

# Scala, Inc.

4845

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## Summary

### FY6/20 is a year to build the foundations on which to realize high growth

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 the SaaS/ASP\*<sup>1</sup> business, 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. (currently Scala PLAYce), 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\*<sup>2</sup>, 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 cost benefit for companies that make a lot of calls that last a very short time, such as outbound calls.

#### 1. Overview of FY6/20 1H results

In the FY6/20 1H (July to December 2019) consolidated results, sales revenue increased 2.4% year-on-year (YoY) to ¥8,606mn and operating profit decreased 34.2% to ¥747mn. Sales continued to trend upward, including in the mainstay SaaS/ASP business and in subsidiary Softbrain’s SFA business. However, the main reasons for the decrease in profits were the increase in upfront investment (mainly human-resources investment) costs toward growth, and also as temporary costs (¥81mn) were incurred following the relocation of the head office. In particular, in the SaaS/ASP business, the Company invested in upfront costs in order to complete by the end of 2020 the construction of the new offshore development system in Myanmar and the new development platform to increase development efficiency. In parallel with this, it progressed preparations for the outside-orders Cloud platform for external consignment partners, which is considered to realize high growth from 2021 onwards.

#### 2. Outlook for FY6/20

For the FY6/20 results outlook, the Company does not disclose forecasts due to the large impact of the new businesses that it will focus on going forward. In the 2H, in addition to the upfront investment, it seems that the effects on sales of the spread of the new-type coronavirus infection are starting to appear, so profits may decline for the full fiscal year. In March 2020, the Company newly acquired the shares of Grit Group Holdings Co., Ltd. (hereafter, GGH) for ¥500mn, and in April 2020, it announced that it had made it a wholly owned subsidiary. GGH conducts businesses inside and outside Japan, including a human resources business, a regional revitalization business, and a sports and infant education business, and in the most recent fiscal period, its sales scale was estimated to be ¥1,999mn and its operating profit ¥31mn. In terms of synergies with GGH, in the regional revitalization business, introductions are expected to increase of the Company’s ASP service and the next generation digital ID service provided by blockhive, Inc., its business partner, at the approximately 600 local governments that are GGH’s customers. Also, in Myanmar, GGH is progressing a children education business and a FinTech business in collaboration with local financial institutions, while for the aspects of possibilities for business expansion and the recruitment of human resources as well, acquisitions of excellent human resources through GGH can be expected in Myanmar.

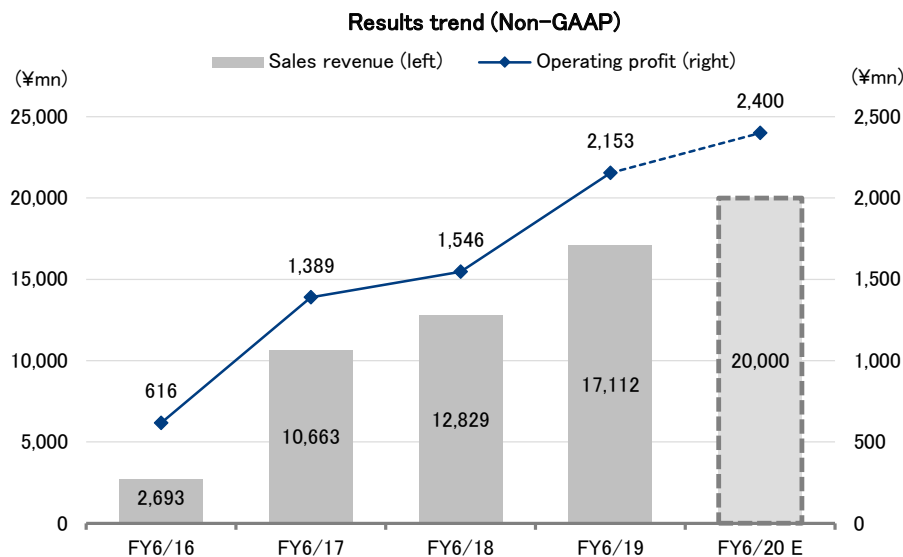
Summary

3. Medium-term management plan and initiatives

The medium-term management plan announced in August 2019 calls for the Company to implement its three capabilities (the capability to determine real issues, the capability to discover hidden value of resources, and the capability to maximize value by proposing and executing optimal combination of issues and resources) to develop the three segments of the Value Creation Support Business, the IT/AI/IoT-related Business (an existing business), and the Social Issue-solving Business. The plan's numerical management targets include sales revenue of ¥100bn and operating profit of ¥10bn in FY6/25, and sales revenue of ¥500bn and operating profit of ¥50bn in FY6/30. In the Value Creation Support Business, the Company newly established Scala Partners, Inc., and it has started providing management consulting services toward improving enterprise value. In addition, in November 2019 it established SCL Capital LLC., which will start investment fund management from May 2020, with the investment targets being listed companies with market capitalizations of ¥10bn or less. It is considered that it wants to first invest in around 10 companies, targeting a total investment amount of ¥1bn to ¥2bn. The target for the IT/AI/IoT-related Business is an annual sales growth rate of more than 20%, while for the Social Issue-solving Business, in addition to the domestic regional revitalization business, it is thought that it is developing an IT solutions business for developing countries, including to prepare health and education environments and for environmental issues. Toward achieving the targets, the policy is also to progress the M&A strategy continuously.

Key Points

- In the FY6/20 1H results, sales increased but profits decreased due to the rise in upfront investment costs
- As a new M&A, GGH, which mainly conducts a human resources business and a regional revitalization business, joined the Group
- The Company's medium-term management plan targets sales revenue of ¥500bn and operating profit of ¥50bn in FY6/30



Source: Prepared by FISCO from the Company's financial results and medium-term management plan

## Company profile

### The SaaS/ASP services 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 such 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 distributed processing (client/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.

The Company made subsidiaries of Softbrain, a major sales support software company (as of the end of December 2019, an ownership ratio based on voting rights of 50.2%) in July 2016; plube (ownership ratio: 100.0%, currently Scala PLAYce), an EC website management company, in August 2017 in order to enter the EC business; 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 (ownership ratio: 51.0%), 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. Also, in December 2018, as part of the preparations toward strengthening development capabilities and deploying the overseas business, the subsidiary Scala Next, Inc., established a Mandalay branch in Myanmar, and it has started to recruit local engineers and will be a base for offshore development.

