of package-based SI services, the operating profit margin increased from 7.8% in FY3/20 before the COVID-19 pandemic to 10.6% in FY3/23, rising to 12.6% in FY3/24.

Trends in net sales and operating profit margin by service line



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

Business profile

Growth of package-based SI services greater than forecast

1. Systems integration services

Systems integration services are a mainstay business, with a share of total net sales of 54.9% in 1H FY3/25. Breaking down the services by industry type, services for finance account for 43% (including 26% for banks, 13% for credit card companies, and 4% for financial and other), services for industry and distribution account for 41%, public sector 9%, and medical care 7%.

The systems integration services cover a wide range of fields, including finance, industry and distribution, public sector, and medical care. It mainly conducts outsourced development for customers such as end users, domestic manufacturers, and major systems integrators. The Company has in place a system to provide total services covering all processes, from planning and system construction through to system management. Banks are investing in IT in order to reduce workloads and to save labor, and demand is expected to be at a high level in the medium to long term. There are also many projects for online banks and distribution-related financial subsidiaries.

Financial institutions are the biggest customers for the IT services industry. In the case of the Company, it serves prime contractors including FUJITSU and Hitachi, Ltd. <6501> as a collaborating company. For many years, it has maintained excellent business relations with major systems integrators including FUJITSU at the top of the list, followed by the Hitachi Group centered on Hitachi and Hitachi Solutions, Ltd., the NTT DATA Group Corporation <9613>, and NS Solutions Corporation <2327>. The Company's strategy for growing transactions with manufacturing-based systems integrators, which are its largest customer base, is to expand package orders and pursue quality.

Close business relations with the FUJITSU Group were formed immediately after founding, and it has become a core partner. In FY3/23, the degree of dependency on FUJITSU for net sales was 27.0%. In FUJITSU's FY2022 PQI (Partner Quality Improvement) skill level certification, the Company ranked GOLD for all three steps of the skill levels, including the first step (quality records), second step (quality evaluation), and third step (quality plan), for the seventh consecutive year. In FY2021, in the Fujitsu Software Master Award 2022, which recognizes the efforts of companies that are cultivating large numbers of engineers, the Company was the recipient of first place in the Top Technology Company category due to its cultivation of high-level engineers. FUJITSU is advancing DX business and the Company is actively working to cultivate DX personnel.

Direct user transactions have been positioned as a high growth area, even within systems integration services. The Company is leveraging its customer base to win repeat orders and using package-based SI services as a hook to cultivate new customers. It is advancing highly productive development by focusing on fields where it has expertise and new strategic fields. Main users include Mitsubishi Research Institute DCS Co., Ltd., Sumitomo Mitsui Trust Systems & Services Co., Ltd., Idemitsu Kosan Co., Ltd. <5019>, OPTAGE Inc., and NOMURA HOLDINGS, INC. <8604>. This customer base can be said to be the result of high evaluations from customers of the Company's technological capabilities, its business knowledge in areas such as finance and distribution, and its track record in terms of quality.

2. Infrastructure solutions services

Infrastructure solutions services covers an array of services including installing the hardware, such as servers, that form customers' IT system infrastructure; constructing networks and systems infrastructure, including databases and application infrastructure; and performing subsequent management and maintenance. It has also recently established a new office for cloud business, and focuses on cloud-related services. After surveying and analyzing the IT systems infrastructure environments of various customers, including general companies, universities and other educational facilities, hospitals, and government ministries and agencies, it provides infrastructure solutions services that are tailored to meet their needs. Specifically, in addition to infrastructure solutions services such as network construction, it provides total, one-stop services by combining systems integration services.

3. Package-based SI services

As growth businesses, the Company forms alliances with system and package vendors and in some cases is provided with packages, and offers a total service to customers, from support for introducing software package products (Salesforce, SAP, SuperStream, COMPANY, etc.) to customization, add-on development, maintenance, and management. Net sales of package-based SI services in 1H FY3/25 were ¥2,429mn, an increase of 12.5% YoY. The ratio of net sales by package was 41% for Salesforce, 25% for SAP, 23% for accounting packages, 7% for personnel salary packages, and 4% for others.

(1) Salesforce—cloud-based SFA/CRM applications

US-based Salesforce, Inc. <CRM> provides a platform that enables users to access combinations of multiple functions, with a focus on the cloud-based business applications Sales Force Automation (SFA) and Customer Relationship Management (CRM). It is the world's biggest platform in its field and has been introduced by over 150,000 companies globally. It established a Japanese subsidiary in 2000. The Company started a business with Salesforce in April 2010 and concluded a sales partner agreement in November 2016. In June 2023, the Company acquired the highest position of "Expert" in the Experience Cloud domain of the Salesforce Navigator Program. Under the Salesforce Navigator Program, the expert capabilities of partners' products, industries, and services are evaluated by Salesforce from the three aspects of knowledge, experience, and quality, and their level is certified on a three-step scale. Experts are partners who possess the highest level of experience and technology in a specific field.

