

Scala, Inc.

4845

Tokyo Stock Exchange First Section

10-Apr.-2019

FISCO Ltd. Analyst

Yuzuru Sato



FISCO Ltd.

<http://www.fisco.co.jp>

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Summary

Earnings growth potential has further increased from the effects of M&A

Scala, Inc. <4845> (hereafter, also “the Company”) is a leading provider of website search services, FAQ services, and other services for corporate websites. It continues to develop its businesses and achieve sustainable growth, centered on SaaS/ASP*1 services, which are a business model with recurring (stock-type) income. It also actively conducts M&A to expand its business area, and in July 2016, it made a subsidiary of Softbrain Co., Ltd. <4779>, which is a major sales support software company. It also made subsidiaries of plube Co., Ltd., an EC website management company, in August 2017; of Leoconnect, Inc., which provides customer support consulting to call centers operated by the HIKARI TSUSHIN <9435> Group, in March 2018; and of Connect Agency Inc., which provides a Cloud PBX service*2, in November 2018. The Company has adopted International Financial Reporting Standards (IFRS) accounting.

*1 Service that supplies application software functionality to customers over a network

*2 An IP phone service with a service design that generates call fees every second. Compared to the usual, three-minute fees, this service offers a costs benefit for companies that make a lot of calls that last a very short time, such as outbound calls.

1. FY6/19 1H results exceeded the Company forecasts

In the FY6/19 1H consolidated results, sales revenue increased 43.6% year on year (YoY) to ¥8,405mn and operating profit rose 38.1% to ¥1,135mn, and both results were above the Company forecasts (sales revenue of ¥7,850mn and operating profit of ¥900mn). This was because, while progress was made as forecast in the mainstay SaaS/ASP business, results at the subsidiaries, of Softbrain and plube, grew more than expected. Looking at the YoY comparison also, higher sales and profits were achieved in all the business segments, with operating profit growing particularly significantly in the SFA business, rising 47.5% to ¥516mn, which contributed 53% of the increase in profits. This was mainly due to the strong sales of e-Sales Manager, which is a tool to improve sales productivity. Also, the results of Leoconnect, which was made a subsidiary in the 2H of the previous fiscal year, added ¥1,340mn to net sales and ¥26mn to operating profit.

2. The FY6/19 full year results forecasts have been upwardly revised

For the FY6/19 full year consolidated results, both Company forecasts have been upwardly revised, to sales revenue to increase 29.4% YoY to ¥16,600mn and operating profit to rise to 29.3% (the previous forecasts were sales revenue of ¥16,200mn and operating profit of ¥1,880mn). This was mainly because the 1H results were above forecast. Operating profit is expected to decrease slightly in the 2H compared to in the 1H, but this is because the results of the Softbrain Group will be reflected. However, the strong impression is that these forecasts are conservative, and moreover synergies with Leoconnect and Connect Agency are expected from the 2H onward. So at FISCO, we think there is still room for the full fiscal year results to further increase above the forecasts.

Summary

3. Synergies with Leoconnect, Connect Agency are expected

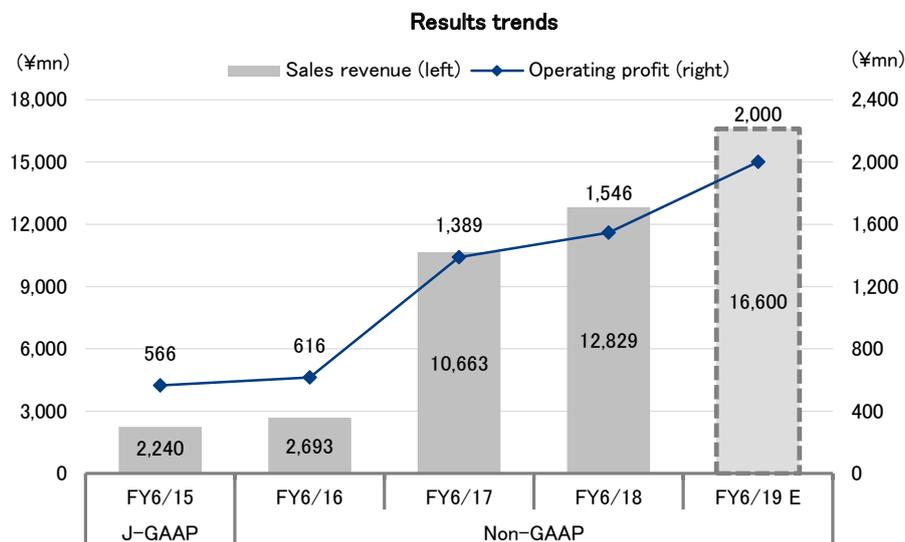
From FY6/19 2H onwards, synergies are expected with Leoconnect and Connect Agency, which were recently made into subsidiaries. Leoconnect provides consulting with the aim of improving the quality of call center services, while Connect Agency provides a Cloud PBX service to companies and call centers making outbound calls, and both have as customers the HIKARI TSUSHIN Group and its agencies. Together with these subsidiaries, the Company provides sales proposals to the HIKARI TSUSHIN Group and other customers of its own products, such as i-ask. When including its agencies, the HIKARI TSUSHIN Group contains thousands of companies throughout the entire country, so there is huge potential to grow earnings through acquiring these prospective customers.

4. Will continue to increase dividends, assuming earnings growth

The Company's basic dividend policy is to stably and continuously pay dividends while retaining the internal reserves necessary to strengthen its financial structure and to develop its businesses in the future. In FY6/19, it plans to pay a dividend per share of ¥24, up ¥4 YoY, for the 10th consecutive fiscal year of higher dividends. It also aims to continue to increase the dividend in the future alongside the growth in earnings.

Key Points

- In the FY6/19 1H results, sales and profits increased by double digits and exceeded the Company forecasts
- Collaborating with Leoconnect and Connect Agency to acquire as customers the thousands of companies related to the HIKARI TSUSHIN Group
- Newly established a subsidiary to conduct the planning and development of new businesses and services, and going forward also, is targeting double-digit growth while aiming to strengthen the service lineup



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

■ Company profile

The corporate cloud service in the CRM field is its core business and it is expanding business domain through an M&A strategy

1. History

The Company was founded in December 1991 with an initial start as a sales distributor of database systems. It realized significant growth in 1999 by inheriting support services, including customers, for the Model 204* mainframe database management system license from Mitsui Knowledge Industry Co., Ltd.

* Developed by US-based Computer Corporation of America and Sirius Software (now, Rocket Software). Major customers were large companies in Japan like as Bank of Japan <8301> and Tokyo Electric Power Company Holdings, Inc. <9501>. Demand for it ceased due to changes in the market environment, and the service was ended in the fall of 2016.

In 2000, the Company determined that it needed to change its business structure to continue growing amid the migration of corporate information systems from mainframes to small-scale open servers, and it started expanding its business through M&As utilizing funds obtained from its IPO in 2001. It began with the purchase of PatentManager, a patent management software business from Interscience in 2003, and then acquired Dbecs Co., Ltd. with the aim of entering the CRM field, Vodamedia Inc. with the goal of entering the IVR field, the news distribution service provider NewsWatch Inc., the website developer TriAx Corp., and other firms in the Internet domain as subsidiaries one after another. The Company is steadily expanding its SaaS/ASP business, which is a business model with recurring income, as its core operations and bolstering its recruitment of system engineers to enhance its own service development capabilities.