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

#### 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

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Date	Major event
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)
July 2019	Established Scala Partners Inc.
October 2019	Made a subsidiary of J-Phoenix Research Inc.
November 2019	Established SCL Capital LLC.
April 2020	Made a subsidiary of Grit Group Holdings, Co. Ltd.

Source: Prepared by FISCO from the Company's website

**Subsidiaries by business segment and business content**

Business segment	Subsidiary	Ownership ratio (%)	Main business
The SaaS/ASP business	Scala Communications Inc.	100.0	SaaS/ASP services and software development, sales, and maintenance
	Scala Services Inc.	100.0	Provides solutions to enhance business efficiency and to improve added value
	Scala Next	100.0	Development and operations of the SaaS/ASP services, as well as planning and development of new businesses
	Connect Agency	51.0	Cloud-based PBX services, telephone equipment for office and call-center operations, and management of telephone lines, etc.
SFA business	Softbrain Co., Ltd.	50.2	Sales of support-system licenses and provision of Cloud services
	Softbrain Service Co. Ltd.	98.7*	Sales consulting and sales-skills training
	Softbrain Integration Co., Ltd.	100.0*	Support and consulting for introductions of iPads, etc., and education and operations support, etc.
Field marketing business	Softbrain Field Co., Ltd.	85.6*	Field-activity operations, market research and other services
Customer support business	Leoconnect, Inc.	66.0	Consulting service relating to customer support including call center management and BPO
Other	Scala PLAYce Inc.	100.0	Management of an EC site for the buying and selling of battle-type trading cards
	Softbrain Offshore Co., Ltd.	100.0*	Outsourced development of software
	Diamond Business Planning, Inc.	70.0*	Services including the planning, editing, and publishing of business books
	J-Phoenix Research Inc.	100.0	Management consulting, securities analyst reports, investment fund management and support, etc.
	SCL Capital LLC.	100.0	Investment fund management
	Scala Partners Inc.	100.0	CSV innovation, CSV incubation, and CSV investment

\*Softbrain's consolidated subsidiaries. Values are Softbrain's ownership ratios.

Note: as of the end of December 2019

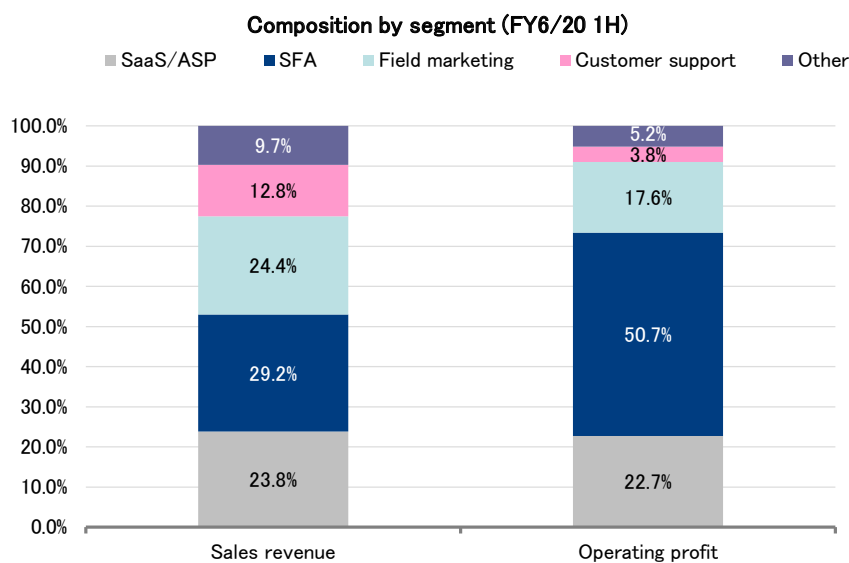
Source: prepared by FISCO from the companies' securities reports and business briefing materials.

## Holds a 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 discloses results divided into the mainstay SaaS/ASP business, in which it provides various IT services that contribute to improving operating efficiency in companies' CRM fields, and also the SFA (Sales Force Automation) business conducted by the Softbrain Group, the field marketing business, the customer support business conducted by Leoconnect, and other businesses (which are the Softbrain Group's systems development and publishing businesses, Scala PLAYce's EC business, and also the businesses of J-Phoenix Research Inc., Scala Partners, and SCL Capital).

In the percentages of total net sales by business segment in FY6/20 1H, the SaaS/ASP business provided 23.8%, the SFA business 29.2%, the field marketing business 24.4%, the customer support business 12.8%, and other businesses 9.7%. Looking at the percentages of segment profit also, the SaaS/ASP business provided 22.7%, the SFA business 50.7%, and the field marketing business 17.6%, so these 3 businesses provided approximately 90% of the total.



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

#### (1) SaaS/ASP business

The main services in SaaS/ASP 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.

Company profile

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.

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. Therefore, IVR is steadily introduced by many companies as a service that is highly convenient.

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 (now, Sampo Japan Insurance Inc.), 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-flow	Progress management and approval system
CRM service	i-assist	Web chatbot system
	i-livechat	Web chat system
	i-gift	Digital gift service
Telephone system service	SaaS-type IVR	24-hour, 365-day automated voice response
	Cloud PBX service	IP telephone service
News distribution service	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

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## Company profile

**(2) The 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. In addition, e-Sales Manager has an excellent reputation as being No. 1 for usability. It is the industry-leading product from domestic SFA vendors, and it 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 2019, the Company has approximately 92,000 registered staff nationwide who cover more than 180,000 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 (sales agent) as well as B-to-C.

The systems development business and publishing business are included in the other businesses segment. But even for both businesses combined, 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**

The customer support business conducted by Leoconnect provides consulting operations for the management of inbound call centers (24 bases nationwide), from receiving inquiries about customer companies' services and products through to the follow-up after the response, and its main customers include the HIKARI TSUSHIN Group and its agencies. At the present time, it is aiming to improve the call centers' productivity by introducing technologies such as i-livechat, i-assist, and IVR into call centers, and by introducing C7, which is a new core system that reflects customer needs jointly developed with Scala Communications (launched in November 2019), while its policy is also to expand the business through acquiring customers outside of the HIKARI TSUSHIN Group.

**(4) Other businesses**

Other businesses include the Softbrain Group's systems development and publishing businesses, and Scala PLAYce's EC business, which manages "yuyu-tei," an EC website for buying and selling battle-type trading cards. The site has a high name recognition in the gaming industry and is influential to the extent that it is used as a reference indicator for the pricing of used cards, and so it is known as the industry's No. 1 EC shop. Many of the purchases on the site are made by overseas users, and starting in FY6/20, users will be able to purchase from overseas users as well. Other businesses also include the management consulting business of J-Phoenix Research, which has newly been made a subsidiary, the CSV innovation (management and business consulting) business of newly established Scala Partners, the CSV investment business, and SCL Capital's investment fund business.