It is currently a Salesforce certified consulting partner (Gold) and AppExchange partner, with a track record of more than 2,000 projects for around 500 companies. It uses its business findings in many industries and many types of businesses and knowledge of a wide range of products to propose optimal solutions. In terms of industries, it has a track record of projects including for non-life insurance, insurance agencies, universities, vocational schools and cram and preparatory schools, the manufacturing industry (food, equipment, parts, software, etc.), restaurants, wholesale businesses, retail businesses, specialty trading companies, apparel, print and publishing businesses, real estate, dispatches of human resources, internet services, legal offices, and facility management. It is also used in information systems for financial institutions. The Salesforce Business Promotional Office's deployment of Salesforce cloud services not only for business divisions but throughout the entire Company is leading to sustainable growth for the business.

Rapid SAP business growth via M&A, SuperStream expansion via legislative revision-related demand

(2) SAP—enterprise resource planning package

German-based SAP was established in 1972 and is the world's largest market share holder in the enterprise resource planning (ERP) systems package field. In April 2021, in the Company's first ever M&A acquisition, it acquired all shares of infree. and made it a wholly-owned subsidiary. Since its foundation in 2001, infree has wielded strengths both in consulting to facilitate adoption of the SAP R/3 package of SAP enterprise resource planning solutions and in developing add-on software. It was certified as a SAP PartnerEdge Service partner in January 2022. The Group's SAP net sales were ¥69mn in FY3/21 and the M&A contributed to a substantial increase to ¥483mn in FY3/22. In FY3/23, the second year after the M&A, net sales were ¥667mn, and in FY3/24, the third year since the M&A, net sales continued to be strong at ¥943mn. Seeking to leverage synergies, the Company carried out reforms that include integration of offices and having its executives serve as representative directors of infree. Moreover, the Company has successfully grown sales in SAP-related business on a Group-wide basis by sharing resources, such as education tools developed by infree, within the Group.

(3) SuperStream—accounting package

SuperStream Inc. was established in 1986, when it launched GL, a mainframe compatible general accounting system. In March 2022, the cumulative number of companies that had installed its SuperStream accounting package passed the 10,000 mark. In April 2022, the Company acquired the specialist company NESCO SUPER SOLUTION and made it a wholly-owned subsidiary. NESCO SUPER SOLUTION was founded in 2008 when NESCO Co., Ltd split off its SuperStream business and established it as a new company. The Company changed the subsidiary's trade name to Technigate Co., Ltd. in January 2023. In December 2022, it integrated its Tokyo and Osaka offices to quickly realize synergies through the unification of parent company and subsidiary and the sharing of business resources. It recorded net sales of ¥586mn in FY3/21 prior to becoming a subsidiary of the Company. The Group's consolidated sales of accounting packages, including SuperStream, were ¥269mn in FY3/21 and ¥295mn in FY3/22, and the effects of the acquisition led to a substantial increase to ¥837mn in FY3/23. Technigate has been taking action in response to the adoption of electronic invoice systems in accordance with Japan's Electronic Books Preservation Act, with FY3/23 serving as a transitional phase. In FY3/24, demand for updating compatible software packages has emerged, resulting in a significant increase in consolidated sales to ¥1,223mn.

Looking at the situation concerning taxpayers complying with the Electronic Books Preservation Act, as of October 2020 it was 72.7% of 33,000 major companies, 4.8% of 3,099,000 small to medium enterprises, and 1.2% of 5,251,000 sole proprietors. Revisions to the act in January 2022 forbid the saving of information from electronic transactions in hard format, making the preservation of electronic data mandatory for all businesses. A two-year grace period had been enacted up to December 2023, but from January 2024, electronic records must be preserved. The main purposes of the revisions are to promote paperless accounting operations, strengthen security, and encourage workstyle reforms and DX. Points covered by the revisions other than the mandatory preservation of electronic transaction information include the abolition of the pre-approval system, relaxation of timestamp and search function requirements, abolition of appropriate administrative processing requirements, and stronger penalties for falsification. While the relaxation of requirements will make it easier to introduce electronic book preservation, penalties for falsification are more severe.

Building trust and proactively educating new employees by bolstering training and certification acquisition

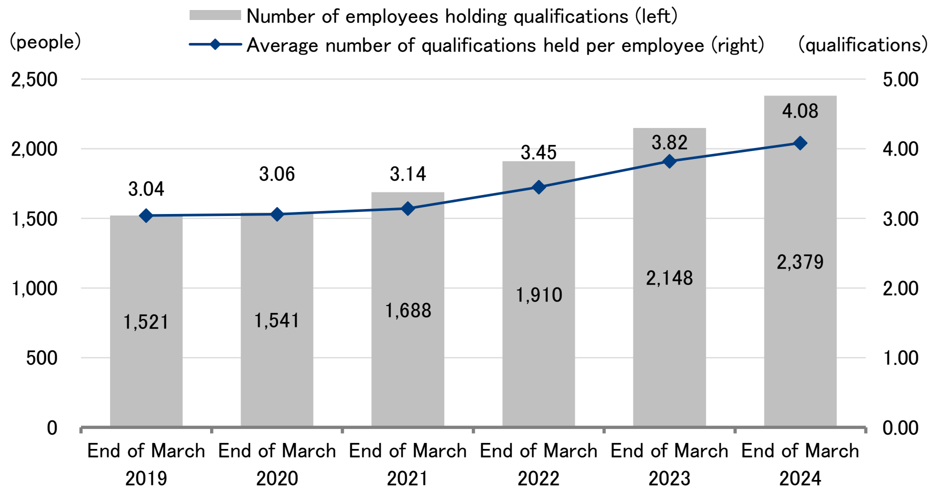
4. IT-related and business-related qualifications

