COMPANY RESEARCH AND ANALYSIS REPORT

UNIRITA Inc.

3800

TSE JASDAQ

10-Jan.-2018

FISCO Ltd. Analyst

Ikuo Shibata

FISCO Ltd.

http://www.fisco.co.jp

Index

Summary

FY3/18 1H results were below the initial forecasts. Achieved a certain level of results for strengthening the ability to provide solutions and developing new products

1. Company profile

UNIRITA Inc. <3800> (hereafter, also "the Company") develops, sells and provides support for package software for the operation of IT systems for a broad range of industries, primarily finance and manufacturing. It also provides solutions utilizing data. In April 2015, BSP Incorporated merged with its consolidated subsidiary, Beacon Information Technology Inc. (Beacon IT), and changed its name to UNIRITA Inc. By absorbing the management resources of Beacon IT, which was strong in the growth field of data utilization, the Company has been able to advance business structural reforms to respond to the changing business environment. In particular, it can be said to have entered a new growth phase by combining its existing businesses that had supported its result up to that time (areas that contribute to improving customer productivity through automating systems management and promoting improved efficiency) with new businesses (areas that directly contribute to the improvement of customers' enterprise value through utilizing data).

2. Change of management structure and the direction for the future

In April 2017, the Company changed its management structure in conjunction with the changes to its representative directors as a generational transfer of leadership to accelerate the reforms to its business structure. In the new system on the axis of the UNIRITA Smart Formation Service, from upstream (consulting) through to the construction of foundations, the implementation of functions, and operations and BPO, it has established the direction for support from the Group as a whole toward the smooth realization of customers' digital reforms. Also, its policy is to strengthen its ability to provide solutions (including directly solving customers' problems and creating new businesses) that are not limited to simply sales of its proprietary products through collaborations with partner companies (sales agencies) that have strengths within specific industries and with alliance partners that complement its IT resources.

3. Summary of the FY3/18 1H results

In the FY3/18 1H results, sales and profits declined, with net sales decreasing 2.9% year-on-year (YoY) to ¥3,311mn and operating income declining 23.3% to ¥561mn, and the results were below the initial forecasts. Although sales grew in the Cloud Business and the Mainframe Business, the results were adversely affected by the declines in the Product Business and the Solutions Business. The main factor was that there were no orders for major projects like in the same period in the previous fiscal year, while the Solutions Business was significantly impacted by the decrease in orders for technical-support services due to the slump in the Product Business. It can be said that the new sales system that integrates sales and technologies (proposal activities from the upstream) did not produce any results during the 1H. However, the Company was able to achieve a certain level of results toward the future, including for strengthening its ability to provide solutions through alliances and for developing products and services that create new value. In addition, there was steady growth for services such as the IoT solutions for bus operators provided by a subsidiary.