## 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 the extensive lineup of services developed in this manner differentiates it from its competitors. The ability to propose multiple services in packages enables the Company to satisfy diverse customer needs, and this cross-selling helps to raise the average price per customer, boost customer satisfaction, as well as prevent cancellations. The Company has done business 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 high 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 eventually.

## Results trends

### In the FY6/20 1H results, sales increased but profits decreased due to the rise in upfront investment costs

#### 1. Summary of FY6/20 1H results

In the FY6/20 1H consolidated results, sales revenue increased 2.4% YoY to ¥8,606mn, operating profit decreased 34.2% to ¥747mn, pretax profit declined ¥34.8% to ¥734mn, and net income attributable to owners of the parent fell 44.3% to ¥255mn. The Company does not disclose forecasts, but it seems that the results were slightly below expectations, including due to the delay of an order for a large-scale project in the SaaS/ASP business.

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Results trends

For sales revenue, sales increased in each of the mainstay SaaS/ASP business, the SFA business, and the field marketing business. However, the profit-decrease factors included the increase in upfront investment costs (mainly personnel costs and development costs) toward growth in the future in the SaaS/ASP business and the SFA business, and also as temporary costs were incurred following the relocation of the head office (¥81mn, including from the changes to the amortization periods of buildings and accompanying facilities, costs relating to replacements of PCs, and rebranding-operations costs due to the relocation). Also, it seems that the costs to launch the newly established subsidiaries, including Scala Partners and SCL Capital were another factor causing profits to decrease by around tens of millions of yen.

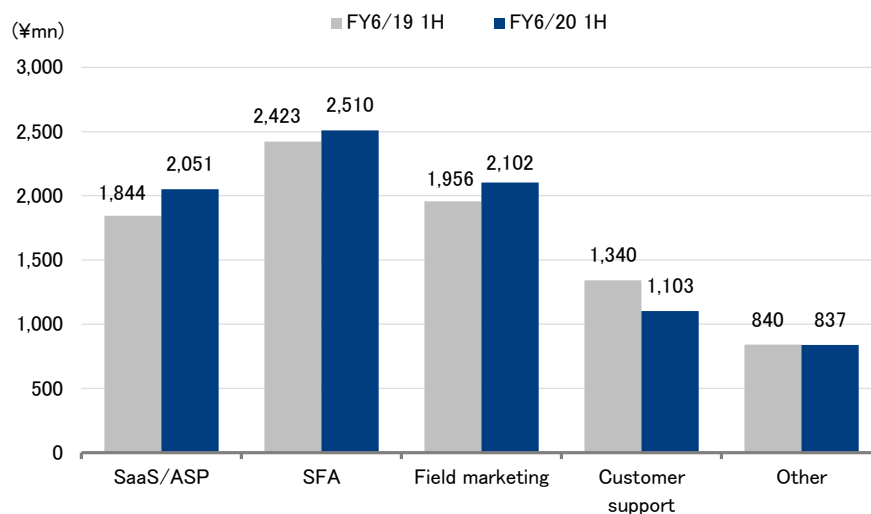
**FY6/20 1H consolidated results**

(¥mn)

	FY6/19 1H		FY6/20 1H		YoY
	Results	vs. sales	Results	vs. sales	
Sales revenue	8,405	-	8,606	-	2.4%
Operating profit	1,135	13.5%	747	8.7%	-34.2%
Pretax profit	1,126	13.4%	734	8.5%	-34.8%
Net income attributable to owners of the parent	458	5.5%	255	3.0%	-44.3%

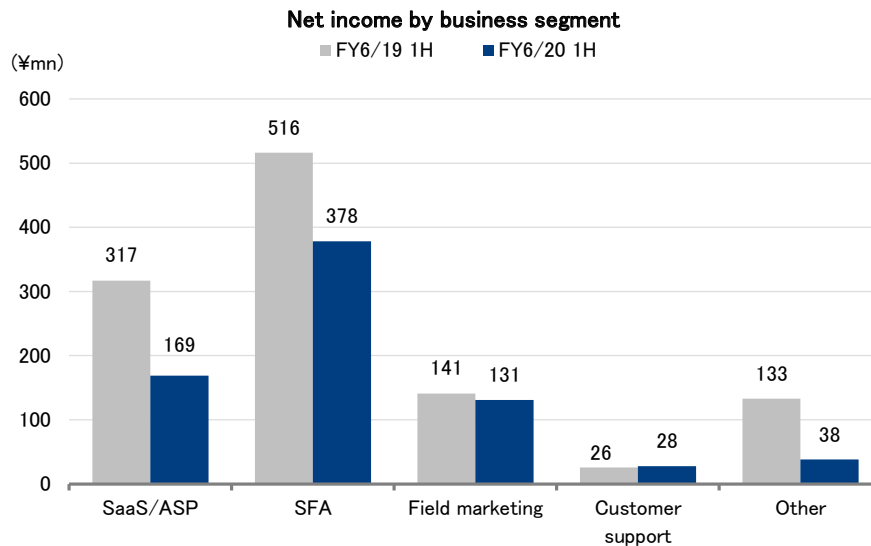
Source: Prepared by FISCO from the Company's financial results

**Net sales by business segment**



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

## Results trends



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

## In the mainstay SaaS/ASP business, is building the business foundations on which to realize high growth

### 2. Trends by business segment

#### (1) SaaS/ASP business

In the SaaS/ASP business, sales revenue increased 11.2% YoY to ¥2,051mn and operating profit decreased 46.4% to ¥169mn. On looking by Group company, results were strong in Scala Communications, which provides the main services like i-ask and i-assist, with sales revenue increasing 1.4% YoY to ¥1,759mn and operating profit rising 6.8% to ¥630mn. Although introductions of i-ask, i-assist and other services were steady, it would appear that the results were below the Company's forecasts due to the delay in the order of a large-scale development project.

As specific introduction projects in the current 1H period, the Company simultaneously introduced the i-ask FAQ system and the i-assist Web chatbot system for Kobe City, and they are contributing to improving convenience for the city's citizens and enhancing the efficiency of inquiries-related operations. It has also introduced i-livechat onto the member's website of Haseko Corporation<1808>, enabling operators responding to inquiries to provide guidance in real time using Web chat, while in addition, they can provide guidance by chat on the registered FAQ through coordination with the already introduced i-ask.

