System Integrator Corporation
Q2 Financial Results Briefing for the Fiscal Year Ending February 2021

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Hiroyuki Umeda President, CEO
Presentation

Umeda: Ladies and gentlemen, thank you for coming to the Q2 Financial Results Briefing today. Now, I would like to begin.

First of all, there are some first-time attendees, so I will introduce you to the Company in a simple manner.

The Company was established in 1995 and has been operating for 25 years. These days, I think it has been going on for quite a long time. Starting with three people, it has now become a Company of 221 people. I, myself, was a Founder and have been President for 25 years. As you can see on the right, I was originally from Toshiba, and after SCSK, I established the Company in 1995.
What kind of Company is this? It’s a software business, and within the software industry, we have been making our own products and continually trying to compete with these products.

In the first year we created the Company, we created SI Web Shopping, an ecommerce package, for the first time in Japan. Then, we created Object Browser, a set of tools to increase our development productivity in this industry. Next, we created GRANDIT, a web-based ERP, and then created Object Browser PM, a project-management package in 2009. These four products are now our mainstay products.

We are making money on existing products and releasing new products with that money. Today, we are launching the fifth and sixth products, TOPSIC and AI-based AISI ∀.
This is the trend in business performance since the Company’s foundation, and there have been about three major periods of stagnation. The first period was around the IT bubble, and almost no profit was made in the two years, the seventh and eighth fiscal years. Then, during the Lehman crisis, there was little profit for three years. And in the 20th fiscal year, a JPY1 billion deficit project was generated, and a large loss was generated there.

Since then, we have been recovering steadily, but in this fiscal year, we have experienced deficit projects, not to that degree though, which have resulted in a slight YoY decline.
Mainstay segments. Segments are divided by products.

Ecommerce, which we created first, is the first pillar. Recently, we have built large-scale ecommerce systems as our strengths.

The bottom left is GRANDIT, and AI business division has the same production and is developing ERP in plants as its strengths. They have the same target, the manufacturing industry, so AI is now included in the same business as GRANDIT.

Object Browser Business is shown in the upper right, and the lower right is TOPSIC. We are doing business with these segments now.
This is an overview of the Q2's Financial Results. In the Q2, ERP sales surpassed the previous year by only about 10%, but profits fell sharply from the previous year due to the impact of COVID-19 and a large-scale unprofitable project.

Originally, we anticipated that the IT industry would actually be less affected by COVID-19, or that the timing of being affected would be delayed. We had set up a plan that somewhat exceeded the previous year's level, but the large-scale unprofitable project occurred, resulting in an extremely disappointing figure in the first half of the fiscal year.
With regard to the outline of the Q2, this is the BS. Looking at the second from the top on the right, the provision for loss on orders received is JPY127 million, which is the large-scale unprofitable project I mentioned earlier. JPY127 million worth of earnings has been pulled back from the results I just mentioned, showing our business performance now.
Looking at the outline by segment, we have summarized it here in the form of ecommerce, ERP/AI, then Object Browser, and then new businesses such as TOPSIC.

Concerning ecommerce, I think ecommerce is relatively unaffected by the coronavirus crisis, and I still see it as true. However, in May and June, orders stopped around that time or have been delayed. Accordingly, in the first half of the fiscal year under review, sales fell 16.1% and operating income fell 48.5%. Although these figures did not appear to be sufficient, they seem likely to improve slightly from the second half onwards.

In the ERP/AI business, I felt that ERP was not much affected by COVID-19, so I thought that it would not be too bad in the first half of the fiscal year. Actually, the impact of COVID-19 was not so great, and we received a strong inquiry and orders. However, the large unprofitable project generated, and a little more staff was allocated to them, ending up with this result.

Net sales grew in the first half of the fiscal year, but operating income was significantly negative. It was about half that amount, and it was dramatically negative.

