

BSP
3800 JASDAQ

15-Jul.-14

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FISCO Ltd. Analyst
Ikuo Shibata

■ Accelerating growth via expanding the business domains to strategic areas where increased demand is expected

BSP Incorporated [3800] focuses on development, sales and services for package operation control software for backbones systems for a diverse range of industries, including the financial and manufacturing industries. By contributing to the automation of systems operation including job management and form control, it has realized steady sales growth and high profitability. BSP's FY3/14 results showed sales up 6.9% YoY to ¥4,203mn, operating income up 10.0% YoY to ¥1,181mn (an OP margin of 28.1%), and ordinary income up 13.3% YoY to ¥1,241mn (an RP margin of 29.5%), setting new record highs for sales and recurring profit.

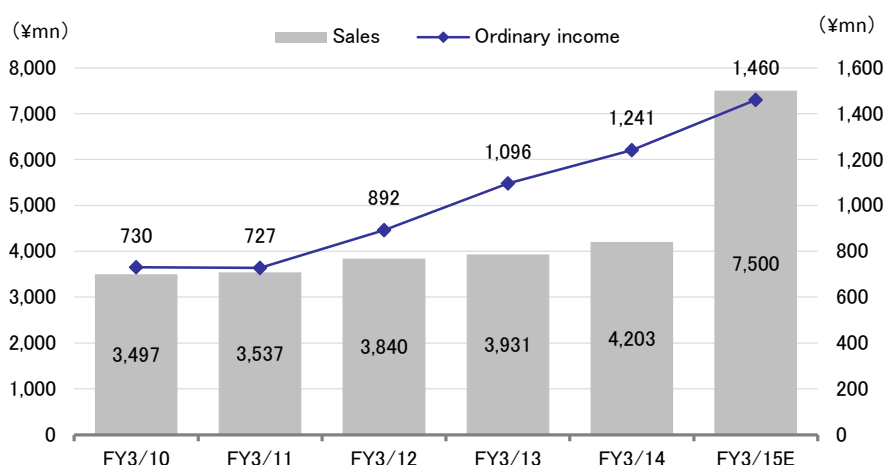
BSP has initiated reforms to its business structure by taking advantage of changes in the external (operating) environment to expand business, such as the shifts to open architecture in systems, downsizing and the shift in expectations on IT departments to being areas that contribute to creating corporate value, as well as the consolidation of Beacon Information Technology Inc. (herein "Beacon IT"), in the fields supporting strategic (information-related) systems, such data utilization. Its policy is to accelerate growth by expanding its business domains into areas where expansion in demand is expected.

In respect of FY3/15 results forecasts, despite assuming that its high profitability will have a period of marking time, including the impact from consolidating Beacon IT and under its policy of giving priority to growth via structural operational reforms, BSP expects a significant increase in both sales and earnings, with sales up 78.4% YoY to ¥7,500mn, operating income up 16.8% YoY to ¥1,380mn (an operating income margin of 18.4%) and ordinary income up 17.6% YoY to ¥1,460mn (an ordinary income margin of 19.5%); and (thus) plans to again set record sales and earnings.

■ Check Point

- Maintaining steady sales growth & high profitability
- New record sales & ordinary income highs from Product Division growth
- Significant sales & earnings growth forecast with the added impact from consolidating Beacon IT

Results Trends



Corporate Overview

Products for mainframes have been a stable income source since establishment & boast high profitability

(1) Scope of Operations

BSP Incorporated (herein “BSP”) focuses on development, sales and services for operations control package software for backbone systems for a diverse range of industries, including the financial and manufacturing industries. In addition to peripheral activities such as operational consulting and human resource development where it utilizes its proprietary know-how, BSP has also commenced administration services as a new business. Products aimed at mainframes, chiefly for financial institutions and large scale corporations, have since establishment been a stable source of income, and boast high profitability. Through contributing to automation and enhanced efficiency in IT operating systems, including job management and form control, BSP has achieved steady growth.

At the same time, BSP has initiated reforms to its business structure by taking advantage of changes in the external (operating) environment to expand its business, such as shifts to open architecture in systems, downsizing and the proliferation of cloud computing. In addition to automation and enhancing efficiency in IT systems operation, by expanding its business domains to areas that are able to contribute to corporate value creation, BSP’s policy is to accelerate growth.