Recently, the Company made subsidiaries of Softbrain (ownership ratio based on voting rights as of the end of June 2018: 50.2%), a major sales support software company, in July 2016; plube (ownership ratio: 100.0%), an EC website management company that conducts trading of battle game trading cards, in August 2017 in order to enter the EC business; and Leoconnect (ownership ratio: 66.0%), which uses 24 call centers to provide customer support consulting for the brands and products of the HIKARI TSUSHIN Group, in March 2018, and Connect Agency, which provides a cloud PBX service to companies and call centers making outbound calls for such customers as the HIKARI TSUSHIN Group, in November 2018.

To conduct more flexible management, the Company switched to a holding company organization in 2004 and currently has 12 consolidated subsidiaries. In FY6/16, it changed its accounting standards to IFRS to disclose its results.

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Company profile

History

| Date | Major event |
|----------------|--|
| December 1991 | Founded Database Communications (now, Scala, Inc.) |
| January 1999 | Formed sales distribution contracts for the Japanese market with US-based Computer Corporation of America and Sirius and started Model 204 support |
| May 2001 | Listed on the Osaka Securities Exchange's NASDAQ Japan market (now, TSE JASDAQ (Standard)) |
| April 2003 | Acquired Interscience's patent management software (product name: PatentManager) with the aim of entering the intellectual property system field |
| October 2003 | Acquired Dbecs Co., Ltd. as a subsidiary to enter the CRM field |
| April 2004 | Acquired Vodamedia Inc. as a subsidiary with the aim of entering the IVR (interactive voice response) field |
| September 2004 | Renamed as Fusion Partners Co. in the transition to a holding company structure and established Database Communications (now, Scala Services Inc.) as a new company and transferred its business |
| June 2006 | Merged subsidiaries Vodamedia and Dbecs and changed the company name to Digi-Ana Communications Inc. (now, Scala Communications Inc.) |
| November 2010 | Acquired NewsWatch Inc. as a subsidiary |
| April 2012 | Merged subsidiaries Digi-Ana Communications and NewsWatch (now, Scala Communications Inc.) |
| May 2014 | Listing transferred to the TSE Second Section |
| December 2014 | Shares elevated to the TSE First Section |
| November 2015 | Acquired TriAx Corp. as a subsidiary |
| January 2016 | Renamed subsidiary Database Communications as PAREL, Inc. |
| July 2016 | Acquired Softbrain Co., Ltd. as a subsidiary |
| December 2016 | Changed trade name to Scala, Inc. |
| December 2016 | Merged the subsidiaries Digi-Ana Communications and TriAx Corp. and changed the trade name to Scala Communications Inc. |
| August 2017 | Acquired plube Co., Ltd. as a subsidiary |
| March 2018 | Acquired Leoconnect, Inc. as a subsidiary |
| November 2018 | Acquired Connect Agency Inc. as a subsidiary |
| November 2018 | Established Scala Next, Inc. |
| December 2018 | Established the Scala Next, Inc., Mandalay branch (Myanmar) |

Source: Prepared by FISCO from the Company's website

Main affiliates

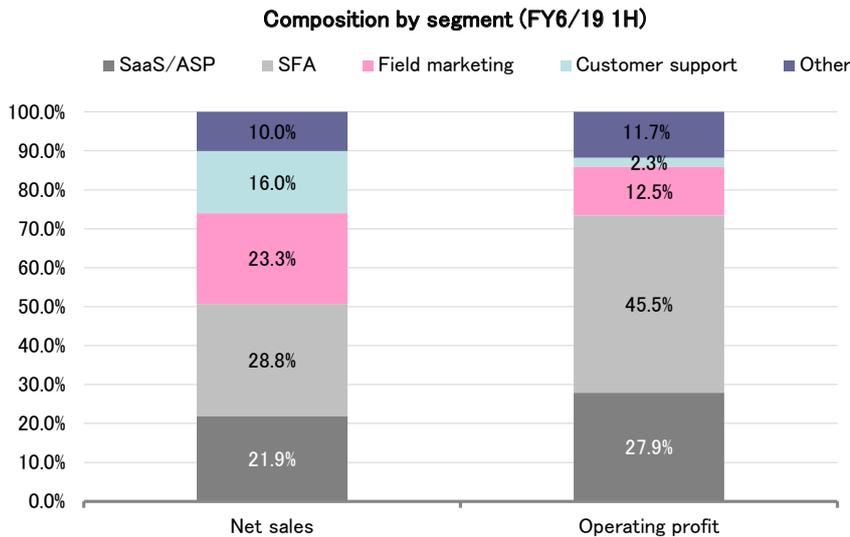
| Consolidated subsidiary | Ownership ratio (%) | Main business |
|---------------------------|---------------------|--|
| Scala Communications Inc. | 100.0 | SaaS/ASP services and software development, sales, and maintenance |
| Scala Next | 100.0 | Development and operations of services for the SaaS/ASP services the Scala Group provides, as well as planning and development of new businesses |
| Scala Services Inc. | 100.0 | Solution services for business processes relating to communication between corporations and individuals |
| plube Co., Ltd. | 100.0 | EC site management |
| Softbrain Co., Ltd. | 50.2 | Development, sales, and consulting service to support the introduction of sales support software |
| Leoconnect, Inc. | 66.0 | Customer support consulting relating to call center management |
| Connect Agency | 51.0 | Cloud PBX service |

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

Holds the leading share in the domestic market, including for i-search (an internal website search service) and i-ask (an FAQ service)

2. Business description

The Company divides and discloses information on its businesses into its 4 mainstay businesses: The SaaS/ASP business, which provides IT services that contribute to improving operational efficiency in the corporate CRM area; the Softbrain Group's SFA business (sales innovation business); the field marketing business; and Leoconnect's customer support business, and also the other businesses (Softbrain's systems development and publishing business and plube's EC business). In FY6/19 1H, the percentages of total sales by business were 21.9% from the SaaS/ASP business, 28.8% from the SFA business, 23.3% from the field marketing business, 16.0% from the customer support business, and 10.0% from the other businesses. In the percentages of segment profit to total profit, the SaaS/ASP business provided 27.9%, the SFA business 45.5%, and the field marketing business 12.5%, so these 3 businesses provided approximately 85.9% of the total.



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

(1) SaaS/ASP business

The Company provides SaaS/ASP services as its core business. The main services are the i-search website search service, i-ask FAQ service, IVR service, and news distribution service.

The i-search service was launched in 2007, and it currently holds the leading market share at around 15% with more than 400 customers, particularly large enterprises. While the Company has over 10 competitors, its i-search service offers better visibility by displaying images in search results and provides effective guidance to users. The average usage fee per month is ¥100,000-150,000.

The Company launched the i-ask service around 2008 and it is used by about 200 companies, mainly in the financial and insurance industries. This service lets users resolve issues on their own by listing frequently asked questions and related answers on their corporate sites. It helps to lower costs by reducing accesses to call centers and can improve customer satisfaction. The Company holds a roughly 15% market share, ranked second after OKWAVE <3808>. The average usage fee per month is ¥200,000-300,000.