(1) Number of employees holding qualifications

One of the Company's strengths is that it is a group of excellent engineers. It actively progresses employees' acquisitions of qualifications not only for IT-related qualifications but also for business-related qualifications to deepen their understanding of customers' businesses, such as finance, industry and distribution, and medical care. At the end of March 2024, a cumulative total of 2,379 employees held IT-related and business-related qualifications (breaking this down, 2,099 employees held IT-related qualifications and 280 employees held business-related qualifications) and the average number of qualifications held per employee was 4.08. Compared to the end of FY3/21, the cumulative number of employees holding qualifications has grown by 40.9%, and the average number of qualifications held per employee has increased by 0.94.

By actively promoting acquisitions of business-related qualifications, the Company's engineers are able to provide systems integration services from the customer's viewpoint. As a result, customer satisfaction is increasing, which becomes the driving force behind building strong relations of trust.

Trends in the number of employees holding qualifications and average number of qualifications held per employee



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

(2) New employee training

The Company also focuses on educating new employees. Prior to joining the Company, employees complete an e-learning course to prepare for the basic information processing test, and after joining spend three months receiving training to become members of society and on basic technologies. During this training period, trainees learn basic program development knowledge, programming languages, and systems design. The curriculum includes an introduction to Java programming, Java programming fundamentals, Java programming applications (DB access), Java application development fundamentals, introduction to Java DB access application development, web application development fundamentals, web application building practice, and a results presentation. It is high level training that not only teaches simple program building, but also challenges trainees to acquire two vendor certifications during the new employee training period. The pass rate for “Oracle MASTER Bronze Oracle Database 12c” has achieved 100%. Employees from core collaborating companies can also join the training, and in 2023, 50 people participated, including 30 employees from the Company. Following the new employee training, new employees then transition to OJT for their assigned positions. There, they receive support from senior colleagues who are their trainers.

When recruiting, the Company seeks graduates and postgraduates from both the sciences and humanities. The ratio of men to women entering in April 2024 was equal at 1:1. The Company aims to create a workplace where women can play an active role, as evidenced by the 100% return to work rate from parental leave in FY2023. In addition, the ratio of new graduates in the humanities to those in the sciences is 65% for humanities and 35% for sciences. Employees in their 20s and 30s make up half of the Company’s workforce, with 31.9% in their 20s, 22.6% in their 30s, 28.0% in their 40s, and 17.5% in their 50s or older. As it has in place a complete education system, it seems that it prioritizes recruits with “the ability to think logically,” “a willingness to learn” and “a passion for the IT industry and SE,” and recruits people who have the aptitude to use its system positively and want to grow.

Results trends

1H FY3/25 results were well below plan, owing to impact from an unprofitable project for a certain customer

1. Outline of consolidated results for 1H FY3/25

In 1H FY3/25 results, net sales rose 4.5% YoY to ¥6,754mn, operating profit declined 37.1% to ¥479mn, ordinary profit decreased 36.2% to ¥495mn, and profit attributable to owners of parent declined 30.4% to ¥365mn. Net sales were broadly in line with the initially announced 1H forecast of ¥6,750mn. However, all profit items came in well below the initial outlook for operating profit of ¥806mn, ordinary profit of ¥815mn and profit attributable to owners of parent of ¥554mn. This reflects significant impact from a provision for loss on orders received that had to be posted at the time of 1Q results because an unprofitable project for a certain customer arose. As the Company is continuing to work towards the final handover of this project, whether it can deliver results within range of its downwardly revised forecasts appears to remain uncertain. In addition, the Company is making the most of internal and external resources at its disposal to prevent additional losses due to delays with this project. Therefore, we want to keep an eye on whether other projects progress as planned, and, although it appears unlikely, whether similar unprofitable projects arise within other large projects as one risk. It is surprising that an unprofitable project of this scale has arisen, given the Company’s track record of earnings growth through the pursuit of sales expansion alongside margin improvement.