Its operations up to FY3/14 may be divided into 4 segments.

(a) Product Division

Within operations control for backbone systems BSP handles open architecture products. As well as undertaking development, sales and support services for proprietary products in the 3 fields of operations automation, forms and IT Service Management (ITMS), BSP also handles certain products from other companies. Royalties on product usage rights (license fees) and maintenance services that are a fixed ratio of the product cost form the sources of income. Also, BSP commenced the cloud service Be.Cloud for which demand is growing from FY3/13.

(b) Mainframe Division

Within operations control for backbone systems, BSP handles proprietary mainframe products, chiefly for financial institutions and large scale corporations. From the year following the sale BSP receives from mainframe product users, as a maintenance service fee, a fixed ratio of the product cost. This has been BSP's flagship business since its establishment and forms a stable source of income.

(c) Solutions Division

BSP engages in services that provide solutions such as solutions in the IT services domain (including systems development consulting and human resource development), its membership system-based "Sys-Doc" service (providing expert advice on IT systems operation via periodic client visits), and a service offering solutions utilizing the ASMO method aimed at developing operations divisions that contribute to management (including corporate value analysis, organizational reform and human resource development).

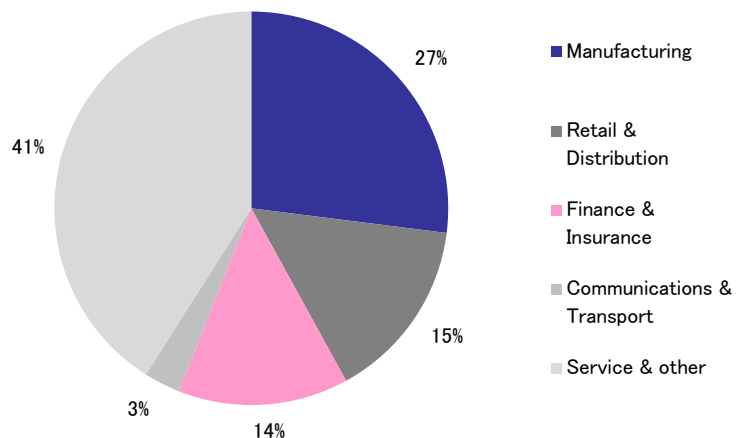
(d) BPO Operations Group

This is an administrative service launched from FY3/14 (October 2013) based on the "Operation-less" concept for IT divisions to contribute to corporate value creation advocated by BSP. Specifically, it undertakes support for activities from proposals for reforms in relation to IT system operation, system development, systems migration, project management and establishing a service desk.

As well as representing 56.1% of Mainframe Division sales in FY3/14 actual results, it delivered almost all of the operating income, and supported BSP's high profitability.

Client numbers (the number of companies that have installed BSP products) exceed 800 companies, with a track record of numerous cases of installations by large scale corporations noticeable. The composition of sales by industry type reveals application in a diverse range of industries, with the ratios for manufacturing, retail and distribution, and finance being relatively high.

Ratio of Sales by Industry



Note: Based on Teikoku Databank's industry categories

Direct sales form the main sales channel, with some (forms etc.) via partners.



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There are 2 consolidated subsidiaries, BSP Solutions Incorporated, that operates the solution business, and BSP (Shanghai), Inc., that is the base for sales in China.

As part of its structural operational reforms, in January 2014 BSP consolidated (with a shareholding of 53.55%) Beacon IT (it being the parent company when BSP became independent in July 1993). From FY3/15 the operating segments will alter as set out below.

(a) Systems Operations Business

This will combine what have been the Product, Solutions and BPO Operations Divisions to date.

(b) Mainframe Business

What has been the Mainframe Group to date will continue in the same form.

(c) Data Utilization Business

This is a new business acquired through the consolidation of Beacon IT. It will undertake activities such as software development and sales for data utilization, including increasing data processing speeds and strengthening operating functions, as well as consulting in relation to data utilization.

(d) Other Business

These are also new businesses acquired through the consolidation of Beacon IT. They comprise those businesses of Beacon IT apart from those in (c) above, including business continuity plan development, administration and maintenance support, as well as an HR outsourcing management SaaS.