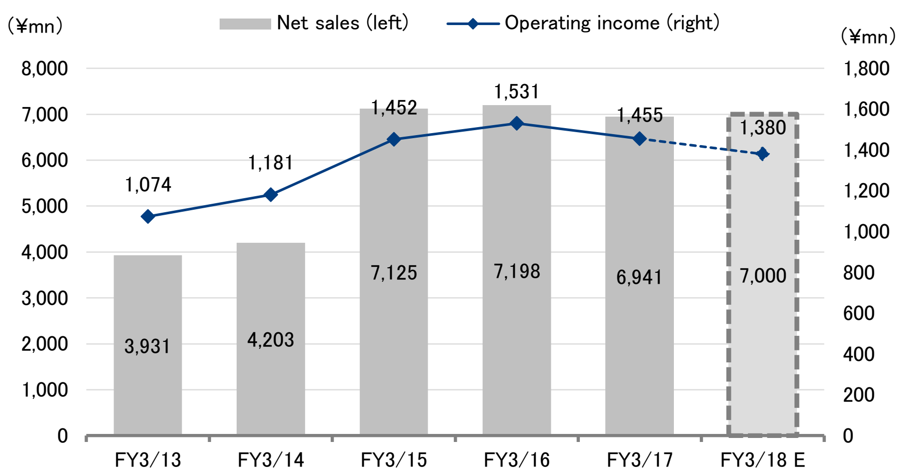
4. FY3/18 results forecasts

The Company has downwardly revised the amounts in the FY3/18 results forecasts, based on factors including the progress made in the 1H results and the current conditions. The revised results forecasts are for a slight increase in sales but a decline in profits, with net sales to increase 0.8% YoY to ¥7,000mn and operating income to decline 5.2% to ¥1,380mn. An assumption for the forecasts is that, continuing on from the 1H, the growth in the Cloud Business and the Mainframe Business will contribute to the higher sales. Conversely, the outlook is that while the Product Business will maintain sales of about the same level YoY, they will decline significantly in the Solutions Business, and therefore overall, the sales increase will be only slight. At FISCO, we think that it is fully possible that the Company will achieve its results forecasts, because the Cloud Business, in which demand is expanding, is growing, and results are trending steadily in the highly profitable Mainframe Business, while in addition, in the Product Business, which lagged behind in 1H, factors such as the alliances with the partner companies and the solutions proposals will gradually produce results. Rather, toward accelerating growth from the next period and onwards, we shall be focusing on the progress made in terms of how much the Company can heighten the degree of completion of its unique value creation model and how this will connect to specific results, such as from the strengthening of the sales system (proposal activities from the upstream), developing the collaboration model with partner companies, and jointly creating new businesses with user companies.

Key Points

- Sales and profits declined in the FY3/18 1H results, which were below the initial forecasts (the full fiscal year results forecasts were downwardly revised)
- The main reasons for the forecasts not being achieved were that there were no major projects for products like in the same period in the previous fiscal year, and the decline in sales of technical-support services
- However, a certain level of results was achieved for the collaboration model with alliance partners and the development of new products and services
- Based on the new structure, the Company is aiming to strengthen its ability to provide solutions to be a co-creation partner that realizes its customers' digital reforms

Results trends



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

Company profile

Established a structure that can support both offensive and defensive aspects of customers' businesses

1. Business overview

The Company develops, sells, and provides support for package software for the operation of IT systems for a broad range of industries, primarily finance and manufacturing. It also provides solutions utilizing data.

Products for mainframe computers, chiefly for financial institutions and large corporations, have been a stable, highly profitable, source of income since the Company's establishment. The Company achieved steady results growth by contributing to automation and enhanced efficiency in IT systems operation, including job management and report management.

However, to prepare for growth in the medium- to long-term in light of rapid changes in its operating environment, such as the shift to open architecture systems, downsizing, the proliferation of cloud computing, and the use of big data, the Company initiated reforms to its business structure. It plans to accelerate growth by developing its business domain in areas that directly contribute to raising its customers' corporate value (e.g. market expansion and enhanced competitiveness). Faster growth will also be targeted for traditional business areas that contribute to automating and increasing the efficiency of IT systems operations (increased productivity etc.) in other ways.

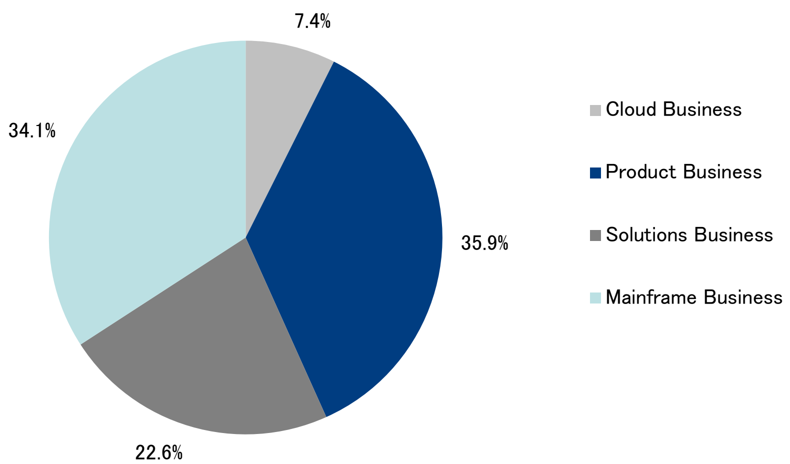
* As part of its business structure reforms, in April 2015, BSP merged with its consolidated subsidiary, Beacon IT, and changed its name to UNIRITA. The goals of this merger were to promote the establishment of an operating structure that combined BSP's forte of systems operation and Beacon IT's forte of data utilization to realize synergies that would help it respond to changes in its operating environment.