1H FY3/25 consolidated results

(¥mn)

	1H FY3/24		1H FY3/25			Change		vs plan %
	Results	% of net sales	Initial plan	Results	% of net sales	Amount	%	
Net sales	6,465	-	6,750	6,754	-	288	4.5%	0.1%
Systems integration	3,657	56.6%	-	3,704	54.9%	47	1.3%	-
Infrastructure solutions	648	10.0%	-	620	9.2%	-27	-4.3%	-
Package-based SI	2,160	33.4%	-	2,429	36.0%	269	12.5%	-
Gross profit	1,429	22.1%	-	1,220	18.1%	-209	-14.7%	-
SG&A expenses	668	10.3%	-	740	11.0%	72	10.9%	-
Operating profit	761	11.8%	806	479	7.1%	-282	-37.1%	-40.5%
Ordinary profit	775	12.0%	815	495	7.3%	-280	-36.2%	-39.2%
Profit attributable to owners of parent	525	8.1%	554	365	5.4%	-159	-30.4%	-34.0%

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

2. Trends by service line

Net sales grew for both of the two core service lines, systems integration services and packaged-based SI services. However, growth was most prominent in package-based SI services, where the Company aggressively conducted M&A, lifting the share of total net sales to 36.0%, or one third, and continuing to contribute to profit expansion.

(1) Systems integration services

Net sales in systems integration services were ¥3,704mn, up 1.3% YoY. By industry, net sales in the finance field declined 1.6% to ¥1,576mn, and net sales in the industry and distribution field declined 0.4% to ¥1,540mn. However, public sector net sales rose 36.9% YoY to ¥324mn, driven by growth in sales for a large-scale project for a government organization. That offset slightly lower sales in the mainstay finance and industry and distribution fields.

Systems integration services net sales by industry

(¥mn)

	1H FY3/24		1H FY3/25		Change	
	Results	% of net sales	Results	% of net sales	Amount	%
Finance	1,602	43.8%	1,576	42.6%	-25	-1.6%
of which, banks	965	26.4%	948	25.6%	-17	-1.8%
of which, credit cards	519	14.2%	478	12.9%	-41	-7.9%
of which, other finance	117	3.2%	150	4.1%	33	28.5%
Industry and distribution	1,547	42.3%	1,540	41.6%	-6	-0.4%
Public sector	236	6.5%	324	8.8%	87	36.9%
Medical care	270	7.4%	262	7.1%	-7	-2.9%
Total	3,657	100.0%	3,704	100.0%	47	1.3%

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

(2) Infrastructure solutions services

Net sales in infrastructure solutions services declined 4.3% YoY to ¥620mn. Network service sales rose due to sharp growth in orders for network building projects associated with social infrastructure and government system upgrades, but server/client and cloud service net sales declined as starts for new project schedules were delayed and training periods extended.

Infrastructure solutions services net sales by industry

(¥mn)

	1H FY3/24		1H FY3/25		Change	
	Results	% of net sales	Results	% of net sales	Amount	%
Server/client	414	63.9%	335	54.1%	-79	-19.1%
Network	146	22.5%	201	32.5%	54	37.4%
Cloud	86	13.3%	83	13.5%	-3	-4.0%
Total	648	100.0%	620	100.0%	-27	-4.3%

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

(3) Package-based SI services

Net sales of package-based SI services climbed 12.5% YoY to ¥2,429mn, for a share of total net sales of 36.0%. Growth in this service line continued to be driven by Salesforce-related business, which saw a slowdown in growth with net sales of ¥987mn, up 14.8% YoY. On the other hand, SAP-related business, which continued to experience M&A effects, recorded growth of 53.6% to ¥610mn, and accounting packages declined 2.4% to ¥566mn. Technigate, which handles the SuperStream accounting package, has seen a decline in growth following a significant increase in net sales in FY3/24 with the introduction of the invoicing system in October 2023 and start of Japan's Electronic Books Preservation Act in January 2024.

Package-based SI services net sales by industry

(¥mn)

	1H FY3/24		1H FY3/25		Change	
	Results	% of net sales	Results	% of net sales	Amount	%
Salesforce-related business	860	39.8%	987	40.6%	126	14.8%
SAP	397	18.4%	610	25.2%	213	53.6%
Accounting packages	580	26.9%	566	23.3%	-13	-2.4%
Personnel salary packages	207	9.6%	177	7.3%	-29	-14.4%
Other	113	5.2%	85	3.5%	-27	-24.0%
Total	2,160	100.0%	2,429	100.0%	269	12.5%

Note: Accounting packages (SuperStream, Bugyo), personnel salary packages (COMPANY, SuperStream), and other (DynamicsCRM, others)
Source: Prepared by FISCO from the Company's results briefing materials

3. Financial condition

Total assets were ¥8,167mn at the end of 1H FY3/25, down ¥545mn from the end of FY3/24. Looking at the main factors in the change, current assets decreased ¥416mn to ¥6,950mn, and non-current assets decreased ¥128mn to ¥1,217mn. Current assets declined many because accounts receivable - trade and contract assets decreased ¥530mn, whereas cash and deposits increased ¥16mn, remaining nearly unchanged. In intangible assets, goodwill decreased ¥35mn to ¥237mn. The Company practices debt-free management, and is extremely financially sound with a current ratio of 366.7% and an equity ratio of 69.0%. As it has ample liquidity on hand, we at FISCO believe that it can take an agile approach to M&A and further strengthen shareholder returns.