Track record in backbone systems (mainframes) for financial and other institutions

(2) Corporate History

BSP's former incarnation Three-B was established in 1982 in Tokyo's Chuo Ward as a subsidiary of KK Business Consultant, a provider of programs for HR and organizational development. The origins of Business Consultant were in Software Age of Far East (the current Beacon IT), which had been selling A-Auto (software for automating the scheduling of complicated computer systems jobs and achieving enhanced efficiency in IT systems administration) domestically, and targeted selling in the US market.

Subsequently, in 1987 it changed the company name to BSP. The turning point for BSP was when it took over the operations relating to systems management from SoftwareAG of Far East in 1993 and commenced full-scale operations as a specialist systems administration software company. Following that, while steadily seeking to strengthen its operating platform, and with expansion in IT systems investment as a tailwind, it built-up a track record chiefly in backbone systems (mainframes), including those for financial institutions and large scale corporations.

In 2011 it established BSP Solutions and commenced full-scale consulting solutions operations. In 2006 it listed on the JASDAQ Securities Exchange (currently JASDAQ).

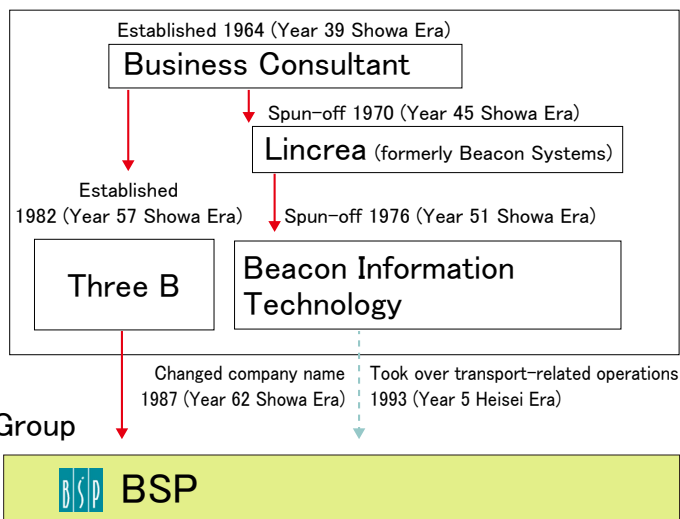
In 2008 it expanded into China by establishing BSP Shanghai. In 2013, based on the “Operation-less” concept, it commenced the Be.Cloud cloud service and administrative BPO Operations Service.

In January 2014, by consolidating Beacon IT, as well as tackling growth areas such as data utilization, BSP initiated structural operational reforms.

In May 2014 for handling products in the big data and business process management area, BSP entered into a business alliance with Software AG, Inc. (herein Software AG), with this being its opening gambit for operational expansion into the big data field.

BSP Corporate History Schematic (to Jan 24 2014)

Beacon Group



Source: Company materials

Establishing a business portfolio with a balance between stability & growth

(3) Corporate Characteristics

BSP advocates as corporate philosophy of “Using flexible IT, we aim to be a company that contributes the development of society and the creation of a better future”.

We may cite as BSP’s distinguishing characteristics: (a) it is an independent software vendor specializing in IT systems operation, (b) it secures high profitability, with mainframe operations being the stable income source, and (c) through structural operational reforms associated with the consolidation of Beacon IT it has achieved a structure that allows it to provide support for customer businesses in both the attack and defense aspect.

(a) Independent software vendor specializing in IT systems operation

BSP's products are not restricted by, for example, the scale of a computer or manufacturer, with the strength being in the fact that it allows for smooth system operation. Given that manufacturer-related products that compete with BSP products do not allow the hardware component to be replaced by those of another manufacturer, there is a clear distinction in that for customers it becomes a factor hindering flexible systems development. Further, because BSP's offering price is defined by the extent to which it is able to contribute to automation and enhanced efficiency in IT systems, the track record and know-how it has amassed specializing in this field are reflected in the high degree of detail and performance in its products and services and precision of its proposals. In installing systems, amidst the trend amongst many to outsource to agents, the fact that BSP's products are provided through direct sales to mainly financial institutions and large scale corporations, and when updating systems that there are many cases where they are adopted as replacements, is arguably proof thereof. Further, in the System Managers Club in which BSP is contracted to operate (systems), being on the largest scale of system manager networks in Japan, boasts over 13,000 members (and 139 endorsing companies), and demonstrates that BSP is the driving force in this field.