In April 2017, the Company changed its management structure in conjunction with the changes to its representative directors as a generational transfer of leadership to accelerate the reforms to its business structure. In the new structure, it is taking a direction that prioritizes the provision of more concrete solutions (directly solving customers' problems and creating new businesses), including through evolving the measures up to the present time, strengthening collaborations with partner companies and conducting proposal activities from the upstream, and constructing an integrated support system from the upstream (consulting) to the downstream (maintenance, management, etc.)

The Company has four business segments*; the Cloud Business, the Product Business, the Solutions Business, and the Mainframe Business. The percentage of sales provided by the Mainframe Business, which has been main business since its establishment, has been declining due to the growth of the other businesses. But on the other hand, the percentage provided by the Cloud Business, which is a growth field, has grown significantly, although it is still only small scale.

* Changed to new segments from the current fiscal year (FY3/18)

Percentages of total net sales by business (FY3/18 1H results)



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

Review of the reportable segments

■ Former segments

	Former segments	Breakdown (1)	Breakdown (2)
	Data Utilization	(Products) (Solutions: Data M Consulting)	Products Technical support Maintenance
	Systems Operations	(Products) (Solutions: Solutions Operations Consulting) (Outsourcing)	Products Technical support Maintenance
	Mainframe		Products Technical support Maintenance
	Other Businesses	Subsidiaries' (Aspex, Bitis, and UNITRAND) businesses	

■ New segments (from FY17)

	New segments	Breakdown
1	Cloud	Usage-fees model Monthly-fees services
2	Products	Product (package) sales Maintenance
3	Solutions	Consulting Technical-support services
4	Mainframe	Everything relating to this business (products, technical support, and maintenance)

Source: From the Company's results briefing materials

An overview of each business is provided below,

(1) Cloud Business

This segment is the consolidation of the cloud-based services business (usage-fees type) that was included in the former segments of the Data Utilization Business and the Systems Operations Business and Other Businesses. In addition to the mainstay products, such as the ITSM (IT services management) tool "LMIS on cloud"*1 and "Be.Cloud"*2, it includes SaaS-type attendance management services*3 for the personnel outsourcing industry, and LIVE UNIVERSE, which is a human resources education tool for the restaurant and other industries (the details are given below). Also, recently, the Company has released the communication specialized-type PaaS Smart Communication Platform (the details are given below), and it is the first vendor of this platform in Japan. It has also begun providing its security solutions on the cloud-based platform of I-NET CORP <9600>*4, which manages cloud-based data centers.

*1 "LMIS on cloud" is a cloud-based service that provides a framework for the appropriate management of IT services as a whole, centered on a service desk function.
*2 "Be.Cloud" is a cloud-based service that provides an extensive menu, including from expanding and the management of the cloud-based services used by customers.
*3 Provided by the subsidiary, Aspex Inc.
*4 The Company entered into capital and business alliance with I-NET CORP on May 2017. The Company and I-NET are collaborating-on and have entered into a technical alliance to provide the middleware products for automating systems operations and for data linkage previously developed by the Company within the corporate cloud-based services provided by I-NET. The aim of the capital and business alliance is to utilize the strengths of both companies in order to quickly and strategically respond to the rapidly expanding corporate cloud market, particularly to customers' needs for digital reforms in their businesses.

(2) Product Business

This segment is the consolidation of "products (package)" sales and "maintenance" that were included in the former segments of the Data Utilization Business and the Systems Operations Business, and Other Businesses. Its main products include the job management tool "A-AUTO" (automation area)*1 and the data coordination and integration tool "Waha! Transformer" (ETL area)*2. The sources of revenue are the royalties from product usage rights (license fees) and maintenance service fees, which are a fixed ratio of the product cost. This business is also developing other products and services, including BPM*3 and IoT solutions for bus operators by a subsidiary (more details are given below), and products to respond to BCP*4.