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Company profile

IVR is a system for voice-based automated responses at corporate phone help desks, and the Company's service stands out for being provided in the SaaS format. Companies previously incurred large investment costs for IVR, including the need to install a PBX (private branch exchange) system. However, the SaaS format enables them to access the service inexpensively and use it during limited periods, such as campaigns.

Other than these businesses, the Company also provides various other services, including a news distribution service for corporations, and a service for the planning, development, production, maintenance, and management of websites according to customer needs, and one of its features is that it has a rich service lineup and it does not rely upon a specific service. It also includes the Cloud PBX service provided by Connect Agency, which was made a subsidiary in October 2018.

It also develops systems and provides services related to IoT and big data as customized development projects. Examples of this are Smiling Road, a safe-driving assistance service (for corporations)*1 sold by Sampo Japan Nipponkoa Insurance, and Portable Smiling Road, a smartphone app (for individuals)*2. In these services, big data, such as driving-related data sent from the users' dashboard cameras, is received by the server of Scala Communications and is operated and managed by the web system developed by the Company.

*1 A service that contributes to the promotion of continuous safe driving and accident prevention. It does so by using a website or smartphone app to provide various functions to facilitate safe driving, for example, processing of driving data collected from dashboard cameras utilizing IoT technologies, providing safe driving analysis for drivers and administrators, granting points to drivers rated highly in the driving evaluation system, and enabling them to apply for prizes.

*2 A service that contributes to the promotion of safe driving and accident prevention. It does so by using a smartphone app to provide various functions for "peace of mind," reporting accidents with a single push of a button should the driver be in an accident, and for "safety," being useful for accident prevention including through driving analysis and the provision of information in real time, and GPS for "convenience."

Description of the SaaS/ASP business services

| Type | Product name | Description |
|---------------------------|-----------------------|--|
| Site assistance service | i-search | Site internal search engine |
| | i-linkcheck | Link-loss detection system |
| | i-print | Site print service |
| | i-linkplus | Related link display service |
| CMS service | i-ask | FAQ system |
| | i-catalog | Product site management system |
| | i-learning | e-learning service |
| | i-flow | Progress management and approval system |
| CRM service | LaCoon | Web system building platform |
| | i-entry | Comprehensive questionnaire CRM service |
| | dbecs | High-performance web mailer |
| | i-assist | Web chatbot system |
| | i-livechat | Web chat system |
| Telephone-system service | i-gift | Digital gift service |
| | SaaS-type IVR | 24-hour, 365-day automated voice response |
| News distribution service | Cloud PBX service | IP phone service |
| | Corporate news | Corporate news Monitoring important business information |
| Data management | PatentManager6 | Latest patent management system |
| | GripManager | Contract operations management system |
| Site operations business | Fresheye | Search portal site |
| IoT, Big Data | Safe driving analysis | Processing and management of Big Data |

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

Company profile

(2) Softbrain Group's businesses

The Softbrain Group's businesses can be divided into the SFA business, field marketing business, and other businesses. The SFA business is mainly the development and sales of e-Sales Manager, which is SFA/CRM software, but also includes a consulting service to solve sales issues, skills training, and a service to support the introduction of smart devices into companies. e-Sales Manager has an excellent reputation as being No. 1 for usability. It is the industry-leading product from domestic SFA vendors, and has been introduced by a total of more than 5,000 companies.

The field marketing business is mainly for consumer goods manufacturers, and involves conducting field activities, market research, and other activities in stores utilizing registered staff, who are mainly housewives aged in their 30s to 50s. As of the end of December 2018, the Company has approximately 90,000 registered staff nationwide who cover more than 160,000 stores, including convenience stores and drugstores, and it is deploying this business on the largest scale within Japan. Recently, field activities have expanded to encompass the B-to-B domain and not just B-to-C.

The systems development business and publishing business are included in the other businesses segment. But even for both businesses combined, in the last few years their annual sales have trended around ¥700mn to ¥800mn and operating profit has been in the range of tens of millions of yen, so their impact on earnings is negligible.

(3) Customer support business

This is the business of Leoconnect, which was made a subsidiary in March 2018. It provides consulting services for the management of the inbound call centers (24 centers nationwide), from accepting enquiries about customer companies' services and products through to the follow-ups after the responses. For the time being, its strategy is to improve the productivity of its customers, including the HIKARI TSUSHIN Group and its agencies, by introducing its services, such as i-livechat and i-assist, into call centers, and also to collaborate with the other companies in the Group to expand sales of various IT services to existing customers. In addition, as the second stage, it intends to progress the acquisition of customers outside of the HIKARI TSUSHIN Group.

(4) Other businesses

The other businesses include Softbrain's systems development business and the publishing business. They also include plube's EC business, which manages "yuyu-tei," an EC website to buy and sell battle-type trading cards. The site has a high name recognition in the game industry and is influential to the extent that it is used as a reference indicator for the pricing of used cards, and many of the purchases on it are made by overseas users.

Aims to differentiate itself from competitors by increasing convenience through developments from the customer's perspective and providing a rich service menu

3. The Company's strengths

One of the Company's strengths in the SaaS/ASP business is that it develops services from the customer's perspective. It handles most of its business as direct sales and 80% of sales revenue is from direct salesforces. It improves service functions and develops new services by listening closely to customer needs and feeding this information back to its development team, and its development policy is to meet 100% of customer requests. The Company developed its core i-search and i-ask services thanks to this approach of meeting customer requests and its services are characterized specially by their ease of use, and this has also enabled it to make smooth progress in expanding sales to new customers.

Another strength is that its extensive lineup of services developed in this manner differentiates it from its competitors. While many competitors offer SaaS/ASP services for corporate websites, most of these companies only supply standalone services and few can provide multiple services as the Company does. The ability to propose multiple services enables it to meet diverse customer needs, and this cross-selling helps to raise the average price per customer and customer satisfaction. It has a track record of transactions with over 1,000 companies, including 400 listed companies.

The features of the SaaS/ASP business are that monthly billing revenue accounts for approximately 70% of sales revenue and its recurring income business model, in which monthly revenue is accumulated in accordance with the number of service contracts. The Company's basic policy is to avoid usage-based billing as much as possible and to provide services only from fixed monthly billing. Also, the main services are maintaining a high level of profitability, with the gross profit margins at around 80% (the margin is lower for the news distribution service, at around 70%, because of the costs of purchasing content). A reason for this is that the Company initially develops services customized to customer needs, and then develops them horizontally as general services, which enables it to keep development costs down.

Results trends

In the FY6/19 1H results, sales and profits increased by double digits and exceeded the Company forecasts

1. Summary of FY6/19 1H results

In the FY6/19 1H consolidated results, sales revenue increased 43.6% YoY to ¥8,405mn, operating profit rose 38.1% to ¥1,135mn, pretax profit grew 38.0% to ¥1,126mn, and net income attributable to owners of the parent increased 23.1% to ¥458mn. So sales and profits increased by double digits, and moreover every result exceeded the Company forecasts that were upwardly revised at the time of the Q1 results announcement. The main reason for the increases compared to the Company forecasts was that the results of Softbrain, Leoconnect, and plube were better than initially forecast. The operating margin declined 0.5 of a percentage point (PP), but this was due to the addition of the customer support business, which has a low profit margin.