(b) Investment from the stable mainframe income source in the next growth areas

As well as BSP's mainframe business segment profitability being an astoundingly high 71.9% (FY3/14 actual results), it has supported its results as a stable source of income. What makes this possible, as well as there being also confidence in BSP's products and services, lies we feel in the high customer switching cost (the costs that arise due to replacing systems). Despite the mainframe business gradually shrinking, it is expected that for some time it will fulfill the role of the cash cow, and we feel that for BSP, being able to earmark those funds for investment in the next growth areas (e.g. cloud services, data utilization), is a significant advantage.

(c) Achieving a structure that allows customer support from both the aspects of attack & defense

Through the current structural operational reforms, not only will there be contributions to IT systems operation and enhanced efficiency, by expanding its business domains to include areas where customers will reallocate management resources (staffing, budget etc.) after that (i.e. areas that create corporate value), it will enable more persuasive proposals and development of a diverse array of solutions, which we feel will define BSP's superiority.

■ Industry Environment

While sound systems operation software faces changes in its operating environment

According to a survey by IDC Japan, the domestic software market in 2013 was ¥2.3988tr (+6.0% YoY), with the market in BSP's field of "systems/network management software" being in the order of ¥291.3bn. The main reason that this market is growing, apart from a review of the operating process in line with system upgrading and virtualization, is that (the market for) job management and automation software is growing. It is thought that this trend will continue for the time being, however, on the other hand, along with a shift from the conventional mainframe focus to open architecture (systems), the industry is facing changes in the operating environment due to technological advances in IT, such as an increase in the usage of cloud services.

The main players are centered on domestic manufacturer-related vendors (Hitachi Corporation [6502], Fujitsu [6702] etc.), with foreign players such as IBM and HP also represented in the top tier. However, if we limit this to mainframe operations, BSP represents a large share, and is arguably in a position where it is benefiting from being the last man standing. Further, amongst listed companies there are no software vendors specializing in IT systems operation.

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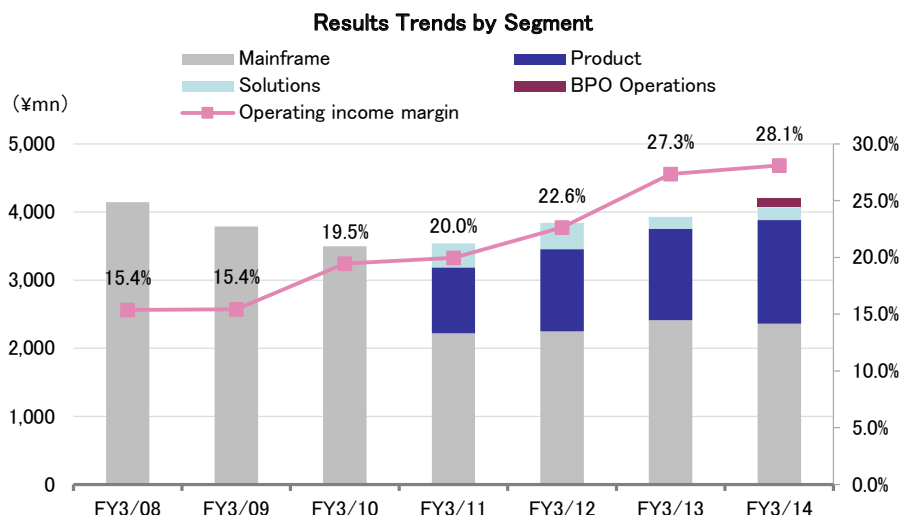
■ Operating Results Trends