Results trends

In addition to the above, the Company is developing an “automotive insurance 1 click insurance premium approximate estimate system” for E.design Insurance Co., Ltd., which is part of the Tokyo Marine Holdings <8766> Group. Previously, in order to accurately estimate automotive insurance on a website, it was necessary to answer all the questions on around 30 items. But in order to meet the needs of users who first want an approximate estimate, it has developed a system in which the questions have been narrowed down to just 8 items that can be answered intuitively, each with just a single click. This system has been attracting a lot of attention, including winning the Good Design Award for the first time for online automotive insurance, and inquiries are increasing not just from the insurance industry, but from other industries as well. Also, for Sampo Japan, it introduced a service that uses IVR to receive cancellations of special-contract fire insurance. It had previously automated the process of operator responses to improve productivity, and in addition, it has linked API to the sales force, which is leading to even further improvements in work efficiency. For a collaborative project with Leoconnect, it is progressing introductions for companies including Haluene Co., Ltd., hi-ho Inc., and Fene Co., Ltd., in the HIKARI TSUSHIN Group, and it has completed introductions for a total of 12 companies.

**The main new customers for SaaS/ASP business services (FY6/20 1H)**

Type	Product	Description	Customers
Site assistance service	i-search	Site internal search engine	Haluene Co., Ltd.
CMS service	i-ask	FAQ system	Haluene Co., Ltd., Fene Co., Ltd., hi-ho Inc., Community Network Co., Ltd, Kobe City
CRM service	i-assist	Web chatbot system	Kobe City
	i-livechat	Web chat system	Haseko Corporation
Telephone system service	SaaS-type IVR	Automated voice response service	Sampo Japan Insurance Inc.

Note: Red text indicates collaborative projects with Leoconnect.

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

Connect Agency's sales revenue increased from ¥108mn in the same period in the previous fiscal year to ¥291mn, and operating profit grew from ¥13mn to ¥33mn. Its consolidation period in the same period in the previous fiscal year was only two months, so on an actual basis, it seems that the results were about at the same level YoY. It is progressing responses for Softphone, for which customer needs are high, and the outlook is that introductions will be advanced in the 2H.

Scala Next, which was newly established in November 2018, receives consignment development projects from Scala Communications and plans and develops new businesses and new services, so it has no sales revenue from external customers. It recorded an operating loss of ¥62mn, but this was mainly due to development costs for these consignment projects and for new services. It also established an offshore development base in Myanmar and recruited around 25 engineers for it, and it has started undertaking one part of the development work.

At Scala, which is responsible for the head office functions, the operating loss increased from ¥300mn in the same period in the previous fiscal year to ¥449mn. But as previously stated, this was mainly due to increases in costs, of temporary costs of ¥81mn following the head-office relocation and also as the Company conducted upfront investment toward realizing the medium-term management plan.

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Results trends

SaaS/ASP business results by Group company

Group company	FY6/19 1H			FY6/20 1H			YoY change amount	
	Sales revenue	Operating profit	Profit margin	Sales revenue	Operating profit	Profit margin	Sales revenue	Operating profit
Scala Communications Inc. Scala Services Inc.	1,735	590	34.0%	1,759	630	35.8%	24	39
Scala Next (upfront-investment stage)	-	-	-	-	-62	-	-	-62
Connect Agency (its consolidation period in the same period in the previous fiscal year was only 2 months)	108	13	12.2%	291	33	11.5%	183	20
Scala (upfront investment, head office functions)	0	-300	-	0	-449	-	-	-148
Inter-company transactions with other segments	0	14	-	0	18	-	-	4
<b>Total</b>	<b>1,844</b>	<b>317</b>	<b>17.2%</b>	<b>2,051</b>	<b>169</b>	<b>8.3%</b>	<b>207</b>	<b>-147</b>

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

### (2) SFA business

In the SFA business, sales revenue increased 3.6% YoY to ¥2,510mn and operating profit declined 26.7% to ¥378mn. Sales trended strongly of the mainstay product, the e-Sales Manager sales support software, mainly for the Cloud-based version. But sales of education and training services declined and the sales-increase rate was sluggish. In profits, the profit-decrease factors included the increases in upfront investment toward growth and in development costs to improve service quality, and also the recording of head office relocation-related costs. It seems that compared to the Company forecasts, sales revenue and operating profit were both below forecast.

### (3) Field marketing business

In the field marketing business, sales revenue increased 7.4% YoY to ¥2,102mn and operating profit decreased 7.5% to ¥131mn. Results trended strongly for the regular field service, which is a stock business mainly for major consumer goods manufacturers. But the reason for the decrease in profits was that costs increased in the B-to-B area, including sales costs to acquire projects for third-party sales services and personnel costs.

### (4) Customer support business

In the customer support business, sales revenue decreased 17.7% YoY to ¥1,103mn, while operating profit increased 8.5% to ¥28mn. Sales revenue decreased due to the progress made in reducing the number of incoming calls from the effects of introducing services like i-ask and IVR and in liquidating unprofitable projects, but profitability improved.

The C7 core system, which was jointly developed with Scala Communications and which is expected to further improve profitability, was completed in FY6/20 2H. The Company started providing it from November 2019 and several companies have already decided to introduce it. C7 is a system to digitize call centers' day-to-day operations and management processes, and to narrow down the functions to the absolute minimum necessary, which means that compared to conventional systems, it can be introduced at a significantly reduced cost. In the future, it will be introduced sequentially into Leoconnect's customers of call center businesses, to support their enhanced operations efficiency and improved productivity. By introducing C7, call center businesses can expand their operations-processing capabilities and thereby acquire orders for new projects. For these businesses, the Company is obtaining introductions for new customers outside of the HIKARI TSUSHIN Group, and it records the C7 usage fees as sales revenue by proportionally dividing them between the SaaS/ASP business and the customer support business, depending on the project.

Results trends

**(5) Other businesses**

In other businesses, sales revenue decreased 0.3% YoY to ¥837mn and operating profit declined 70.9% to ¥38mn. Looking at the breakdown by business, in the EC business, sales revenue was strong due to the active buying and selling of battle-type trading cards, increasing 18.2% YoY to ¥488mn, but operating profit declined 3.7% to ¥41mn. It seems that the main reason for this decline in profits was that it is currently developing a smartphone app version of its card shop “yuyu-tei,” an EC website, so development costs increased.