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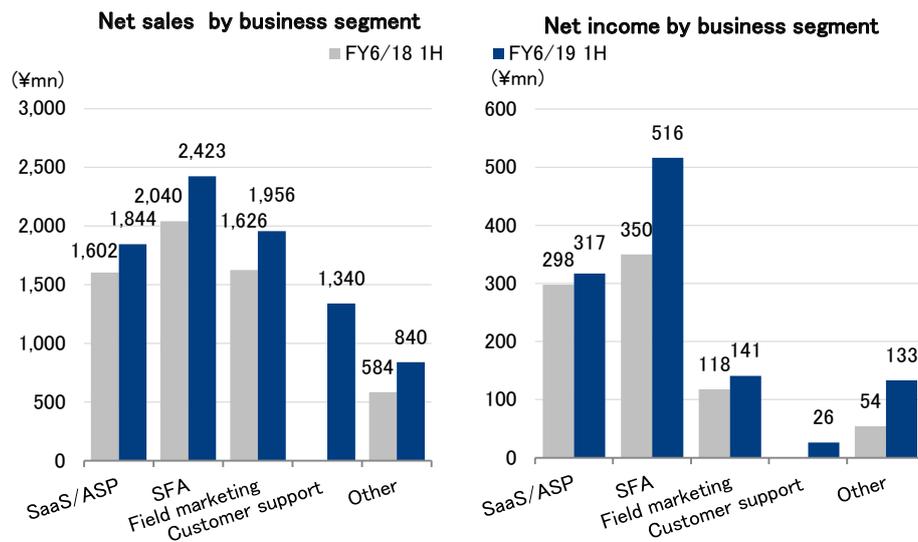
Results trends

Sales revenue increased by double digits YoY in all the business segments. Even when looking on an existing business basis after excluding the customer support business, which was added in the 2H of the previous fiscal year, and Connect Agency, which was made a subsidiary in FY6/19 Q2, sales revenue still increased 19%. Operating profit also increased in all the business segments. Among them, the SFA business played the driving role behind the earnings growth, contributing 53% of the total increase in profits. On an existing business basis, it seems that the operating profit increase rate was an increase of 39%.

FY6/19 1H consolidated results

| | FY6/18 1H | | Forecast (announced in November 2018) | FY6/19 1H | | | |
|---|-----------|------------|---|-----------|------------|-------|-------------|
| | Results | % of sales | | Results | % of sales | YoY | vs forecast |
| Sales revenue | 5,854 | - | 7,850 | 8,405 | - | 43.6% | 7.1% |
| Operating profit | 822 | 14.0% | 900 | 1,135 | 13.5% | 38.1% | 26.2% |
| Pretax profit | 815 | 13.9% | 890 | 1,126 | 13.4% | 38.0% | 26.5% |
| Net income attributable to owners of the parent | 372 | 6.4% | 400 | 458 | 5.5% | 23.1% | 14.6% |

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



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

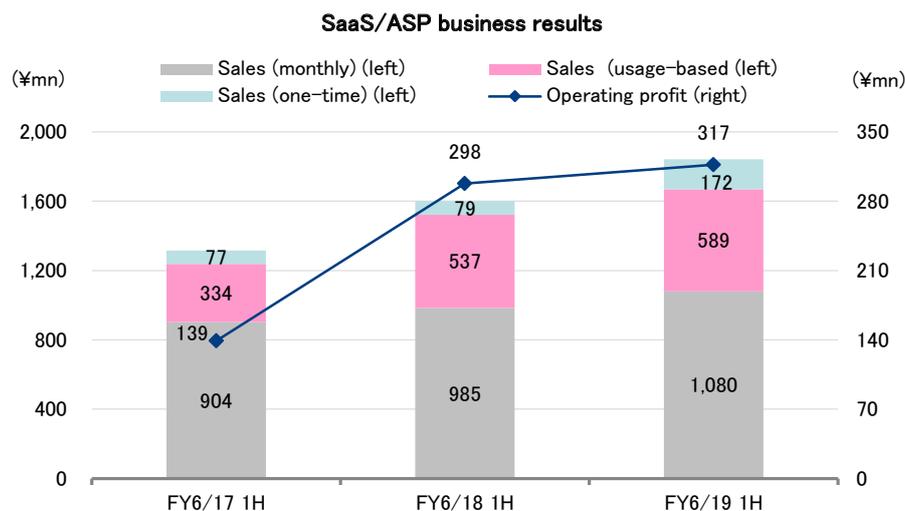
Results trends

In the SaaS/ASP business, monthly sales are steadily increasing and synergies with Leoconnect are also starting to appear

2. Trends by business segment

(1) SaaS/ASP business

In the SaaS/ASP business, sales revenue increased 15.1% YoY to ¥1,844mn and operating profit rose 6.0% to ¥317mn, which were new record highs for a 1H. Looking by type of sales revenue, monthly billing increased 9.6% to ¥1,080mn due to the penetration of cross sales among existing customers and the progress made in acquiring new customers, while usage-based billing rose 117.7% to ¥172mn, including due to the addition of Connect Agency's sales. One-time sales revenue grew 9.7% to ¥589mn, including from the contribution of the provision of a systems development and management application to Sompo Japan Nipponkoa Insurance, which provides products to LINE Hoken. The reason for the decline in the profit margin was a reaction to the fact that there were highly profitable, large-scale development projects in the same period in the previous fiscal year, and after excluding this factor, it was unchanged YoY. Connect Agency contributed two months of results, of November and December 2018, adding net sales of more than ¥100mn and seems to have been a slightly positive factor for profits also.



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

Sales by service

| | (¥mn) | | | | |
|----------------------------------|--------------|--------------|--------------|------------|-------------|
| | FY6/17 1H | FY6/18 1H | FY6/19 1H | YoY | YoY (%) |
| i-search | 191 | 221 | 251 | 30 | 13.6% |
| i-ask | 175 | 204 | 259 | 55 | 27.0% |
| Web services | 185 | 206 | 396 | 190 | 92.2% |
| Services related to IoT/big data | 137 | 320 | 161 | -159 | -49.7% |
| Telephone system service | 131 | 135 | 165 | 30 | 22.2% |
| News distribution | 206 | 210 | 233 | 23 | 11.0% |
| Other | 288 | 303 | 267 | -36 | -11.9% |
| Total | 1,317 | 1,602 | 1,735 | 133 | 8.3% |

Note: Does not include Connect Agency's sales

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

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Results trends

The main new customers for SaaS/ASP business services

| Type | Product name | Description | Customers |
|--------------------------|---------------|----------------------------------|---|
| Site assistance service | i-search | Site internal search engine | QVC Japan, Inc., NISHIMATSUYA CHAIN Co., Ltd., Haluene Co., Ltd. |
| CMS service | i-ask | FAQ system | ORIX Credit Corporation, SymEnergy Inc., E.design Insurance Co.,Ltd., Haluene Co., Ltd., Hi-Bit Inc. |
| | i-assist | Virtual assistance | The Nishi-Nippon City Bank, Ltd., Daiwa Securities Co. Ltd., Hi-Bit Inc. |
| CRM service | i-livechat | Web chat system | Sony Assurance Inc. |
| | i-gift | Digital gift service | MONEY PARTNERS CO., LTD |
| Telephone system service | SaaS-type IVR | Automated voice response service | R-bies, INC. |

Note: Red text indicates collaborative projects with Leoconnect.