Maintaining steady sales growth & high profitability

(1) Previous results performance

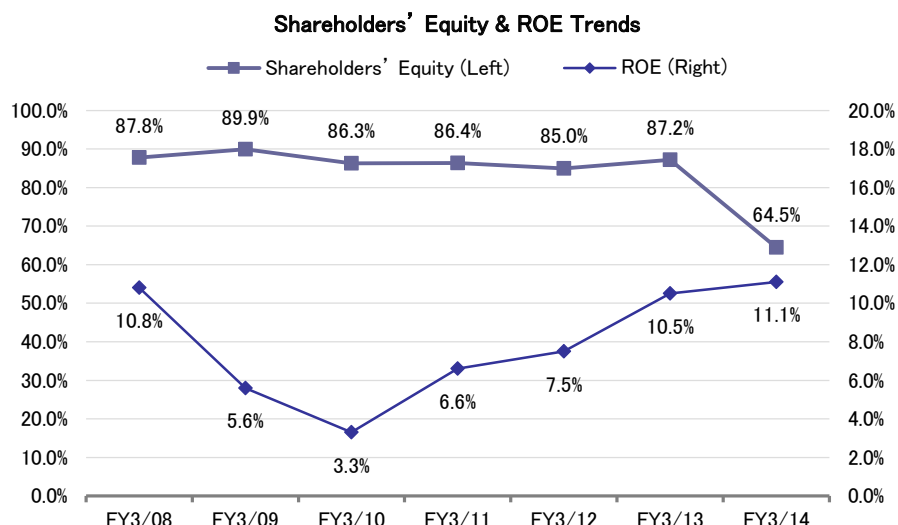
Reviewing BSP's results, despite sales showing a decline from FY3/09 to FY3/10 from the impact amongst other things of the Lehman Shock, from FY3/12 onwards amidst a shift to open architecture systems, there is a pattern of growth in product business driving BSP's sales growth, with underlying earnings growth continuing.

From a profit perspective, despite there still being a high degree of reliance on the mainframe business, with progress also in improvement in profitability in the product business, the operating income margin is in an uptrend, reaching 28.1% in FY3/14.



Further, from a financial perspective along with the high level of shareholders' equity, which is an indicator of the stability of BSP's financial platform, its quick ratio also, which indicates its ability to make short-term payments, is at high level (420% as of the term-end FY3/14) reflecting its ample balance of cash and near cash, marking arguable a highly conservative financial strategy. However, at the stage it becomes necessary to invest in the next growth areas, one can take the view that the strength of the financial platform will become the driving force for BSP's growth. ROE, which indicates capital efficiency, has improved in lock step with the rise in BSP's operating income margin, reaching a level exceeding 10% in FY3/14.

Moreover, in FY3/14, March 31 of that year being the deemed acquisition date, only Beacon IT's balance sheet has been consolidated.



Record high sales & ordinary income set by growth in the Product Business

(2) Overview of FY3/14 Results

FY3/14 results set new record highs for sales and ordinary income with sales up 6.9% YoY to ¥4,203mn, operating income up 10.0% YoY to ¥1,181mn, ordinary income up 13.3% YoY to ¥1,241mn, and net income up 12.7% YoY to ¥799mn.

Looking at sales by segment, despite a slight decline in the mainframe business, growth in product business, and the addition of the BPO operations business which started from this term, contributed to revenue growth. Moreover, growth in product business was due to significant increases in the IT management area (ITSM) in line with expansion in Service Desk* development needs and big-ticket orders.

From a profit perspective, there is no significant change from the earnings structure that relied on mainframe business, however, due to improved profitability in product business, cost reductions and other factors the operating income margin rose to 28.1%.

* A point of liaison that responds to incident management and inquiries from internal BSP system users. The configuration function possessed by BSP's IT management tool LMIS on cloud that responds flexibly to customer systems environments is rated highly, and the number of companies that have installed it is growing, including replacements of other companies' (products).