*1 "A-AUTO" is a batch processing job management tool that manages the jobs on systems that are operating on different platforms in an integrated manner and that realizes automatic implementation controls.
*2 "Waha! Transformer" is an ETL tool produced in Japan that uses non-programming to convert the data in various formats used for operations into the necessary format.
*3 An abbreviation of Business Process Management. It involves ascertaining and analyzing the sequence of operations in a company as a whole, and using an information system to continuously manage, improve, and optimize.
*4 A business continuity plan (BCP) is a plan to continue key businesses after emergencies, such as natural disasters and scandals, or to minimize losses from the discontinuation of these businesses. This business is conducted by consolidated subsidiary Bitis, Inc.

(3) Solutions Business

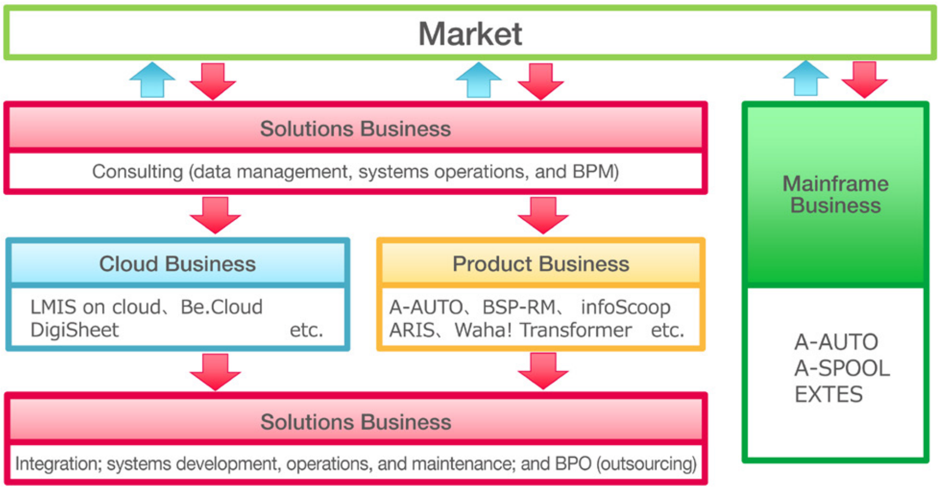
This segment is the consolidation of the "data management and systems operations consulting," "technical-support services," and "outsourcing" that were included in the former segments of the Data Utilization Business and the Systems Operations Business, and Other Businesses. The Solutions Business involves pre- and post-processes for both the "Cloud" and "Product" Businesses, and it is necessary to be aware of their relationship that means they mutually affect each other. In other words, in order to expand both the "Cloud" and "Product" Businesses, the markets are approached from the Solutions Business (consulting), which leads to the sales of products and services in both these businesses. Then after that, integrated services are provided from the Solutions Business (integration, systems development, technical support, outsourcing, etc.)

(4) Mainframe Business

This is the same segment as the former Mainframe Business segment, and it includes the products, technical-support services, and maintenance of the former business. It has been the mainstay business since the Company's foundation and is a stable source of revenue. Although it is positioned as a mature field, the Company is working to develop new demand, including by starting to provide new functions* that user companies are highly interested in.

* The Company has started to provide software with added systems operations simulation functions for mainframe users that utilize the expertise and skills it has accumulated up to the present time.

The positioning of each segment



Source: From the Company's results briefing materials

As of September 30, 2017, more than 1,200 companies had installed the Company's products. Most of these were large corporations. The range of customer industries was wide, but the manufacturing, retail and distribution, and finance and insurance industries accounted for high percentages of total aggregate sales.

In terms of sales channels, previously the Company provides its products and services mainly through direct sales, but recently it has been working to strengthen its ability to provide solutions through collaborations (promotion of a collaboration model) with its partner companies (sales agencies). The number of partner companies is increasing and has reached 93 companies (up 5 companies YoY).

The Company had the following seven consolidated subsidiaries. BSP Solutions Incorporated runs an IT service consulting business. BSP (Shanghai) Inc. is the base for sales in China. Aspex Inc. handles SaaS products for human resources outsourcing attendance management. Bitis, Inc. offers BCP development, administration and maintenance support. Data Research Institute is a data management consulting business. UNITRAND, Inc. offers solution services for IoT-based mobile equipment. UNIRITA PLUS Inc. offers sales channels to customers in western Japan and boost sales of its products while collaborating with partners.