Object Browser Business was the most affected by COVID-19. The above two are solutions businesses, focusing on packages and then customizing them. However, Object Browser is a business that sells packages or offers cloud services, but there is a slight increase in customers who either refrain from buying or stop buying due to COVID-19. The impact of this was significant, with net sales down 16% and operating income down 38.1%, nearly 40%.

In the others, TOPSIC was expected to grow more, but this was also affected by COVID-19 to a considerable extent, so it is almost unchanged.
Performance is graphically depicted.

The left is ERP. ERP sales have been flat compared to the previous year. This is an 8.8% decrease compared to the plan and remains unchanged for the full fiscal year. Earnings were down 21.4% of the forecast, so in the first half of the fiscal year, the provision for loss on orders received was considerably large.

In the current fiscal year, we have divided ERP and AI to clearly show how the AI is doing.

It’s been less than two years since AI started in earnest. We have been doing it for a year and 10 months, but sales have not yet grown significantly, and the operating loss is close to JPY100 million every year. We expected as much, and we’ve been doing it for about three years in the form of investing.

At last, we have accumulated know-how and knowledge about what we have done so far, and we have received a considerable increase in inquiries, so we will continue to make investments with a little more patience.
Following that, Object Browser was the most affected by COVID-19, and we plan to reduce sales by 18.5% and operating income by 29.8%.

Ecommerce is slightly lower compared to our plan and also YoY, and it is a little worse than our forecast. I think there will be a slight improvement, as orders for large-scale projects have been received recently.
This is TOPSIC. As I mentioned earlier, TOPSIC was expected to grow slightly more, but the number of customers who are willing to stop due to the impact of COVID-19 has slightly increased, so it has decreased compared to the plan, and it is almost unchanged from the previous year.

Across the Company, sales decreased 12% compared to the plan and profits decreased 33% compared to the plan. I’m a bit depressed because the word decrease is on the pages here and there, and I feel like it’s going to be a little bit of a pitiful year.
With Object Browser’s cloud migration, I mentioned earlier that Object Browser is being affected by COVID-19, but there is just another impact. This is not such a bad thing but is the original assumption.

Object Browser is a product-oriented business, so we are currently making considerable progress in converting to cloud computing, and the cloud ratio is gradually increasing each year. In the case of the cloud, rather than immediately losing revenues, the plan is about to break even after about two or three years. In this sense, there are some aspects that are falling. The percentage of cloud services is gradually increasing.
Regarding stock businesses, this has been a much more consistent issue for us than in the past. It was very low at first, but it has been rising little by little each year. Second from the right, Object Browser Business is 54.6% this fiscal year, so the cloud ratio will finally rise to around 55%, exceeding 50%. We are planning to expand with new products next year.

In the past, the percentage was 10% or more, but now, it is about 26% for the Company as a whole, and it has grown considerably.
What you are interested in is the productivity or the business activities amid the COVID-19 confusion, and the table summarizes these.

First of all, in the COVID-19 confusion, we are unable to conduct door-to-door sales, so we have no choice but to make considerable efforts to enhance our website and acquire those who enter through natural searches from Google, as a lead through content marketing such as web-based seminars, and digital advertising.

As a result, I feel that we are able to secure a stable acquisition of projects, even in the COVID-19 confusion. Rather, it is more efficient than conventional sales activities in some areas. We feel a good response that we can use both methods considerably even if the confusion is settled in the future.

For reference, the trend of the number of sessions is shown. As a result of these efforts, the number of customers on our website has increased by about 1.5 times.

Then is the essential productivity of development. We had been working at home for about three months, 100% completely working at home. During that time, we took several questionnaires and looked at various figures. Fortunately, in our industry, the result is that productivity has hardly fallen. I feel that there are no problems with remote work, and we can continue without reducing productivity.
This is a summary of the sluggish performance of the current fiscal year or the reasons for the deterioration.

The leftmost is the operating income of Q2 of last year, the fiscal year ended February 2020, and the ERP/AI Businesses originally planned to boost the increase in profit to JPY112 million. Allow me to explain that all of this has been offset by the provision for loss on orders received of JPY127 million, making it negative.