Consolidated balance sheet and management indicators

(¥mn)

	FY3/20 non-consolidated	FY3/21 non-consolidated	FY3/22 consolidated	FY3/23 consolidated	FY3/24 consolidated	1H FY3/25 consolidated	Change
Current assets	4,969	5,187	5,823	6,139	7,366	6,950	-416
Cash and deposits	2,167	2,384	2,906	3,062	3,601	3,618	16
Accounts receivable - trade and contract assets	2,339	2,321	2,428	2,649	3,253	2,723	-530
Non-current assets	528	559	676	1,362	1,345	1,217	-128
Property, plant and equipment	85	75	64	113	103	100	-3
Intangible assets	9	6	121	727	644	618	-26
Goodwill			114	345	273	237	-35
Investments and other assets	433	476	489	522	597	498	-99
Total assets	5,498	5,746	6,500	7,502	8,712	8,167	-545
Current liabilities	1,404	1,317	1,625	2,013	2,317	1,895	-421
Non-current liabilities	466	482	508	623	621	615	-6
Total liabilities	1,871	1,800	2,133	2,637	2,939	2,510	-428
Total net assets	3,626	3,946	4,366	4,865	5,773	5,657	-116
[Stability]							
Current ratio	353.9%	393.8%	358.3%	304.9%	317.9%	366.7%	48.8pp
Equity ratio	66.0%	68.7%	67.2%	64.7%	66.0%	69.0%	3.0pp

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

Outlook

Company revised down FY3/25 forecasts. Earnings recovery from FY3/26 is a focal point

On November 13, 2024, the Company revised down its FY3/25 consolidated results forecast for net sales from ¥14,420mn to ¥14,200mn (up 3.4% YoY), operating profit from ¥1,860mn to ¥1,230mn (down 28.9% YoY), ordinary profit from ¥1,900mn to ¥1,265mn (down 27.4% YoY), and profit attributable to owners of parent from ¥1,267mn to ¥840mn (down 31.9% YoY). The Company plans on net sales broadly in line with its initial outlook, but sharply cut its forecasts from the operating profit line down to reflect impact from an unprofitable project for a certain customer. That project is currently scheduled for final handover by March 2025. If it wraps up as planned, it should only result in the posting of a temporary loss and not impact results in FY3/26 beyond. However, whether margins similarly worsen for other projects continues to warrant attention. Also, the Company forecasts higher sales but lower profits for the six months of 2H, but sales with a gross profit margin of zero have been booked for the unprofitable project since a provision for it has been recorded, and FISCO presumes the Company's plan also factors in a certain amount of risk.

Consolidated outlook for FY3/25

(¥mn)

	FY3/24				FY3/25				YoY	
	1H	2H	Full year	% of net sales	1H	2H (E)	Full year (E)	% of net sales	Change	Change (%)
Net sales	6,465	7,267	13,732	-	6,754	7,446	14,200	-	468	3.4%
Systems integration	3,657	3,913	7,570	55.1%	3,704	3,896	7,600	53.5%	30	0.4%
Infrastructure solutions	648	840	1,488	10.8%	620	880	1,500	10.6%	12	0.8%
Package-based SI	2,160	2,513	4,673	34.0%	2,429	2,671	5,100	35.9%	427	9.1%
Operating profit	761	968	1,729	12.6%	479	751	1,230	8.7%	-499	-28.9%
Ordinary profit	775	968	1,743	12.7%	495	770	1,265	8.9%	-478	-27.4%
Profit attributable to owners of parent	525	708	1,233	9.0%	365	475	840	5.9%	-393	-31.9%

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

Medium- to long-term growth strategy and status of progress

Achieving medium-term plan looks slightly more challenging now. Focusing on promptly wrapping up unprofitable project and getting earnings back to normal

1. Status of progress on medium-term management plan VISION 2025

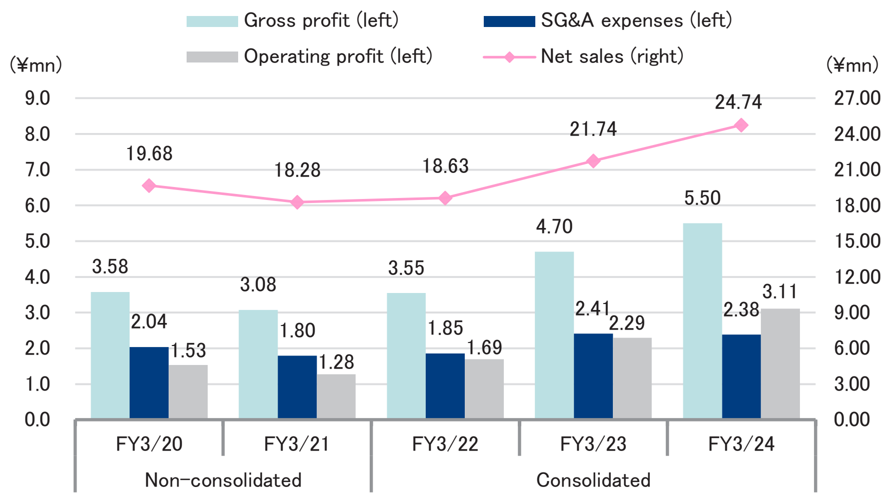
In VISION 2025, the Company’s medium-term management plan covering the three years from FY3/24 to FY3/26, the key strategies are 1) proactively advance M&A, 2) further strengthen relationships with alliance partners, 3) promote DX business, 4) invest in human resource training and strengthen areas of expertise, and 5) further grow sales in existing SI fields. The Company’s numerical targets for FY3/26 are net sales of ¥15,000mn and operating profit of ¥1,800mn. This would correspond to three-year CAGR of 9.0% for net sales and 13.8% for operating profit. By service line, projected net sales CAGR is 5.5% for systems integration services, 4.4% for infrastructure solutions services, and 15.6% for package-based SI services. The share of total net sales for package-based SI services, a high-value-added business, is projected to increase 6.5 percentage points (pp) YoY to 40%, contributing to an increase in the operating profit margin of 1.4pp to 12.0%.