FY3/14 Results Overview

(Unit: ¥mn)

	FY3/13		FY3/14		Change	YoY	FY3/14 Initial Forecast		
	Sales	%	Sales	%			Sales	%	vs Plan
Sales	3,931	—	4,203	—	272	6.9%	4,200	—	100.1%
Product Group	1,345	34.2%	1,524	36.3%	179	13.3%	1,810	43.1%	84.2%
Operations automation	580	14.8%	569	13.5%	-11	-1.8%	—	—	—
Forms	615	15.6%	622	14.8%	7	1.1%	—	—	—
ITSM	124	3.2%	251	6.0%	127	102.5%	—	—	—
Other	25	0.6%	79	1.9%	54	216.0%	—	—	—
Mainframe Group	2,410	61.3%	2,359	56.1%	-51	-2.1%	2,160	51.4%	109.2%
Solutions Group	175	4.5%	188	4.5%	13	7.4%	230	5.5%	81.7%
BPO Operations Group	0	—	131	3.1%	131	—	0	0.0%	—
COGs	280	7.1%	513	12.2%	233	83%	—	—	—
Gross profit	3,650	92.9%	3,690	87.8%	40	1%	—	—	—
SG&A	2,576	65.5%	2,509	59.7%	-67	-3%	—	—	—
Operating income	1,074	27.3%	1,181	28.1%	107	10.0%	1,160	27.6%	101.8%
Product	-502	—	-443	—	59	-11.8%	-290	—	—
Mainframe	1,731	71.8%	1,697	71.9%	-34	-2.0%	1,427	66.1%	118.9%
Solutions	5	2.9%	16	8.5%	11	220.0%	23	10.0%	69.6%
BPO operations	—	—	-38	—	-38	—	—	—	—
Other	-160	—	-51	—	109	—	—	—	—
Adjustments	—	—	—	—	—	—	—	—	—
Ordinary income	1,096	27.9%	1,241	29.5%	145	13.3%	1,200	28.6%	103.4%
Net income	709	18.0%	799	19.0%	90	12.7%	750	17.9%	106.5%

The operating income by segment ratios represent segment profit margins

Significant sales & earnings growth forecast including the impact from consolidating Beacon IT

(3) FY3/15 Operating results outlook

BSP's FY3/15 forecasts anticipate significant growth in both sales and earnings, with sales up 78.4% YoY to ¥7,500mn, operating income up 16.8% YoY to ¥1,380mn, ordinary income up 17.6% YoY to ¥1,460mn and net income up 11.3% to ¥890mn.

As noted above, BSP has reorganized its business segments due to expansion in its business domains in line with the consolidation of Beacon IT. Looking at sales by segment following the reorganization, in addition to growth in systems operation business, the plan is for the data utilization and other businesses, which have been newly added due to the consolidation of Beacon IT, to contribute to a significant increase in income. Further, in the mainframe business, aside from a round of systems upgrades and back-up projects which were solid performers in FY3/14, amidst the tide of transition to open architecture and downsizing, BSP has conservatively forecast a decline in revenues.

From a profit perspective, due to consolidation of Beacon IT which has low profitability and decline in mainframe business, BSP are expecting deterioration in the operating income margin. However, through improvement in profitability in the systems operation business and utilizing cost synergies with Beacon IT, the plan is to secure an increase in (absolute) profits. Based on a policy of giving priority to growth via the structural operational reforms, the scenario envisioned is for BSP to enter a phase of marking time with respect to the profit margin.

FY3/15 Results Outlook

(Unit: ¥mn)

	FY3/14 (Actual)		FY3/15 (Forecast)		Change	
	Sales	%	Sales	%	Sales	%
Sales	4,203	—	7,500	—	3,296	78.4%
Systems operation	1,843	43.8%	2,500	33.3%	657	35.6%
Mainframe	2,359	56.1%	2,000	26.7%	−359	−15.2%
Data utilization	—	—	2,500	33.3%	2,500	—
Other	—	—	500	6.7%	500	—
COGs	513	12.2%	—	—	—	—
Gross Profit	3,690	87.8%	—	—	—	—
SG&A	2,509	59.7%	—	—	—	—
Operating income	1,181	28.1%	1,380	18.4%	199	16.9%
Ordinary income	1,241	29.5%	1,460	19.5%	219	17.6%
Net income	799	19.0%	890	11.9%	91	11.3%

■ Mid-term Results Outlook

Aiming to accelerate growth through expanding business domains into growth areas

(1) Mid-term Management Plan Progress

BSP has been proceeding with a Mid-term Management Plan that has FY3/15 as its ultimate fiscal term. BSP adopted “Operation’less2.0” as a business concept, which contributed to operational reform through automation of customers’ IT departments and efficiency enhancements, targeting FY3/15 sales of ¥5,000mn, and an operating income of ¥1,800mn (an operating income margin of 36.0%). Although, with contributions from the BPO operations business and consolidation of Beacon IT, there is a strong probability that BSP will exceed the plan significantly, from a profit perspective it is forecast to fall below plan due to delays in progress in the product business and the consolidation of Beacon IT.