In the systems development business, projects for existing users were steady and sales revenue increased 0.1% YoY to ¥222mn, but operating profit decreased 74.9% to ¥4mn due to the rise in development costs. In the publishing business, book sales were sluggish, so sales revenue declined 39.6% YoY to ¥123mn and operating profit fell 65.8% to ¥24mn.

Other businesses include the businesses of Scala Partners, such as the CSV innovation (management and business consulting) CSV incubation, and CSV investment businesses. In November 2019, it announced that it had invested (¥22mn) in VALT JAPAN Co., Ltd., as the first project for the CSV investment business. The Company provides various types of employment support specialized for people with disabilities through the start-up company it established in 2014, and it has built a network in Japan of more than 6,000 people with disabilities. Recently, in the Study Group for an Employment System that Considers People with Disabilities, which is one of the support businesses of the Nippon Foundation, it became the only private-sector company participating as an outside member. It also plans to advance its partnership with Kamakura City (concluded a partnership agreement in October 2019) for the demonstration experiment of NEXT HERO, which is system that supports both the employment and health management of people who have difficulties in finding employment. Going forward, it will support the development of the NEXT HERO system in the Scala Group. In the FY6/20 1H results, no sales revenue was recorded and the operating loss was ¥21mn.

## Interest-bearing debt increased, but the net cash equilibrium maintained a healthy financial condition

### 3. Financial condition and business indicators

Looking at the financial condition at the end of FY6/20 1H, total assets were up ¥4,222mn on the end of the previous fiscal period to ¥22,917mn. Breaking down the change factors, in current assets, there were increases in cash and cash equivalents of ¥770mn and operating receivables and other receivables of ¥582mn. In non-current assets, usage-rights assets increased ¥2,120mn following the adoption of IFRS No.16, while goodwill rose ¥202mn.

Total liabilities were up ¥3,468mn on the end of the previous fiscal period to ¥12,554mn. Interest-bearing debt increased ¥1,523mn, while lease liabilities rose ¥2,167mn following the adoption of IFRS No.16. Total equity increased ¥754mn to ¥10,362mn. The main factors were increases in capital of ¥95mn due to the exercising of share acquisition rights, and in capital surplus of ¥309mn, mainly due to the exercising of share acquisition rights and exchanges of shares, and also because while net income attributable to owners of the parent of ¥255mn and net income attributable to non-controlling interests of ¥218mn were recorded, dividend payments of ¥203mn were also recorded.

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Results trends

Looking at the business indicators, the ratio of equity attributable to the owners of the parent declined by 4.6 percentage points (pp), from 37.5% at the end of the previous fiscal year to 32.9%. Of this decline, around 3.5pp was from the effect of recording lease assets following the adoption of IFRS No.16, so on an actual basis, it only declined slightly more than 1pp. The main factor was the accumulation of interest-bearing debt for upfront investment costs toward realizing the medium-term management plan, and the interest-bearing debt ratio rose from 85.3% at the end of the previous fiscal period to 99.4%. But as net cash (cash and cash equivalents – interest-bearing debt) was kept at the equilibrium level, the Company can be judged to be maintaining financial soundness. However, goodwill accounts for approximately 28% (¥6,394mn) 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 is extremely low.

**Consolidated balance sheet**

	(¥mn)				
	FY6/17	FY6/18	FY6/19	FY6/20 2Q	Change
<b>Current assets</b>	7,167	8,120	10,165	11,575	1,409
(Cash and cash equivalents)	4,999	4,950	6,393	7,163	770
<b>Non-current assets</b>	7,774	8,112	8,529	11,341	2,812
(Goodwill)	5,684	5,787	6,192	6,394	202
<b>Total assets</b>	14,941	16,233	18,694	22,917	4,222
<b>Total liabilities</b>	7,021	7,587	9,086	12,554	3,468
(Interest-bearing debt)	4,768	4,793	5,978	7,502	1,523
<b>Total equity</b>	7,919	8,645	9,608	10,362	754
(attributable to non-controlling interests)	1,934	2,196	2,597	2,813	215
<b>Indicators</b>					
<b>(Stability)</b>					
Ownership ratio attributable to owners of the parent	40.1%	39.7%	37.5%	32.9%	-4.6pt
Interest-bearing debt ratio	79.7%	74.3%	85.3%	99.4%	14.1pt
<b>(Profitability)</b>					
ROE	60.4%	11.4%	14.1%		
ROA	30.4%	9.9%	12.2%		
Operating margin	35.0%	12.1%	12.6%		

Note: Based on IFRS

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



## ■ Outlook

### For the FY6/20 results, a decrease in profits is unavoidable due to the impact of the spread of the new-type coronavirus infection

#### 1. Outlook for FY6/20

In the medium-term management plan, the Company clarifies its policy for new business development from FY6/20 onwards, but as there are many uncertainties for these new businesses, it has not disclosed forecasts for the FY6/20 results. In the results outlook for the existing businesses presented in the medium-term management plan, it forecasts higher sales and profits, with sales revenue to increase 16.9% YoY to ¥20,000mn and operating profit to rise 11.4% to ¥2,400mn. But as previously stated, the rates of progress in the SaaS/ASP business and the SFA business up to the 1H were slightly below forecast, and in addition, the impact of the spread of the new-type coronavirus infection on its sales activities started to appear from February. Therefore, at FISCO we think that profits may decline for the full fiscal year. In this severe market environment, the Company's policy is to work on the following initiatives toward growth in the future.

##### (1) SaaS/ASP business

In the SaaS/ASP business, development projects are becoming larger in scale, and alongside this, the tendency is also for their degree of difficulty to increase. In this situation, the current issues include that the lack of development resources means that the limits of in-house production are starting to be seen. As the policy to solve this issue and to realize high growth in the future, the Company is working on three initiatives; "the construction of an offshore development system in Myanmar and the reconstruction of the in-house development platform," "the construction of an outside-orders Cloud platform," and the "construction of a process to increase sales of appealing general-purpose services." It is thought that it will have constructed these systems by the end of 2020, which will lead to high growth from 2021 onwards.

Of these initiatives, the Company is working on the following three points for the "reconstruction of the in-house development platform."

##### a) Creating micro services from reusable modules

To enable flexibility in development cooperation at the service level by modularizing from the upstream process of development, the Company intends to update its systems, including existing services. Modularization will make possible not only external consignments of customized developments, but also development conducted at the same time and in parallel with large-scale projects, which will increase development capacity. It will also make it possible to increase sales of non-customized, general-purpose version of services.