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

By service, sales revenue trended strongly for both mainstay services, up 13.6% YoY to ¥251mn for i-search and up 27.0% to ¥259mn for i-ask. Also, the new i-gift service (a store visit-type product exchange digital gift service)*1, which was released in 2017, was newly introduced by Money Partners Co., Ltd. (Money Partners Group <8732>); i-assist (a web chatbot system)*2, was introduced by the Nishi-Nippon City Bank, Ltd. (Nishi-Nippon Financial Holdings <7189>) and Daiwa Securities Co., Ltd. (Daiwa Securities Group Head Office <8601>); and i-livechat (a Web chat system)*3 and the SMS distribution management service were newly introduced by Sony Assurance Inc., an existing customer. So the Company is steadily accumulating results for these advanced services as well. Synergies are also starting to appear through joint proposals with Leoconnect, such as the introductions of i-search and i-ask into Haluene Co., Ltd., and i-ask and i-assist into Hi-Bit. Going forward also, further introductions into companies in the HIKARI TSUSHIN Group are expected.

*1 i-gift is a digital gift service in which companies conducting sales promotion campaigns for new products or gifts can send customers an SMS or email (electronic message with an ID, such as a QR code) that can be presented at stores to receive a product. As the billing system is a combination of usage-based billing according to the number of IDs issued and fixed monthly billing, the greater the number of IDs issued, the more the Company's sales revenue will increase.

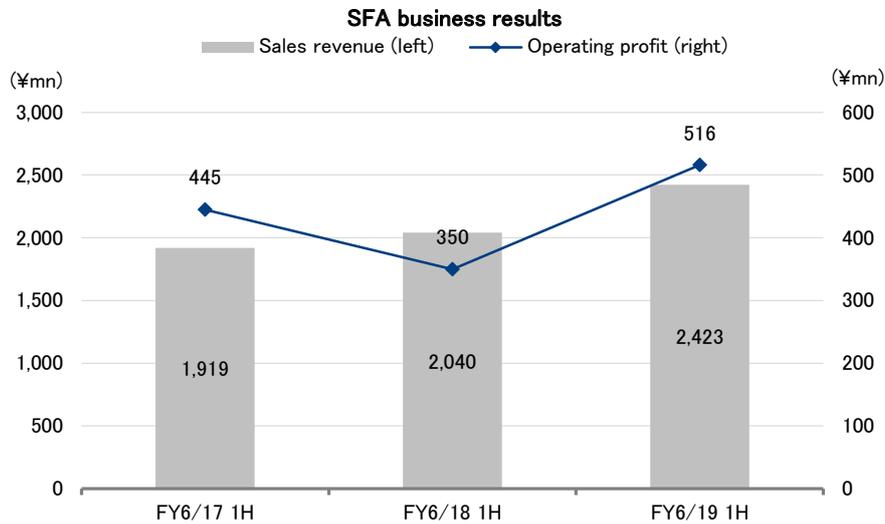
*2 i-assist is a chatbot system that utilizes AI.

*3 i-livechat is a web chat service that enables site operators, such as in a customer support center, to guide users in solving problems they may face and addressing their questions or concerns through real-time chat. By linking and checking users' i-search and i-ask history, site operators are able to respond while confirming content on the chat response screen. i-livechat is a service that contributes to improving customer satisfaction. It is anticipated that it will be introduced mainly at corporate call centers.

(2) SFA business

In the SFA business, sales revenue increased 18.7% YoY to ¥2,423mn and operating profit rose 47.5% to ¥516mn, which were new record highs for a 1H. Sales of e-Sales Manager, which is sales-support software that contributes to improved productivity in sales departments, were strong, particularly of the Cloud version. Sales of consulting, training, and other services also trended favorably. In the context of the increase in companies reforming ways of working, demand is growing for SFA tools that contribute to improved sales productivity, and among them, e-Sales Manager has been evaluated as being No.1 for ease of use, and its sales are strong. The profit margin also rose by 4.1 PP YoY to 21.3%, as the effects of the higher sales of e-Sales Manager absorbed the increases in personnel costs and development costs.

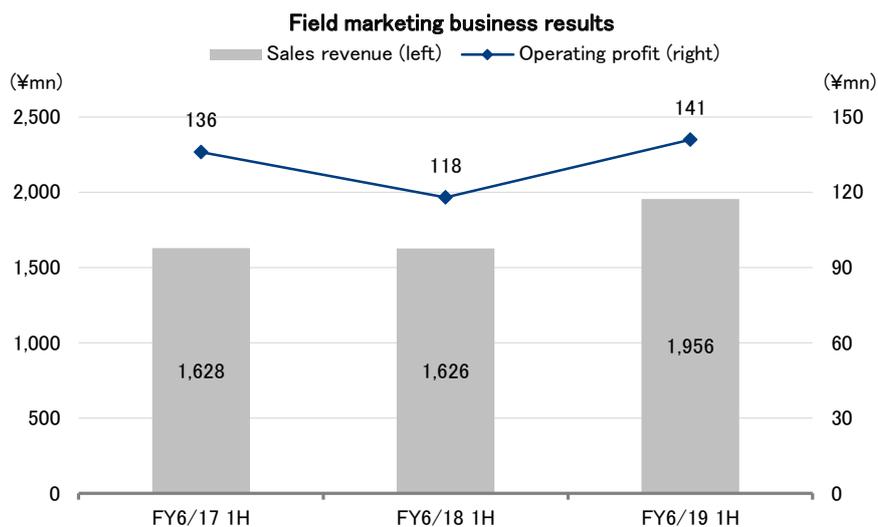
Results trends



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

(3) Field marketing business

In the field marketing business, sales revenue increased 20.3% YoY to ¥1,956mn, and operating profit rose 19.6% to ¥141mn, for higher sales and profits for the first time in 2 years. The main reasons for the higher sales and profits were that orders for spot projects, such as store construction, which had slumped in the same period in the previous fiscal year, recovered due to the change to the sales organization structure and from the effects of focusing on new customer acquisition. It was also because lump sum contract projects for field activities for existing customers performed well. In addition, in the efforts to develop new markets, orders for field-activity services in the B-to-B field (sales services for hotels and transport companies) have started to increase.