Increasing growth & income sources by expanding the business domains to high-value-added areas

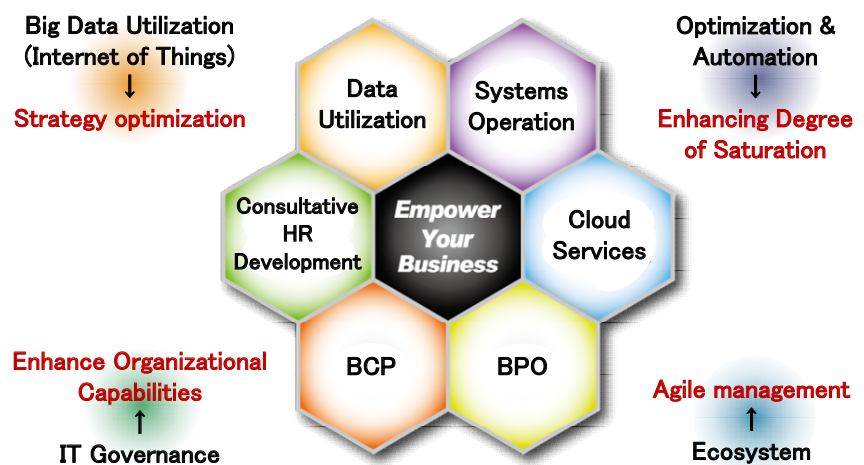
(2) Growth Strategies

BSP’s policy is, as demands by management to IT departments become increasingly sophisticated, to seek to accelerate growth and expand sources of income, not only by automating systems operation and promoting efficiency, but by also expanding its business domains to high-value-added areas (areas that contribute to corporate value) where customers’ management resources (budget, staff etc.) will then be reallocated.

As part of that, BSP consolidated Beacon IT which possesses strengths, including in consultation by way of data utilization and data modeling. Through the combination of BSP in field of core banking systems support and Beacon IT in the field of strategic (information) systems support, at the same time as enabling business opportunities to be embraced from both aspects of customer defense and attack, it seeks to achieve a balance in BSP's business portfolio between stability and growth (investment and return). Further, the business alliance with Software AG, which is engaged in global expansion, is the opening gambit aimed at strengthening the ability to provide solutions in the field of big data utilization that it expected to expand going forward.

BSP, based on its Group message to "Empower Your Business & Change Your Work style (~supporting reform in customers' businesses work practices through flexible IT~)", has initiated reforms to its operational structure in the 6 business domains of data utilization, system operation, cloud services, BPO (Business Process Outsourcing), BCP (Business Consultation Planning), and consultative human resource development, and will tackle strengthening its operational base via the early fusion of management resources with Beacon IT in FY3/15. Further, going forward also its policy is to proactively promote utilization of external resources also, including by commercial alliances and M&A. BSP plans to publicly announce specific management targets in its next Mid-term Management Plan.

6 Business Domains



Source: Company materials

■ Shareholder returns

FY3/15 dividend to be increased to ¥70 & shareholder incentive scheme to be introduced

BSP's shareholder reward policy aims for a 30% consolidated dividend payout ratio. It was decided that dividend would be ¥60 in FY3/14 (¥30 mid-year, ¥30 year-end), a payout ratio of 29.3%. BSP is planning to increase the dividend to ¥70 in FY3/15 (¥35 mid-year, ¥35 year-end), a payout ratio of 30.1% against their forecast earnings). In the mid-term also, we feel that the likelihood of dividend increases in line with earnings growth is high.

Further, on May 8, 2014, BSP introduced a shareholder incentive scheme, targeting an increase in the number of its individual shareholders (and enhanced liquidity). On March 31 every year current shareholders will be presented with JCB gift cards corresponding to the amount of shares they hold, with the first target group being March 31, 2015 shareholders.

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