##### b) A development method with functionality

It is improving productivity by introducing a development method with no reworking. Introducing this method enables the project team to be constructed more flexibly, while it is also expected to have effects that will lead to improved engagement among the engineers.

##### c) Incorporating the latest technologies.

The Company is advancing developments that incorporate the latest technologies for each service in order to improve operating performance and scalability. It is also establishing technology branding that will lead to the recruitment of highly skilled engineers.

#### Outlook

If the new development platform can be constructed through these initiatives, not only will the profit margin improve, it will also make it possible to utilize external consignment partners and to increase sales of general-purpose services, which can be expected to further accelerate the pace of sales growth. For these external consignment partners, the Company plans to establish the outside-orders Cloud platform and progress partnerships.

As the projects expected to be ordered in FY6/20 2H, in the DX service field, the Company has currently proposed to multiple insurance companies an insurance recruitment core system, and it is expected that several of them will decide to introduce it. It is a service that contributes to improved operations efficiency through a system that standardizes processes, from the acceptance of contract applications through to the operations process. Its initial introduction costs are expected to be from ¥20mn to ¥50mn and the monthly usage fees from ¥500,000 to ¥2mn. In the AI services field also, following requests from customers, it is developing an AI credit system for credit card companies, and it is currently at the stage of proposing it to several companies. The initial introduction costs will be from ¥10mn to ¥20mn and the monthly usage fees from ¥300,000 to ¥500,000. In addition, in the telematics (driving-diagnostic services) field, it expects an order for an additional development project from an existing customer, and the outlook is that this order will be on a scale of tens of millions of yen to hundreds of millions of yen. The situation is fluid with regards to whether or not the sales of these projects will be recorded in FY6/20, but as the demand is certain, there is no change to the fact that they will contribute to earnings in the future.

#### (2) SFA business

In the SFA business, despite the recent severe market conditions, sales of e-Sales Manager continue to grow. In addition, for e-Sales Manager Remix MS, which is the self-service version intended for medium-sized companies and SMEs, the Company plans to conduct fully fledged sales-promotion activities from the summer of 2020 onwards. Compared to previously, it widens the scope of potential customers by providing a service in which the service fee is kept down, and the strategy is to accelerate sales growth from 2021 onwards.

#### (3) Field marketing business

In the field marketing business, results are expected to trend steadily in the FY6/20 2H as well. This is because the spread of the new-type coronavirus will have hardly any impact on retail sales of daily-use products and healthcare products, and in fact, it will actually stimulate sales of some products. There has also been an increase in new projects for B-to-B third-party sales services, such as introducing cashless payment systems in stores and lodging facilities, and this is expected to contribute to an increase in earnings going forward.

#### (4) Customer support business

In the customer support business, the Company's strategy is to grow earnings by improving operating efficiency and increasing the call centers' processing capacities through introducing the C7 core system, while at the same time, reviewing unprofitable projects and working to acquire new customers. For the future, it is targeting an operating profit margin of 10%.

#### (5) Other businesses

The outlook for the EC business is that the double-digit increase in sales will continue in the FY6/20 2H as well. Going forward also, the Company's policy is to expand the business as the EC site that acquires the most trading card game users, while also increasing the number of game titles it handles and providing game tips in a timely manner. Conversely, the outlook for the systems development and publishing businesses is that results in the 2H will remain around the same levels as in the 1H, because it is not considering active business expansion even within the Softbrain Group.

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Outlook

In February 2020, Scala Partners announced that it had concluded a capital and business partnership agreement with blockhive, Inc., a GovTech\*1 company, toward spreading the use of next generation digital ID technologies. Since 2017, blockhive has been developing and providing digital ID and blockchain-related solutions in Estonia, and as the company that cooperates with this country's e-Residency (electric residency program) \*2 team, it is aiming to increase domestic introductions of the digital ID technologies it has developed. In December 2019, the Company partnered with the Digitization Promotion Project of Kaga City, Ishikawa Prefecture, and it plans to provide an electronic application platform in coordination with xID\*3, which is a digital identify card app released in March 2020. Members of the Scala Group are also introducing services, including in Kobe City and Shibuya Ward, Tokyo, and in the future, the Group will progress the digitization of government-administrative services by coordinating the Company's service development capabilities with blockhive's technological capabilities, and also by utilizing GGH's network of local governments, as described below. In the Scala Group, the policy is to develop and increase sales of applications and services that coordinate not only with existing services, but also with xID.

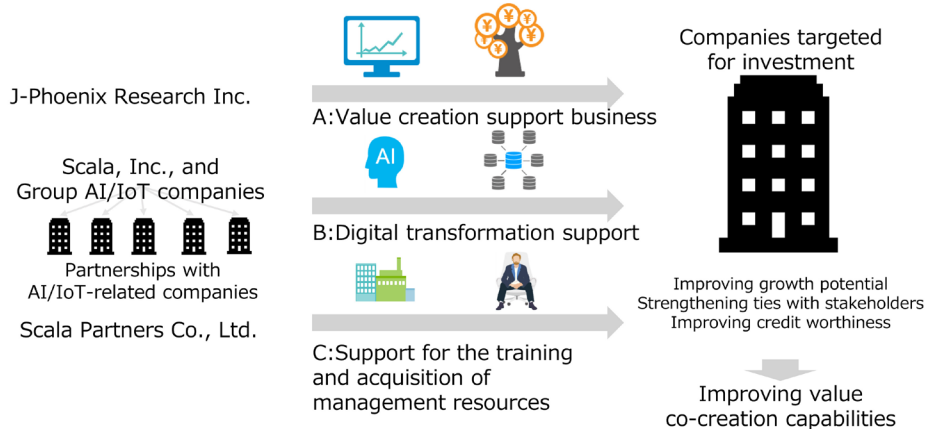
\*1 GovTech is the abbreviation of Government Technology, which refers to IT services that aim to use technologies to solve the problems facing governments and government administrations. The companies that support these services are called GovTech companies.

\*2 e-Residency is a system in which Estonian citizens who do not reside in Estonia can be registered electronically as Estonian residents. Using e-Residency makes it possible for foreigners to establish a company and open a bank account in Estonia, even while living overseas.

\*3 xID is a digital identity card app that coordinates with the My Number card to make it possible to easily identify the person in question.