The decline in sales due to the coronavirus crisis is mainly from Object Browser, which is JPY65 million. The decline in profit due to delays in new contracts was from ecommerce and TOPSIC, so these orange parts show the impact of COVID-19. Here, these figures amount to JPY115 million, and as a result, the operating income for the Q2 in the fiscal year ended February 2021 was JPY140 million.
The first half was in such a situation, and regarding what happens in the second half of the fiscal year, we have compared the second half alone in this graph.

In the plan for the second half, in the previous fiscal year, ERP sales were concentrated in the second half, so compared to this, sales are declining. However, from a profit perspective, we expect that comparing the second half alone sales will increase from the previous fiscal year.

All of the unprofitable projects mentioned earlier were booked as the provision for loss on orders received in the first half, so no impact will be seen from the second half onward.

In Object Browser, we anticipated the impact of COVID-19 in the second half of the fiscal year, and we forecast a slight decline in both sales and profits in the second half due to the impact of COVID-19.

In ecommerce business, although there was a delay in contracts in the first half, this has been eliminated. Accordingly, we are planning to increase sales and profits in the second half compared to the previous fiscal year.

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This is the current medium-term management plan, a three-year plan announced in April 2018.

The graphs on the left are sales, and the three graphs on the right are ordinary income. The gray figures, which are the planned figures, are the figures announced in the medium-term management plan in 2018. Sales were slightly lower than expected in the last year, but this year, they declined and did not reach the target.

Recently, the Company has been focusing on improving profitability, so ordinary income mostly reached the target in 2018 and 2019 under the medium-term management plan. This year, however, it has fallen sharply due to the impact of COVID-19 and the unprofitable project just mentioned. I feel that the medium-term management plan may have fallen through in the final year.
Sorry to return to the former topic, but I would like to give a brief introduction to major products.

The biggest source of sales is this GRANDIT, which is a package and solution business. The package, itself, is worth JPY50 million for one type, for example, and there are a number of solutions based on this. GRANDIT Business operates multiple projects in the scale of JPY300 million, JPY500 million, and so forth.

At the bottom is SaaS offering, and the left triangle shows the size of the targeted customers. This is called package integration. Based on packages, this is our mainstay business with annual sales of JPY30 billion or more and less than JPY100 billion. Both ends are sticking out, though.

GRANDIT, itself, is performing well, and in particular, the Company has been prized AWARD for six years. I think this is a Company that is achieving fairly good results.
The following is SI Web Shopping, an ecommerce product. The number of large-scale customers is increasing each year, and based on this product, we offer customizing to a variety of customers. This is also a business in which many projects are running in parallel that cost JPY100 million or more per project.
On the other hand, Object Browser is a product for sale, and while Object Browser and ER were the original mainstay products, we are developing Object Browser PM into a new mainstay product. Recently, the fourth category, Object Browser Designer, has been growing at a relatively good rate.

As the lineup grew more and more, it was a good feeling, but I think this year we were completely influenced by COVID-19. However, as the cloud ratio has risen, it is becoming more stable as a source of revenue.
This TOPSIC is the fourth pillar of our business. This is a new genre called the Programming Skills Determination Service. This TOPSIC is a service for hiring engineers, by letting them write the programs and seeing how much they can do.

Then, regarding education, we are doing it both by getting trainers to take this and seeing how much skills they’ve got.

We have steadily increased the number of cloud users to 132 companies over the past two years.

In addition, PG BATTLE is actually scheduled for the end of this week on the 24th. We are using this TOPSIC to develop a PG BATTLE that competes in three divisions of companies, universities, and high schools or below, and each team consists of three people.

It is becoming more popular year by year, with 780 participants for the first and 1,332 for the second sessions. This year, it is decided that the number of participants has been a little larger than last year. Now, we are raising this as the fourth pillar.
The next pillar of this effort is AISI Anomaly Detection, in which we are investing heavily. We use deep learning for anomaly detection and make AI identify defective products that are being inspected by humans.