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

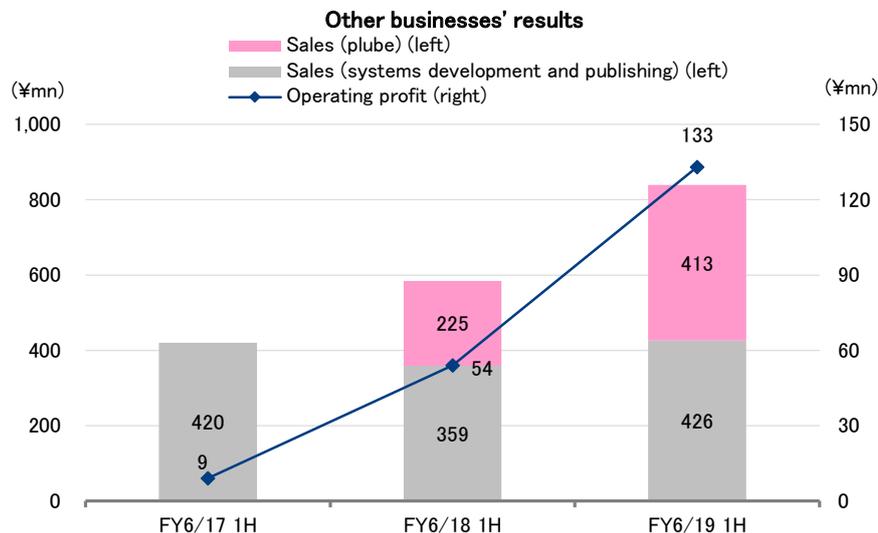
Results trends

(4) Customer support business

In addition to the outsourcing of customer support consulting operations for various companies in the HIKARI TSUSHIN Group, a track record of orders and introductions through joint proposals of SaaS/ASP services is starting to appear. Sales revenue was ¥1,340mn and operating profit was ¥26mn, and although the profit margin is still low, at around 2%, in the future it is expected to gradually improve from the introductions of SaaS/ASP services.

(5) Other businesses

In other businesses, sales revenue increased 43.7% YoY to ¥840mn and operating profit rose 146.2% to ¥133mn. Looking at the breakdown of sales revenue, in the systems development and publishing business, it rose 18.7% to ¥426mn. Also, in the EC business of plube, which became a consolidated subsidiary in August 2017, sales were strong of battle game trading cards, particularly Pokémon cards, and sales revenue increased significantly, up 83% YoY. In terms of the change factors, it seems that the increase in profits in plube's EC business contributed.



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

Interest-bearing debt increased, but is maintaining a net cash equilibrium

3. Financial condition and business indicators

Looking at the financial condition at the end of FY6/19 Q2, total assets were up ¥2,022mn on the end of the previous fiscal year to ¥18,256mn. Breaking down the main change factors, in current assets, cash and cash equivalents increased ¥1,092mn and operating receivables and other receivables rose ¥458mn, while in non-current assets, goodwill increased ¥404mn.

Total liabilities increased ¥1,427mn from the end of the previous fiscal year to ¥9,015mn. The main factor was interest-bearing debt increased by ¥1,271mn. Total equity increased ¥595mn from the end of the previous fiscal year to ¥9,240mn, with the main factors being the recording of net income attributable to owners of the parent of ¥458mn, net income attributable to non-controlling interests of ¥297mn, and dividend payments of ¥169mn.

We encourage readers to review our complete legal statement on "Disclaimer" page.

Results trends

Looking at the business indicators, the equity ratio declined by 2.9 PP, from 39.7% at the end of the previous fiscal year to 36.8%. Mainly due to the increase in interest bearing debt, the interest-bearing debt ratio rose from 74.3% at the end of the previous fiscal year to 90.3%. But since net cash (cash and cash equivalents – interest-bearing debt) is being kept at the equilibrium level, it can be judged that the Company is maintaining its financial soundness. However, goodwill accounts for approximately 34% (¥6,192mn) of total assets, and it is necessary to be aware that there is the risk that its financial condition could worsen should the earnings of Softbrain, which provides the majority of this goodwill, deteriorate due to it requiring impairment treatment. But currently Softbrain's results are trending stably, and at FISCO, we think the possibility of this risk materializing is extremely low. The Company has expressed its intention to gradually reduce the level of interest-bearing debt in the future if it does not require funds, such as for M&A.

Consolidated balance sheet

| | End-FY6/16 | End-FY6/17 | End-FY6/18 | End-FY6/19 1H | Change |
|--|--------------|---------------|---------------|---------------|--------------|
| | (¥mn) | | | | |
| Current assets | 5,470 | 7,167 | 8,120 | 9,676 | 1,555 |
| (Cash and cash equivalents) | 5,060 | 4,999 | 4,950 | 6,042 | 1,092 |
| Non-current assets | 4,160 | 7,774 | 8,112 | 8,580 | 467 |
| (Goodwill) | 477 | 5,684 | 5,787 | 6,192 | 404 |
| Total assets | 9,631 | 14,941 | 16,233 | 18,256 | 2,022 |
| Total liabilities | 5,720 | 7,021 | 7,587 | 9,015 | 1,427 |
| (Interest-bearing debt) | 3,300 | 4,768 | 4,793 | 6,064 | 1,271 |
| Total equity | 3,910 | 7,919 | 8,645 | 9,240 | 595 |
| (attributable to non-controlling interests) | - | 1,934 | 2,196 | 2,522 | 326 |
| Indicators | | | | | |
| (Stability) | | | | | |
| Equity ratio (shareholders' equity ÷ total assets) | 40.6% | 40.1% | 39.7% | 36.8% | -2.9pt |
| Interest-bearing debt ratio (interest-bearing debt ÷ shareholders' equity) | 84.4% | 79.7% | 74.3% | 90.3% | 16.0pt |
| (Profitability) | | | | | |
| ROE | 28.1% | 60.4% | 11.4% | | |
| ROA | 18.2% | 30.4% | 9.9% | | |
| Operating margin | 22.9% | 35.4% | 12.1% | | |

Note: Based on IFRS

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

■ Outlook

Remains room for the FY6/19 results to further increase above the forecasts

1. Outlook for FY6/19

The forecasts for the FY6/19 consolidated results are for double-digit increases in sales and profits, with sales revenue to increase 29.4% YoY to ¥16,600mn, operating profit to rise 29.3% to ¥2,000mn, pretax profit to grow 29.6% to ¥1,990mn, and net income attributable to owners of the parent to increase 25.9% to ¥890mn. All of the net sales and profits forecasts have been upwardly revised from the Company's previously announced forecasts. The main reason for this is that results up to Q2 were above forecast.

Outlook

At the end of Q2, the rates of progress toward achieving the full fiscal year forecasts were 50.6% for net sales and 56.8% for operating profit. The 2H operating profit forecast is ¥864mn, which is less than the 1H result of ¥1,135mn. But this is from the effect of Softbrain's FY12/19 Q2 (January to June, 2019) operating profit forecast of ¥470mn (up 1.9%YoY) being reduced from the FY12/18 2H result of ¥772mn. The operating profit forecast after excluding the results of the Softbrain Group is ¥395mn, which is a further increase on the result of ¥363mn in the 1H. The Softbrain Group's results forecasts are based on the values in the medium-term management plan announced in January 2018, and when considering the fact that Softbrain's FY12/18 results were above forecast and the current ordering environment, it is highly possible that its FY6/19 2H results will also exceed the forecasts. In the SaaS/ASP business as well, at FISCO we think it is highly likely that the FY6/19 results will exceed the Company forecasts from the expected synergies with Leoconnect and Connect Agency.