The companies that SCL Capital will invest in include those that are attempting solve social problems, such as SDGs, through their businesses, and those that are aiming to create new industries. To enable them to smoothly realize sustainable growth, SCL Capital is forming the Value Co-creation Engagement Fund to provide managerial, financial, and IR support, and it plans to start managing it from FY6/20 Q4. Its investment targets are companies with market capitalizations of ¥10bn or less, and in the first year, it is looking to invest a total ¥1bn to ¥2bn in around 10 companies. The target companies will be selected by J-Phoenix Research.

**The three elements supporting the Value Co-creation Engagement Fund**



Source: The Company's results briefing materials

Outlook

## As a new M&A, GGH, which mainly conducts a human resources business and a regional revitalization business, joined the Group

### 2. Made GGH a subsidiary

In March 2020, the Company announced that it had acquired GGH's shares for ¥500mn and made it a wholly owned subsidiary. GGH conducts businesses inside and outside of Japan, centered on a human resources business (employment support for sports-related students), but also a regional revitalization business (regional revitalization support, U-tur and I-turn employment support, etc.), and a sports and infant education business. In the most recent fiscal period (FY5/19), its sales scale was approximately ¥1,999mn and its operating profit was ¥31mn, and all of its businesses are profitable. It has approximately 130 employees in its group.

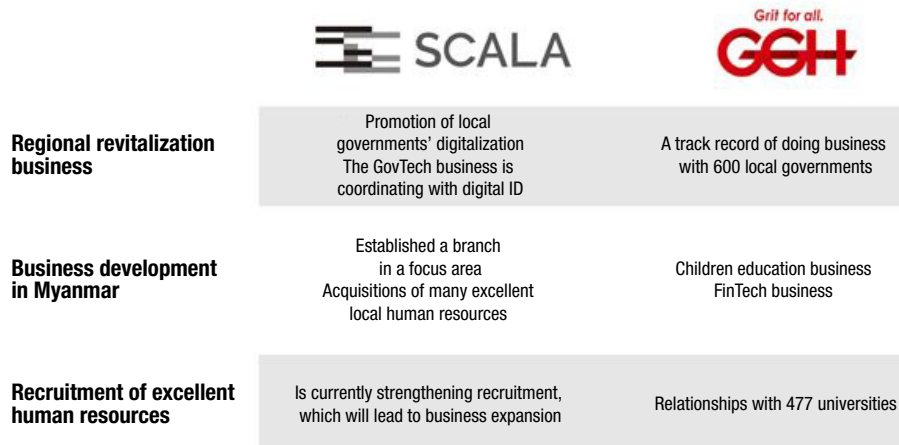
It is considered that three synergies will be generated from making it a subsidiary. First, in the regional revitalization business, the Company will be able to provide proposals for introductions of its SaaS/ASP services and its business partner blockhive's xID service, to the approximately 600 local governments that are GGH's customers. In the future, the use of the My Number card will spread widely, such as through its coordination with health insurance card, so it is inevitable that the use of digital identity cards like xID will also spread. The Group is actively working to capture this demand, and it is aiming to grow the regional revitalization business through advancing the digitalization of government-administrative services.

The second synergy is considered to be accelerating business growth in the overseas market. GGH is developing a children education business in Myanmar (management of Ballschule classes\*) and a FinTech business in partnership with local financial institutions. For the Company, which in the future intends to provide IT services in Myanmar in the insurance and healthcare fields, its partnership with GGH can be expected to have business-promotion effects.

\* Ball games-based classes created in Germany. At the same time as increasing basic motor skills, they are intended to foster spontaneity and social skills.

The third synergy is considered to be strengthening the recruitment of human resources. GGH conducts an employment support business, and it has built long-standing relationships with 477 universities in Japan, centered on 6 universities in metropolitan Tokyo. It is considered that the Company can expect further business growth by acquiring excellent human resources through GGH.

### Synergies with GGH



Source: Company material

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## In the medium-term management plan, is targeting sales revenue of ¥500bn and operating profit of ¥50bn in FY6/30

### 3. Medium-term management plan

In August 2019, the Company announced its medium-term management plan to run to 2030. In terms of the plan's basic policy, the strategy is to aim for growth by categorizing the Company's capabilities into three—"the capability to determine real issues" (the Value Creation Support Business), "the capability to discover the hidden value of resources" (IT/AI/IoT-related business), and "the capability to maximize value by proposing and executing the optimal combination of issues and resources" (the Social Issue-solving Business)—and then setting business policies for each of these capabilities.

The plan's numerical management targets are sales revenue of ¥100bn and operating profit of ¥10bn in FY6/25, and sales revenue of ¥500bn and operating profit of ¥50bn in FY6/30. As sales revenue was ¥17.1bn and operating profit ¥2.1bn in FY6/19, it is aiming for growth through developing not only its existing businesses, but new businesses as well, while it also has in sight developing its businesses for overseas markets. The Company started conducting upfront investment in FY6/20 to build the business foundations in order to achieve these targets.

**Initiatives and Sales Revenue Targets by Segment**

Capabilities	Corresponding segments	Initiatives	Sales revenue target	
			FY6/25	FY6/30
1) Determine real issues	Value creation support business	<ul style="list-style-type: none"> <li>• Value creation comprehensive advisory (consulting)</li> <li>• Launch of the engagement fund (from April 2020 onwards)</li> <li>• Launch of CVC</li> <li>• Investor communications support</li> </ul>	¥30bn	¥180bn
2) Discover hidden value of resources	IT/AI/IoT-related business	<ul style="list-style-type: none"> <li>• Proposal-type solutions</li> <li>• AI/IoT introduction support</li> <li>• Development of IT/AI/IoT engineers</li> <li>• Matching with venture companies</li> <li>• Development of communication tools for the knowledge-creation cycle</li> </ul>	¥60bn	¥220bn
3) Maximize value by proposing and executing optimal combinations of issues and resources	Social-issue solving business	<ul style="list-style-type: none"> <li>• Health and education in developing countries</li> <li>• Business targeting environmental issues</li> <li>• Business related to regional revitalization</li> </ul>	¥10bn	¥100bn

Source: prepared by FISCO from the COMMIT 5000 medium-term management plan

#### (1) Value creation support business

The targets for the Value Creation Support Business are sales revenue of ¥30bn in FY6/25 and of ¥180bn in FY6/30. Scala Partners is working on businesses including CSV innovation (management business consulting), CSV incubation, and CSV investment, while in addition, from April 2020, SCL Capital will start to manage an engagement fund\*. J-Phoenix Research is working on aspects such as formulating a medium-term management plan for investment targets, providing IR support (including creating sponsored reports), and providing proposals on improving value.