In November 2023, the Company announced upward revisions to its full-year consolidated forecast for FY3/24 in light of favorable 1H results. It raised its forecast for net sales to ¥13,300mn and operating profit to ¥1,615mn. It ended up achieving even higher net sales of ¥13,732mn and operating profit of ¥1,729mn. Therefore, it attained a year ahead of plan its targets for net sales of ¥13,700mn and operating profit of ¥1,620mn in FY3/25, the second fiscal year of its medium-term management plan. The operating profit margin rose sharply to 12.6% in FY3/24, already surpassing the target of 12.0% for the final fiscal year of the medium-term management plan. However, the Company revised down its full-year consolidated results forecast for FY3/25 due to impact from an unprofitable project for a certain customer that arose in 1H. Its revised plan calls for net sales of ¥14,200mn and operating profit of ¥1,230mn. Since the Company targeted net sales of ¥13,700mn and operating profit of ¥1,620mn for the second fiscal year of its medium-term management plan, net sales are outpacing but operating profit is trailing the plan.

Human capital is an important management resource, central to value creation for an IT services company; however, the Company faces a worsening shortage of engineers. In its DX Report of September 2018, the Ministry of Economy, Trade and Industry suggested that there is a risk of a shortage of between 400,000 to 800,000 engineers emerging by 2030 due to the "2025 Digital Cliff" and the low productivity of IT human resources in Japan, as it is a labor-intensive business model. In the determination of surplus and shortage of full-time employees and other workers by industry D.I. (Diffusion Index = "shortage" - "surplus") based on the Survey On Labor Economy Trend by the Ministry of Ministry of Health, Labour and Welfare, as of February 2024, the "total of surveyed industries" stood at 51, whereas the "information and communications industry" stood at 62 ("shortage" 63, "surplus" 1), indicating a strong sense of shortage. Only two industries had a more serious shortage of workers than the information and communications industry: the "construction industry" (D.I. 65), which will ramp up workstyle reforms from April 2024, as well as the "academic research and professional/technical services industry" (D.I. 66).

When the Company was primarily operating business based on systems integration services, its targets were to rigorously manage projects and eliminate unprofitable projects in order to lift the operating profit margin above 10%. In FY3/24, the Company achieved an operating profit margin of 12.6% by expanding package-based SI services. Comparing pre-COVID-19 non-consolidated financial results for FY3/20 and consolidated results for FY3/24 including package-based SI services subsidiaries through M&A, per-employee figures have risen in net sales from ¥19.68mn to ¥24.74mn, in gross profit from ¥3.58mn to ¥5.50mn, in SG&A expenses from ¥2.04mn to ¥2.38mn, and in operating profit from ¥1.53mn to ¥3.11mn. By increasing the weight of high-value-added business, the Group has adopted a growth strategy of increasing profitability by enhancing per-employee net sales and gross profit, raising employee compensation, and investing in R&D and human resource development for the future.

Per-employee net sales, gross profit, SG&A expenses, and operating profit



Note: Per-employee net sales, etc., are calculated using the average of the number of employees at the start and at the end of the fiscal year, with the number at the end of the fiscal year used for FY3/22 only
Source: Prepared by FISCO from the Company's annual securities report and results briefing materials

2. Measures for realizing the medium-term management plan

The market environment in the medium-term management plan anticipates steady growth in the domestic IT market, while innovative new technologies such as agile development and generative AI are continuously emerging. The Company works to place the right person in the right position in order to meet customers' expectations. In anticipation of changes in user needs and to build a competitive position in the future, the Company is dynamically engaged in reskilling its employees to enhance agile development capabilities.