Outlook for FY6/19 consolidated earnings

| | FY6/18 | | FY6/19 | | | Progress rate up to 1H |
|---|---------|-------|------------------|------------------|-------|------------------------|
| | Results | YoY | Company forecast | Revised forecast | YoY | |
| Sales revenue | 12,829 | 20.3% | 16,200 | 16,600 | 29.4% | 50.6% |
| Operating profit | 1,546 | 11.3% | 1,880 | 2,000 | 29.3% | 56.8% |
| Pretax profit | 1,535 | 11.1% | 1,870 | 1,990 | 29.6% | 59.6% |
| Net income attributable to owners of the parent | 707 | 28.0% | 840 | 890 | 25.9% | 51.5% |
| Earnings per share (¥) | 41.88 | | 49.65 | 52.59 | | |

* Comparisons with non-GAAP indicators

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

Collaborating with Leoconnect and Connect Agency to acquire as customers the thousands of HIKARI TSUSHIN Group companies and related companies

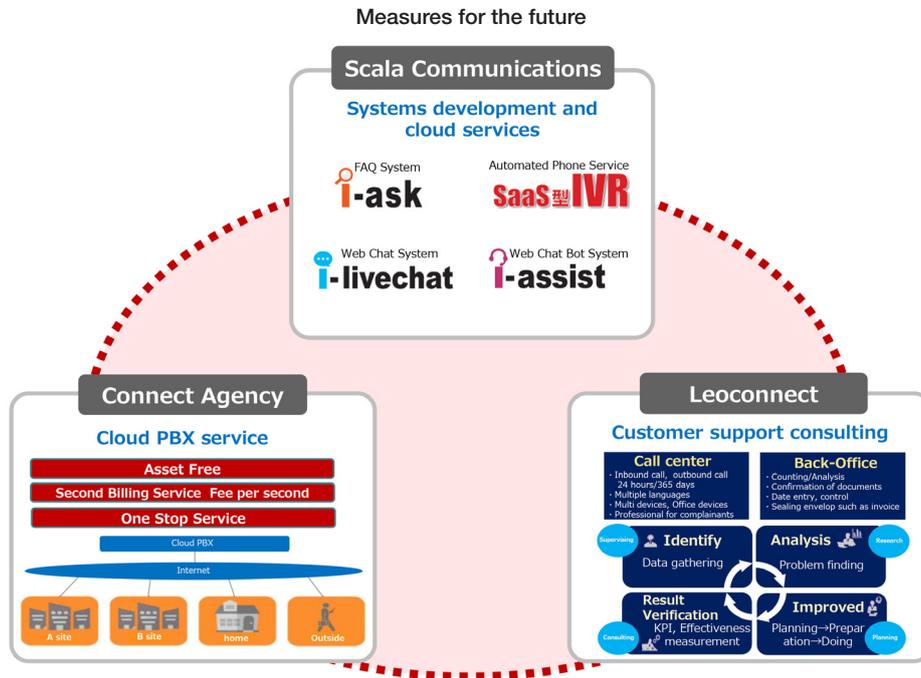
2. Outlook by business

(1) SaaS/ASP business

In the SaaS/ASP business, sales are forecast to increase around 20% YoY. The Company will continue to work on cross sales for the i-series and on acquiring new customers toward accumulating monthly billing. For one-time sales also, in Q3, new development projects for Sompo Japan Nipponkoa Insurance are expected to contribute. The addition of Connect Agency's Cloud PBX service will also be a factor behind the higher sales and profits. The profit margin will be somewhat low as management costs up to FY6/19 Q3 will double, but it is expected to rise from Q4 onwards, as this issue will be resolved by that time.

In particular, there are expectations for synergies with Leoconnect and Connect Agency from the 2H onwards. Leoconnect provides consulting services toward improving service quality at call centers, mainly for inbound calls, while Connect Agency provides a Cloud PBX service for companies that conduct sales and call centers making outbound calls. In both cases, the customers are companies in the HIKARI TSUSHIN Group and its agencies. The products that the Company provides to these customers include i-livechat, i-assist, IVR, and i-ask, and the number of customers introducing these services is expected to increase from joint proposals. As previously explained, a track record of joint proposals with Leoconnect is already starting to appear. The Company has one permanent sales staff already positioned in Leoconnect, and the responsible director also allocates half a week to joint-proposal projects.

Outlook



Source: The Company's results briefing materials

The sales method was previously a style of proposing individual products while interviewing the other party about their needs. But the Company's new strategy is to effectively grow earnings by introducing a package-sales method, of creating a package of several of its leading services. It will first progress sales activities for the customers of Leoconnect and Connect Agency, and as there are 200 to 300 companies in the HIKARI TSUSHIN Group, and moreover thousands of companies nationwide when also including the companies in which it has not invested, such as its agencies, these will be the Company's promising potential customers. For Leoconnect, which provides consulting mainly to inbound-calls call centers, the introduction of i-ask and i-assist will reduce the number of calls, making it difficult for it to grow sales. But conversely, it is thought that the introduction of these services will enable it to provide high value-added services, which will improve its profitability. The FY6/19 1H operating profit margin was 2.0% and this is a low-profitability business, but the average profit margin in the customer support industry is around 10%, so in the future it seems fully possible that it will be raised to around the 10% level. Also, looking at the Group as a whole, as sales are growing of the i-series, which has a high profit margin, overall profitability is expected to improve through synergies.

Another topic is that demand, such as for translation services for websites' FAQ pages and for multilingual call center services for foreigners, is expected to increase as inbound measures for companies in advance of the Tokyo Olympics. In the multilingual call centers, the Company has a business collaboration with Inbound Tech, which has a top-class track record domestically, and it is utilizing its resources to provide high quality services. The number of foreign visitors to Japan exceeded 30 million in 2018, and this number is projected to further increase up to the Tokyo Olympics in 2020. As there are many companies, even major ones, that still did not have a multilingual FAQ page, this service is attracting increasing attention, which will lead to an increase in sales in the future.

Outlook

(2) SFA business

In the SFA business, net sales are forecast to increase by 15% to 20%, mainly due to the continued strong sales of e-Sales Manager. The 2H results are forecast to decline slightly compared to the Company's 1H profit level because Softbrain's FY12/19 Q2 results forecasts are somewhat conservative, but in the short term, earnings may fluctuate depending on the timing of deliveries of on-premises projects. However, improving productivity at sales sites has become a management issue for companies, so in the medium term, the annual double-digit increases in sales and profits are expected to continue.

Regarding Softbrain's e-Sales Manager, e-Sales Manager Remix MS, which is a self-serve version intended for SMEs, has been introduced to expand customer groups. It is also developing industry-specific products. While their contribution to earnings is still in the future, they are attracting attention as measures that will lead to growth in the future.

(3) Field marketing business

In the field marketing business, net sales are expected to increase by around 15% to 20% YoY, mainly because orders for spot projects continued to be strong in the 1H. Consumer goods manufacturers are outsourcing their sales promotions operations due to a shortage of human resources. This shortage of human resources is particularly serious in regional cities and other such places, and this would seem to be providing beneficial for the Company, which has built a network of approximately 90,000 field staff across the country.

As a medium-term growth strategy, the Company is starting field operations for B-to-B, and it is also collecting consumer receipt information and adding additional information, such as the purchase reason, to create a database, and developing a POB (Point of Buy) business to sell to companies. Currently, POS information data is in widespread use, but as additional data, for example on the purchase reason and consumer attributes, is still unclear, the Company is acquiring contracts to add this additional information. In addition, it intends to raise-up the number of data collectors to the leading level in the industry through collaborations with companies with many members due to small numbers of data, with the aim of generating profits in two to three years' time.