Mainframe Business has been a source of stable profit since foundation.
Supporting active investment in the new and growth businesses

2. Corporate characteristics

UNIRITA's corporate philosophy is "Using IT flexibly, we aim to contribute to the development of society and the creation of a better future."

UNIRITA has the following three distinguishing traits.

(1) An independent developer of proprietary software

A strength of UNIRITA's products in its flagship systems operations and mainframe businesses is that they enable smooth system operation regardless of the scale of a computer, its manufacturer or other such factors. Competing manufacturer-affiliated products do not allow the replacement of the hardware component with other maker's products, which is clearly a hindrance to a customer's flexible system development. Also, as the Company's value proposition in its core businesses is the aggregate of how much the Company can contribute to the automation or improved efficiency of an IT system's operation, the track record and know-how the Company has accumulated by focusing in this area are reflected in the precision and superior performance of its goods and services and in the precision of its proposals. Amidst a readily observable trend (by other vendors) to rely on agents to install systems, the fact that UNIRITA provides its products directly, chiefly to financial institutions and large corporations, and that its products are often adopted as replacements during system updates is arguably proof of this. The Company has been hired to operate the SysAdmin's Group, the largest network of system managers in Japan, boasting more than 15,000 members and 174 endorsing companies. This demonstrates that UNIRITA is the driving force in this field. Also, the customer base of more than 1,200 companies has great potential in terms of providing them with solutions in the future to address their various business problems.

(2) Stable income from the Mainframe Business income source being invested in new growth areas

As well as having astoundingly high segment profit margin levels in the order of 53.0% (FY3/18 1H actual results), the Mainframe Business segment provides a stable income source that has supported the Company's growth. We believe this profitability is made possible not only by customer confidence in the Company's products and services, but also by high customer switching costs (costs arising from systems replacement). Sales in the Mainframe Business have been shrinking because of external factors, such as the development of open-architecture systems, but it is expected that it will for the time being play the role of a cash cow, enabling the income from the business to be diverted into investments in new growth areas, such as cloud business and product business, which we feel is a significant advantage for the Company.

(3) Achieving a structure that can support both offense and defense aspects of customers' businesses

The business structure reforms will not only contribute to the automation of and enhanced efficiency of IT systems operation, but will also allow the Company to expand into the business of assisting customers to reallocate management resources, such as HR and budgeting, to create more corporate value. By realizing structures that can support both the offense and defense aspects of customer businesses, the Company will be able to offer comprehensive proposals to improve IT investment performance at its customers and solidify its superiority in the software industry.

Business trends

FY3/18 1H results were below the initial forecasts. The main factors were the declines in orders for major projects and of sales of technical-support services

● **Summary of the FY3/18 1H results**

In the FY3/18 1H results, sales and profits declined and were below the initial forecasts. Net sales decreased 2.9% YoY to ¥3,311mn, operating income fell 23.3% to ¥561mn, ordinary income declined 20.9% to ¥643mn, and profit attributable to owners of parent decreased 23.0% to ¥435mn.

Although sales grew in the Cloud Business, in which demand is expanding, the results were adversely affected by the declines in the Product Business and Solutions Business. The main factor was that although the number of orders increased, there were no orders for major projects like in the same period in the previous fiscal year. In particular, sales in the Solutions Business were greatly impacted by the decline in orders for technical-support services due to the slump in the Product Business. Also, it cannot be said that the new sales system (proposal activities from the upstream), which integrates sales and technologies, produced results during 1H. Conversely, sales increased in the Mainframe Business, if only slightly.

In terms of profits also, while there were no special costs factors, profits declined as they were kept down by the lower sales, and the operating margin fell to 17.0% (compared to 21.5% in the same period in the previous fiscal year). It appears that profits were particularly kept down in the Solutions Business (especially from technical-support services).

On the balance sheet, total assets increased slightly, up 0.7% on the end of the previous fiscal year, to ¥13,718mn, mainly from a rise in investment securities, while equity grew 2.9% to ¥11,012mn from the accumulation of internal reserves. As a result, the equity ratio remained at the extremely high level of 80.3% (78.5% at the end of the previous fiscal year).