Measures for realizing the medium-term management plan

1. Promotion of proactive M&A Expand the Group's overall business scale by investing in companies with businesses that will create synergies with the Company
2. Further strengthen teamwork with business partners Expand the scope of solutions through package-based SI and services by deepening cooperation with companies possessing excellent IT products/services and proprietary technologies
3. Promote the DX business
(1) Cloud, package-based SI
1) Company-wide development of Salesforce-related business
2) Increase the ratio of package-based SI services, such as SAP and SuperStream
3) Expand direct user transactions through expansion of package-based SI services
4) Promote structural reform of the cloud business (AWS, Azure, etc.) in the infrastructure solutions field
(2) Low-code development, agile development
1) Develop low-code development personnel centered on GeneXus and Microsoft Power Platform
2) Make agile development the standard method for low-code and cloud native development
(3) Initiatives on generative AI
1) Start planning development of generative AI business from 2H FY3/24 as a measure to strengthen the DX business
2) Promote investigative research on generative AI services, such as Salesforce "Einstein Copilot," ServiceNow "Now Assist," Microsoft "Azure Open AI Service" and examine necessary skills acquisition for formulation and implementation of a proposal model
4. Investment in human resource development and strengthening of specialization fields
(1) Aggressive investment in human resource development
Accelerate promotion of acquisition of service and IT qualifications and focus on new digital engineer qualification acquisition, such as cloud-based and low-code development for package-based SI services
(2) Bolster areas of strength
Promote high-productivity development, focusing on areas in which the Company possesses know-how and new strategic areas
5. Further improve sales in existing SI areas
(1) Expand domain in the finance field
(2) Increase receipt of orders in the public sector
(3) Strengthen alliances with partners such as Fujitsu Group, Hitachi Group, NTT Data Group
(4) Promote modernization of existing systems

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

Conventional development requires systems to accurately and efficiently record, store and use large amounts of data, with an emphasis on quality. Existing systems are becoming outdated, complex, and black box, and modernization is required to avoid the "2025 Digital Cliff" that Japan's Ministry of Economy, Trade and Industry is warning about. Migrating COBOL assets to languages like Java requires engineers with many years of systems development experience who know older programming languages. For cost-focused customers, the Company provides combinations of package and cloud services. For customers who are focused on development speed, it proposes DX-based development. The Company will overcome the "2025 Digital Cliff" and provide solutions for users aiming for management transformation through DX, so it is pursuing agile development methods as a standard for low-code development and cloud-native development.

Characteristics of conventional development and DX development

Type	Characteristics
Conventional development	System to accurately and efficiently record, store and use large amounts of data • Focus on cost and quality: Scratch development, waterfall development, packages, cloud, joint development
DX development	System to repeatedly provide and improve services in a short space of time • Focus on speed and flexibility: Agile development, low-code development, cloud, generative AI

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

In order to strengthen its agile development capabilities, the Company entered into a software development partnership agreement with GeneXus Japan Inc. in September 2022. The GeneXus low-code software development tool has been adopted by over 8,700 companies located in more than 50 countries worldwide and used by more than 130,000 technical experts. The GeneXus software development tool significantly shortens development timelines by as much as 80% by enabling developers to automatically generate applications and databases simply by entering task requirements. Once the requirements have been declared, developers are able to share a functional prototype of the application or database, thereby making it easier to pinpoint issues at the preliminary stage. In addition, the software development tool automatically generates software applications after requirements have been declared. This makes it possible for users to significantly reduce development costs and shorten timelines, while lowering the occurrence rate of coding bugs and curbing the likelihood of system obsolescence. The tool offers the distinctive advantage of enabling development of systems that are not prone to obsolescence because it provides for substantial maintainability and does not rely on infrastructure.

The Company is working to train low-code developers, mainly around GeneXus and Microsoft Power Platform and is proactively increasing personnel. The DX Promotion Headquarters is taking steps to establish standard approaches to low-code development and agile development with respect to cloud-native development.

The Company has been placing focus on its highly profitable package-based SI services offering hands-off solutions as a growth business. The Company has achieved sustainable growth through strategic investment and inhouse education in the SAP-related business. As a SuperStream NX partner, subsidiary Technigate has knowledge and strong technical capabilities concerning the SuperStream accounting package business. It cultivates direct user transactions with a focus on major companies and to date, it has installed the package at a total of 727 companies. The Company is sharing the knowledge possessed by its subsidiary and using it to grow its own direct user transaction business. It also plans to integrate subsidiaries' customer bases into its package-based SI services business so that it can provide them with next-generation services that offer even greater added value.

The Company has launched a new business handling ServiceNow. US-based ServiceNow, Inc. <NOW> was established in 2004 and provides a cloud-based operations platform for raising worker productivity in a SaaS format. It established a Japanese subsidiary in 2013. Its cloud services encourage workstyle reforms and greater productivity among employees by simplifying and automating a company's routine workflow processes in areas from IT asset management to security, human resources, and customer service.