(4) Customer support business

In the customer support business, the outlook is for sales revenue of around ¥2.6bn. In FY6/18, the amount was ¥856mn for a four-month period. Also, the aim is for operating profit of around ¥60mn. As previously stated, it is possible that sales will slow down due to the reduction in the number of incoming calls following the introduction of IT services, but profitability is expected to rise from FY6/20 onwards. Further, in the event that there is excess capacity for operators due to the reduction in the number of incoming calls, it will be possible to allocate this capacity to efforts to acquire customers from outside of the HIKARI TSUSHIN Group.

(5) Other businesses

In the other businesses, even within Softbrain, the systems development business and publishing business are not considered to be businesses to be actively expanded, and their results are expected to remain at the same level as in the previous fiscal year. On the other hand, the outlook for the EC business in FY6/19 is for double-digit growth in sales and profits from the strong sales of battle-type trading cards.

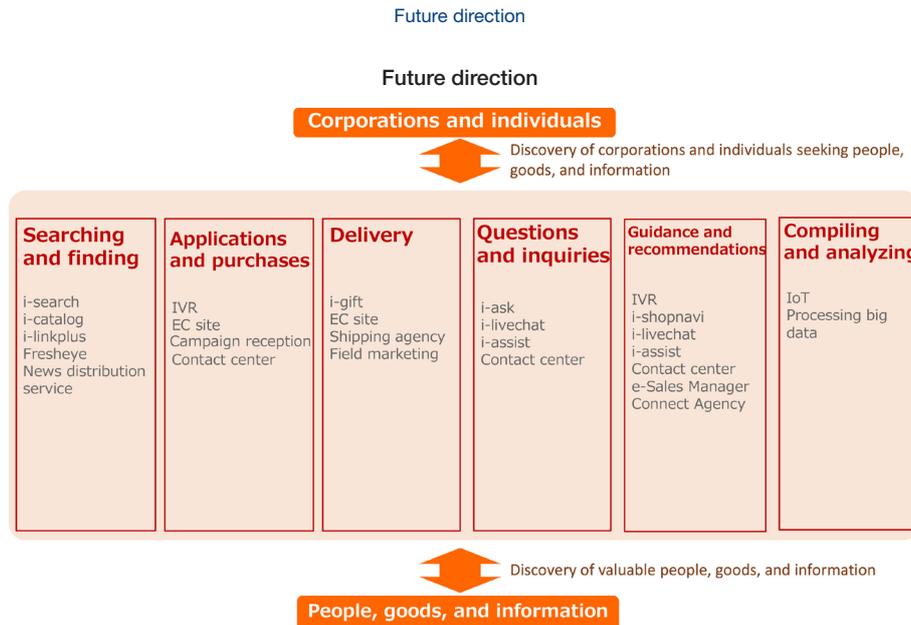
■ Future direction

Newly established a subsidiary to conduct planning and development of new businesses and services, and going forward also, is targeting double-digit growth while aiming to strengthen the service lineup

In terms of its direction for the future, the Company plans to develop a wide range of businesses in the CRM area, which supports communication between corporations and individuals, with the aim of providing the necessary information and goods on the correct timing based on IT services. In addition to the sustainable and stable growth of the existing SaaS/ASP business, its plan is to target double-digit growth by enhancing the synergies with the customer support business acquired through M&A.

The Company established Scala Next, Inc., in November 2018. It has three purposes in establishing it: to conduct the planning and development of new businesses and services, including not only existing IT services for companies, but also services for consumers; to conduct the planning and development of new businesses overseas without excluding any possibilities in terms of the areas to develop a business in and the business content; and to conduct offshore development and management operations for the IT services provided by the Company Group. Of these, in December 2018 it established a branch in Myanmar as an offshore development base, and it is scheduled to start operations in half a year to one year.

By separating into a different company the planning and development functions for new businesses, it is thought that the Company intends to speed-up these functions compared to in the past, to strengthen the services lineup, and to improve the profit margin. For M&A also, it will continue to not focus solely on 100% investment and will investigate a proposal if synergies can be expected from it. The targets for M&A are companies with expertise and technologies for developing new services, companies with a customer base that will lead to an expansion of market share for the existing services, companies with a full service lineup and technologies and expertise that the Company does not possess that will contribute to the evolution of its existing services and to its improved competitiveness, and companies that have many excellent engineers who will strengthen its development capabilities. The Company plans to announce a medium-term management plan in August 2019, and it is thought that the specific strategies for the future will be clarified at that time, so we will be paying attention to its content.



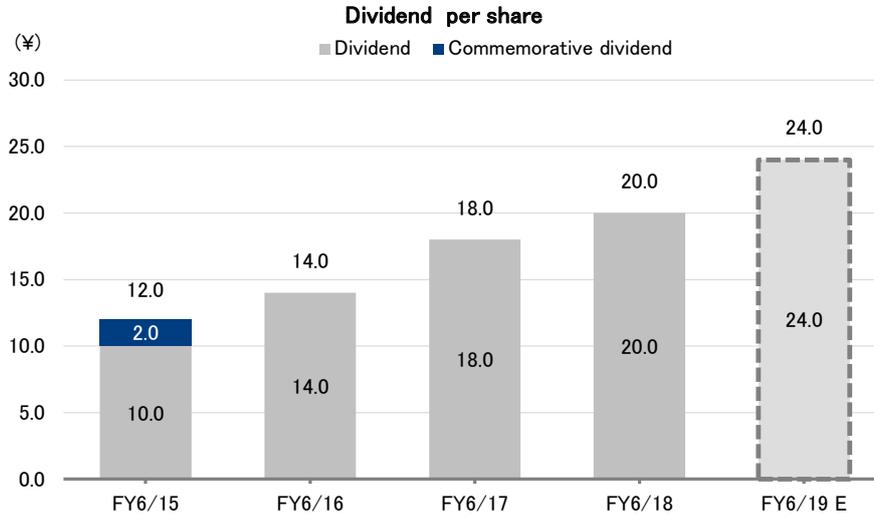
Source: The Company's results briefing materials

Shareholder return policy

Plans to increase the FY6/19 dividend per share by ¥4 YoY to ¥24, for the 10th consecutive fiscal year of higher dividends

The Company's basic policy on returning profits to shareholders is to stably and continuously pay a dividend while also retaining the internal reserves necessary to strengthen its financial structure and develop its businesses in the future. The standard for the consolidated dividend payout ratio is around 50%, and in FY6/19, the Company plans to increase the dividend per share by ¥4.0 YoY to ¥24.0 (dividend payout ratio, 45.6%). This will be the 10th consecutive fiscal year of higher dividends, and it is also expected to continue to increase the dividend in the future, if earnings continue to grow.

Shareholder return policy



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

Information security measure

The Company's mainstay business is SaaS/ASP services that utilize the Internet, so information security is one of its most important management issues. In terms of specific measures, all Group companies have been and continue to work to acquire ISO/IEC27001 certification, which is the international standard for information security, and to implement information security measures incorporating a global-standard third-party perspective. They also strive to thoroughly manage the information assets owned by the Group based on an internal management system. They use in-house servers and some private clouds for the information system, while also constructing backup systems.



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