* From the capital and business alliance with I-NET Corp (acquired 100,000 I-Net shares equivalent to a voting-rights ratio of 0.6% through trading during off-auction hours).

Summary of the FY3/18 1H results

(¥mn)

	FY3/17 1H results		FY3/18 1H results		Change		FY3/18 1H initial forecast		Difference	
		% of sales		% of sales		% change		% of sales		Rate of difference
Net sales	3,410		3,311		-99	-2.9%	3,650		-339	-9.3%
Cloud Business	193	5.7%	245	7.4%	52	26.9%	-	-	-	-
Product Business	1,259	36.9%	1,187	35.9%	-72	-5.7%	-	-	-	-
Solutions Business	851	25.0%	747	22.6%	-103	-12.1%	-	-	-	-
Mainframe Business	1,105	32.4%	1,130	34.1%	24	2.2%	-	-	-	-
Cost of sales	887	26.0%	914	27.6%	27	3.0%	-	-	-	-
SG&A expenses	1,789	52.5%	1,835	55.4%	46	2.6%	-	-	-	-
Operating income	732	21.5%	561	16.9%	-171	-23.4%	790	21.6%	-229	-29.0%
Cloud Business	-85	-	-39	-	46	-	-	-	-	-
Product Business	187	14.9%	145	12.2%	-42	-22.5%	-	-	-	-
Solutions Business	125	14.7%	17	2.3%	-108	-86.4%	-	-	-	-
Mainframe Business	590	53.4%	599	53.0%	9	1.5%	-	-	-	-
Ordinary income	813	23.8%	643	19.4%	-170	-20.9%	870	23.8%	-227	-35.3%
Profit attributable to owners of parent	565	16.6%	435	13.1%	-130	-23.0%	600	16.4%	-165	-27.5%

	At end of March 2017	At end of September 2017	Change	
				% change
Total assets	13,624	13,718	94	0.7%
Shareholders' equity	10,700	11,012	312	2.9%
Shareholders' equity ratio	78.5%	80.3%	1.8%	-

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

Results by business are as set out below.

(1) Cloud Business

Net sales increased 26.8% YoY to ¥245mn, and the operating loss was ¥39mn (compared to a loss of ¥85mn in the same period in the previous fiscal year), so the extent of the loss decreased from the higher sales and profits. Sales of the mainstay product "LMIS on cloud" grew by 1.45 times, including from the collaboration with systems operations consulting, while sales of "Be.Cloud" were also strong and increased by 1.23 times. However, it seems that for the business as a whole, there occurred delays for ambitious plans. In profits, while an operating loss was recorded, the extent of the loss was greatly reduced by the increase in sales and achieving profitability is in sight for this business.

(2) Product Business

Sales and profits declined and were below the forecasts, with net sales decreasing 5.7% YoY to ¥1,187mn and operating income falling 22.1% to ¥145mn. In the mainstay automation and ETL areas, although the number of orders increased, there were no orders for major projects like in the same period in the previous fiscal year, which caused the results to decline. Also, in the context of the structural problems, of the progress of the commoditization of products (a situation in which differentiation is difficult) and that customers are becoming interested in more specific solutions, there seems to be limits for effective proposals for sales of stand-alone middleware products*1 compared to up to the present time. As indicated in its activities policy for the current period, for indirect sales the Company is developing a collaboration model with its partner companies, while for direct sales, it is aiming to strengthen solutions and to improve added value from proposal activities from the upstream (consulting), but these policies do not seem to have produced results during 1H. On the other hand, BPM expanded significantly*2, while sales of products by the subsidiaries, including IoT solutions for bus operators and BCP, grew steadily.

*1 Middleware plays the role of connecting the OS to applications. For applications in a specific field, it provides to the applications the functions and processing common to this field, or the middleware itself is responsible for intermediate processing and controlling applications. Therefore, in addition to being an essential function for systems, it can be said that the performance of the middleware greatly affects the quality of the system as a whole. Conversely, there are limits to proposals for specific solutions (direct solutions to customers' problems) that can be provided using middleware alone.

*2 The Company succeeded with a proposal that ascertains needs to make visible the current operations process to realize automated operations using robots.