There is a great deal of demand for AI, and there are many inquiries. However, it is technically quite difficult for AI to do this on behalf of humans. Today, we are working hard to invest in a variety of R&D projects, and we have accumulated knowledge to some extent and have actually made some projects. I think that we will be able to produce good results with these efforts in the future, and the Company will proceed while investing, although it is still in the red.
Next, shareholder returns. We have targeted a dividend payout ratio of 30%, and although there was a slight failure in the current fiscal year, we have achieved a reasonable level of profit, so we have come up with a forecast of JPY10 per share.
Then, regarding an approach to the working environment, it is extremely important for an IT Company to hire people and prevent personnel turnover at any rate. In terms of how to create a comfortable working environment, we are well recognized, and we received the Platinum Kurumin Certification. That is a little difficult to obtain. Also, many men actually take childcare leave, and the return-to-work rate is 100%.

Moreover, when it comes to COVID-19, we were chosen as one of the 100 teleworking pioneers in FY2017. Since we originally had a history of telework, we were able to smoothly shift to 100% telework on that side, and as I mentioned earlier, we have been able to keep productivity. We are very lucky that we have already developed an environment in which all the systems were transferred to the cloud, and Zoom was also used in the past.

As a result, the retention rate is 96%, and even though the turnover rate in the industry is under 12%, ours is in the 4% range, so it is a Company that has a fairly low turnover rate.

This is all.
Question & Answer

Umeda: I would like to take your questions from now. If you have any questions, please ask through Q&A.

First, please tell us about the details of the unprofitable project and its impact in the future. Are the effects remaining in the second half?

To our shame, we didn’t notice the unprofitable project immediately. We thought we somehow made it through for the fairly difficult case and eventually found out that the quality of the delivered goods was poor. Once again, we did quality enhancement work and extended our shipments. We plan to ship it in December and are currently working hard on the final test. All of the expected costs, including those thereafter, are allocated to the provision for loss on orders received in the first half of the fiscal year, and we expect that there will be no impact in the second half of the fiscal year.

Continuing, how much of the impact of cloud of Object Browser is on sales and profits? Looking at the profit increase/decrease decomposition, it appears that there is little impact on profits on cloud adoption, but is there any impact on profits?

There is actually an impact on sales and profits. So far, Object Browser itself is still on-premises, and structurally, it is a tool that should be on-premises. Products called Object Browser and Object Browser ER are on-premises. We are now trying to bring another mainstay product, Object Browser PM, to the cloud as much as possible. We have been increasing the percentage of cloud services in both on-premises and cloud services, which have been mainly on-premises to date. When simulating, it seems a little hard that the cloud will not catch up unless we do three years for sales and profits to reach on-premises levels. As it will be a simulation for three years and many months, both sales and profits will be affected by the fact that on-premises have fallen considerably behind the cloud in the current fiscal year. Since then, Object Browser Designer does not have as much absolute amount as PM. However, the web-based version published last year is a fully cloud format, and the cloud format is growing. I think that this will have a slight impact on sales and profits for a period of around two years.

Next, it is described that Object Browser has a large market share. What is the percentage?

In the past, competitor products were overseas products, but now, most overseas products are not included, and instead, the trouble is free software. Those free ones are functionally less useful than Object Browser, but some people make do with free ones even if they are not paid service. In some cases, engineers, in particular, often consider it as enough. I think that the number of people who use such things is increasing quite a lot. We don't know much about the combined share, including the free ones. I think that we have a considerably high market share among those who are using these paid products. There may be 70% or 80% among paid market alone. However, when free ones are also included, the number of free ones is large, so I think it will be around 20% or so. There came out a free product against Object Browser, and some free products against PM have also appeared. In the past, Object Browser PM used to have an image that there were not many competitors, but these days, such free products have emerged. How to fight with free ones is a new challenge that we are currently working on in many ways.

Since there are no questions left, we will finish the Financial Results Briefing for now. We apologize for the inconvenience, but could you please answer the questionnaire briefly? Thank you very much.

[END]
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