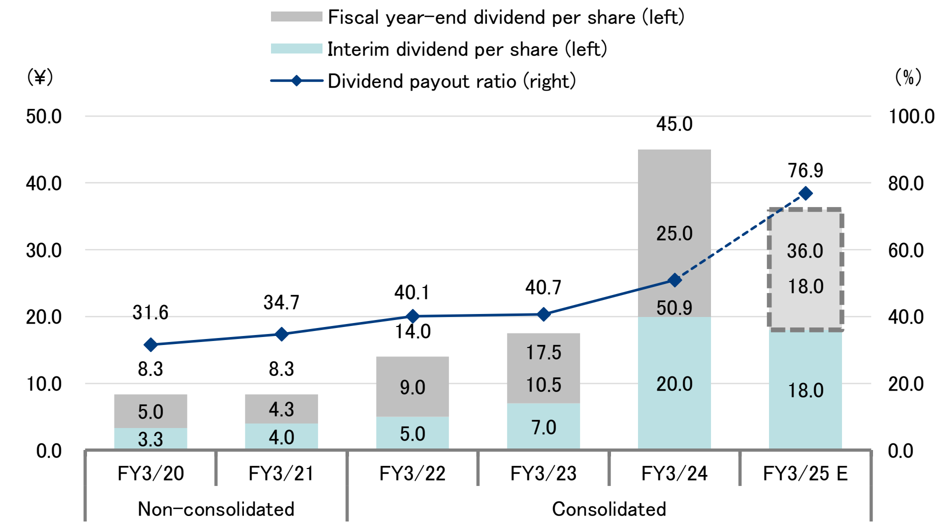
In its initiatives on generative AI, the Company started planning business development in 2H FY3/24 as a measure to strengthen the DX business. It promotes investigative research on generative AI services, such as Salesforce "Einstein Copilot," ServiceNow's "Now Assist," Microsoft's "Azure Open AI Service," and examines necessary skills acquisition for formulation and implementation of a proposal model.

Shareholder return policy

Dividend plan remains ¥36.0. Solid financial standing and strong results also allow potential for dividend increase after earnings recover

The Company considers returning profits to shareholders to be one of its more important management issues. Its basic policy is to continuously and stably return profits to shareholders after considering supplementing internal reserves as necessary to strengthen the management structure and for business development in the future. In November 2021, the Company raised its dividend payout ratio standard from at least 30% to at least 40%. Under VISION 2025, it lifted that standard to at least 50% for the three years until FY3/26. On November 1, 2023, the Company conducted a two-for-one stock split of its common stock. In FY3/24, it paid an interim dividend of ¥20.0 and a fiscal year-end dividend of ¥25.0 for an annual dividend of ¥45.0 per share, up sharply from ¥17.5 in the previous fiscal year. The dividend payout ratio came to 50.9%. For FY3/25, the Company plans to pay an annual dividend per share of ¥36.0, an increase of ¥1 from the previous fiscal year. The expected dividend payout ratio was 51.1% based on initial results forecasts, but has risen to 76.9% as a result of the downward revisions to forecasts announced. FISCO believes that while there is not much room to raise the dividend payout ratio further in FY3/25, there is still plenty of room to lift dividends per share as well as the dividend payout ratio from the current level of at least 50% in FY3/26 onwards, given the Company's solid financial standing.

Dividend per share and dividend payout ratio



Notes: Retroactively revised following the 1.5-for-1 stock split conducted on October 1, 2021
Retroactively revised following the 2-for-1 stock split conducted on November 1, 2023
Source: Prepared by FISCO from the Company's financial results

Sustainability management

The Company's value creation model is to promote corporate management with an emphasis on ESG towards reaching the United Nations Sustainable Development Goals (SDGs) in 2030, serving as an IT partner while continuously creating solutions. Its seven key indicators for sustainability management are 1) human resource development, 2) response to climate change, 3) human rights and diversity, 4) health and productivity management, 5) business partners, 6) quality security, and 7) corporate governance. It has cited 10 of the SDGs to which it will contribute: 3. Good health and well-being, 4. Quality education, 5. Gender equality, 8. Decent work and economic growth, 9. Industry, innovation and infrastructure, 10. Reduced inequalities, 12. Responsible consumption and production, 13. Climate action, 16. Peace, justice and strong institutions, and 17. Partnerships for the goals. By promoting corporate management that emphasizes ESG, the Company aims to contribute to achieving the SDGs through the provision of system solutions that support high-quality, safe and secure social infrastructure by a group of excellent engineers, and to create workplaces that enable individual employees to enjoy a healthy and fulfilling relationship with their work.

Seven key indicators for sustainability management

The Group's key indicators	The SDGs
1. Human resource development	Contribute to the realization of sustainable social infrastructure through the provision of optimal system solutions by a group of excellent engineers.
2. Response to climate change	Recognize that initiatives in response to climate change are a common global issue and aim to conduct corporate activities that are considerate of the global environment.
3. Human rights and diversity	Respect the human rights and individual diversity of all people and aim to establish an environment where individuals can reach their full potential.
4. Health and productivity management	Aim to create a workplace where individual employees can be healthy mentally and physically and enjoy fulfilling relationships with their work.
5. Business partners	Contribute to the achievement of the SDGs through the building of long-term cooperative relationships with business partners.
6. Quality security	Aim to be a company that is trusted by stakeholders by providing high quality, safe and secure services.
7. Corporate governance	Further enhance corporate governance to realize management that can provide benefits to all stakeholders.

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

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■ For inquiries, please contact: ■
FISCO Ltd.
5-13-3 Minami Aoyama, Minato-ku, Tokyo, Japan 107-0062
Phone: 03-5774-2443 (IR Consulting Business Division)
Email: support@fisco.co.jp