(3) Solutions Business

Net sales decreased 12.1% YoY to ¥747mn, and operating income fell significantly, by 85.8%, to ¥17mn. Systems operations consulting trended favorably from the collaboration with the Cloud Business, but the main factors behind the lower sales were that 1) alongside the slump in sales of existing products in the Product Business, sales fell of technical-support services, which accompany the introduction of products, and 2) major projects for BPM and data management consulting declined YoY. Profits also fell significantly, as they were kept down by the lower sales.

(4) Mainframe Business

Net sales increased 2.2% YoY to ¥1,130mn and operating income rose 1.6% to ¥599mn, for higher sales and profits that exceeded the forecasts. The Company focused on proposals aimed at host-computer upgrades and risk management consulting activities when integrating systems centers. Thanks to these efforts, results grew, despite the contraction trend of the market as a whole.

Evaluation of the progress made in 1H and measures for 2H

Achieved a certain level of results toward the future, for strengthening the ability to provide solutions and developing new products and services

As its activities policy for this fiscal period, the Company is implementing four policies, of (1) integrating and enhancing the sales force to expand the customer base, (2) strengthening the ability to provide solutions through alliances, (3) providing and developing products and services that create new value, and (4) leveraging Group synergies. The evaluation of the progress made for these policies and the points for the policies in 2H are described below.

(1) Integrating and enhancing the sales force to expand the customer base

The Company integrated the existing sales functions and the customer-services functions of the technical department and reorganized the front organization. In addition, to respond to the diversifying needs of existing customers and to strengthen its problem-solving abilities, it progressed the construction of a structure for organizational sales activities. It also conducted branding according to customer industry toward appealing to them for solutions for specific targets. In particular, for the horizontal deployment of "LIVE UNIVERSE"*, which is a collaboration model with a major restaurant chain, it has been approaching customer groups different to the customers of the Company Group up to the present time, including by publishing advertisements in industry magazines, such as for the restaurant and the hotel and Japanese inn industries, and it exhibited in the largest exhibition for the restaurant industry in Japan. However, during 1H, there were also factors on the customer side (small starts, etc.) and these efforts are not yet fully contributing to results. In the 2H also, the Company's policies are to strengthen proposal activities from the upstream based on account plans, and to aim to accumulate expertise in responding to problems through approaches tailored to each customer industry.

* An e-learning and knowledge system for companies launched in March 2016 that the Company jointly planned with Golden Magic Co., Ltd.* (wholly-owned subsidiary of Diamond Dining Holdings <3073>), which operates around 100 izakaya (Japanese style) restaurants in the Kyushu Netchuya chain. It is an effective tool for training human resources (such as to pass down expertise and improve skills and motivation) by combing video and SNS (two-way communication) on the system infrastructure provided by the Company.

(2) Strengthening the ability to provide solutions through alliances

In order to strengthen its ability to provide solutions that solve problems, the Company is actively working to create a collaboration model with its partner companies. In May 2017, it entered-into a capital and business alliance with I-NET Corp <9600>, which operates a cloud-based data center, and it started providing its security solution on the cloud-based platform of I-NET Corp. It has also began partnership alliances with T.D.I. Co., Ltd.*1 and Toukei Computer Co., Ltd. <4746>*2. The number of partner companies has increased to 93 (up by 5 companies on the end of the previous fiscal year), while the number of applications of the collaboration model also increased by 6 (for a total of 35). In the 2H, the Company's policy will be to continue to advance the collaboration model with partner companies and to deploy collaborative businesses covering areas from consulting through to operations and infrastructure.

*1 The business alliance between the Company and T.D.I., which has expertise in and an abundant track record for systems migration, will enable them to provide high-quality migration solutions in a short period of time.
*2 The objective is to link Toukei Computer's operations package software for restaurant-related companies to the Company's software.

(3) Developing and providing products and services that create new value

Based on its track record of introducing products and services into more than 1,200 companies, the Company has started providing solutions (17 solutions) for its existing products from the viewpoint of customers' operations. It is focusing on the problems in common with the user companies and rather than selling a single product, it is providing users with co-creation type solutions that covers various aspects, from the selection of the products through to the operations. The previously mentioned "LIVE UNIVERSE" is precisely from this co-creation with the user, and in August 2017, the Company released the system-infrastructure part of this product as the communication specified-type PaaS "Smart Communication Platform"*1 (the first vendor of it in Japan). Also, in October 2017, it equipped "LIVE UNIVERSE" with an image recognition AI function and began providing it as a new service*2.