\* Engagement funds seek to be investment funds that carry out bilateral dialogue with investee companies to ensure that investee companies' commitments align with those of the fund. When necessary, engagement funds introduce business partners and/or customers, propose M&A deals, and otherwise support the management of investee companies and provide them with advice.

#### Outlook

Of these, Scala Partners has concluded contracts with approximately 10 external partners, and it is providing a variety of proposals to venture companies, legacy companies, and other companies, including to improve enterprise value, such as by transitioning to DX and introducing EVA (Economic Value Added) management. It recently concluded a business and capital partnership agreement with the previously mentioned blockhive, and they are jointly progressing the digitalization of government-administrative services. On the other hand, for legacy companies, in many cases, even though they understand the content of the proposals, this does not lead to a final agreement, so this is an issue to be addressed in the future. There are six focus fields including food and healthcare, medical care, education, the environment, regional revitalization, and finance, and together with companies, research facilities, local governments, and others in these fields, Scala Partners is providing support and proposals to improve enterprise value or to solve social problems, while utilizing AI/IoT technologies. The key point for achieving the targets in this business will be whether or not it can acquire large customer companies in the CSV innovation business.

#### **(2) IT/AI/IoT-related business**

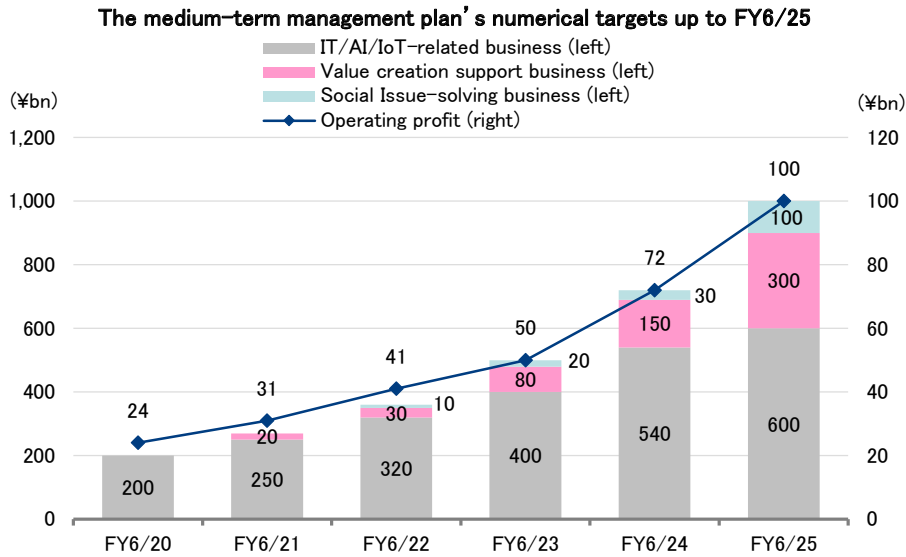
The IT/AI/IoT-related business will extend on a line from the existing business. The sales revenue targets are ¥60bn in FY6/25 and ¥220bn in FY6/30, with an annual average growth rate of 23% for the 6 years up to FY6/25. As previously stated, the Company plans to have reconstructed the development platform by the end of 2020 to establish the foundations on which to realize high growth, so growth is expected to accelerate from 2021 onwards. In Softbrain also, in its next three-year medium-term management plan to start from FY12/21, it is aiming for an annual sales growth rate of 20% to 30%. If both companies can make steady progress for their strategies, it can be said that these targets are fully within an achievable range. In the Myanmar offshore development base, the plan is to increase the number of engineers to around several hundred people in the next two to three years.

#### **(3) Social Issue-solving business**

In the social issue-solving business, the Company will engage in enhancing the health/insurance and education environments in developing countries, and businesses related to environmental problems and regional revitalization. It is targeting sales revenue of ¥10bn in FY6/25 and ¥100bn in FY6/30.

With respect to enhancing health/insurance in developing countries, the Myanmar branch has been partially started as a model business. In Myanmar, the medical infrastructure is extremely poor and there is also a lack of knowledge about nutrition and health maintenance, and there is considerable room to improve the insurance framework. The Company is partnering with an insurance company to develop a smartphone app to provide information on nutrition and health maintenance. It is also building an infrastructure for personal health data, and it plans to provide a service as a set with an insurance framework. It is currently at the stage of proposing this framework locally, and if the decision is taken to launch a business, it will utilize sources of funding like engagement funds and government subsidies and will jointly progress the actual service together with the insurance company. It is also considering supporting the introduction of a telemedicine system and a payment-infrastructure system.

Outlook



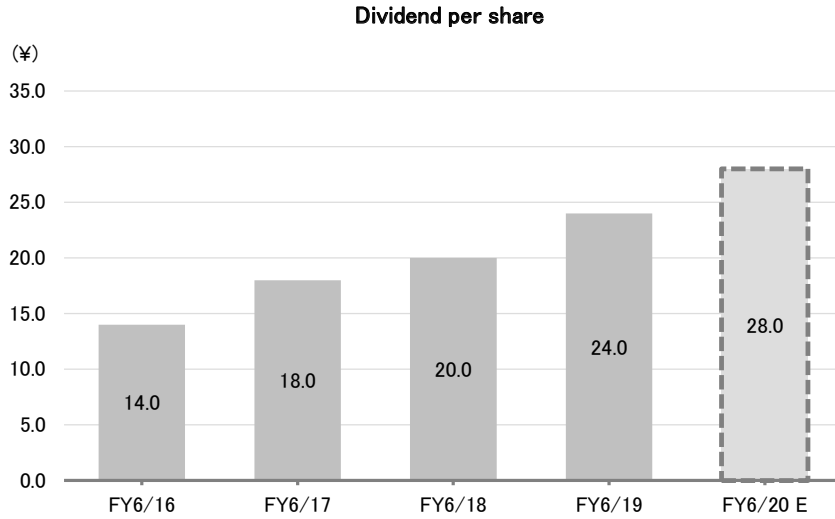
Source: prepared by FISCO from the COMMIT5000 medium-term management plan

## Shareholder return policy

### The Company plans to continually increase its dividend going forward

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. In FY6/20, the Company plans to increase the dividend per share by ¥4.0 YoY to ¥28.0. This will be the 11th 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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