*1 When a company is advancing digital reforms, and when a cloud integrator is developing cloud-based services, it is a platform on which the user can select and quickly deploy the necessary functions from the systems infrastructure provided by the Company and the micro services (video, SNS, etc.)
*2 Based on the collaboration with Golden Magic, it is a framework in which AI replaces the human eye to evaluate the completeness of the meal being prepared.

(4) Leveraging Group synergies

In the second year since its establishment, the subsidiary UNITRAND, which provides solutions for mobile equipment utilizing IoT technologies*1 is steadily expanding, including by introducing its products and services to 35 bus companies and 12 local governments nationwide*2. It has also received numerous awards for the originality, international-development potential, and contribution to local communities of its "bus route search service" and other services*3. As it provides new services never seen before, it seems to be first pursuing a strategy with a sense of speed (to acquire the first-mover advantage).

*1 Solutions for bus operators utilizing IoT technologies. In addition to bus location search systems (bus route searches and bus location tracking searches), it is also developing system to count the number of bus passengers in real time.
*2 In particular, since introducing its services in Hokkaido, it has acquired a two thirds market share, and they have been introduced by 15 bus companies and three local governments. In Kyushu also, they have been introduce by companies and local governments in two prefectures.
*3 Specifically, they include the "JISA Awards 2017 Special Prize," the "ASOCIO Outstanding ICT Company Award," and the "ITS Japan Award for Excellence in Regional Activities."

To summarize the 1H results from the above, while the Company was unable to realize concrete results from its sales system, it can be said to have achieved a certain level of results toward growth in the future, of strengthening its ability to provide solutions through alliances, developing new products and services, and leveraging Group synergies.

Business outlook

Based on the progress made in the 1H results, downwardly revised the full fiscal year forecasts

The Company had downwardly revised the amounts in the FY3/18 results forecasts based on factors including the progress made in the 1H results and the current conditions. The forecasts are for a slight increase in sales but a decline in profits, with net sales to rise 0.8% YoY to ¥7,000mn (extent of revision: -¥500mn), operating income to decrease 5.2% to ¥1,380mn (extent of revision: -¥240mn), ordinary income to decline 6.1% to ¥1,460mn (extent of revision: -¥240mn), and profit attributable to owners of parent to fall 5.4% to ¥1,000mn (extent of revision: -¥170mn).

An assumption for the net sales forecast is that, continuing on from the 1H, the growth of sales in the Cloud Business and the Mainframe Business will contribute to the higher sales. Conversely, the forecast is that while the Product Business will maintain sales of about the same level YoY, they will decline significantly in the Solutions Business, and therefore overall, the sales increase will be only slight. The downwardly revised amounts reflects the slow progress made in the Product Business and other businesses in 1H, and also includes the effects on the 2H results of the decline in orders in the Solutions Business (technical-support services) as a result of this slow progress.

In profits, operating income is forecast to decrease, because in addition to the upfront investment for the future, the decline in the Solutions Business will keep down profits. The operating margin is also expected to fall slightly, to 19.7% (compared to 21.0% in the previous fiscal year)

In order to achieve the revised results forecasts, in the 2H the Company must achieve net sales of ¥3,688mn (up 4.5% YoY) and operating income of ¥818mn (up 13.2%). At FISCO, we think that it is fully possible that it will achieve its results forecasts, because sales are growing in the Cloud Business, and results are trending steadily in the highly profitable Mainframe Business, while in addition, in the Product Business, which lagged behind in 1H, factors such as the alliances with the partner companies and solutions proposals will gradually produce results. Rather, toward accelerating growth from the next period and onwards, we shall be focusing on the progress made by the Company in terms of to what extent it can heighten the degree of completion of its unique value creation model and how this will connect to specific results, such as from strengthening the sales system (proposal activities from the upstream), developing the collaboration model with partner companies, and jointly creating new businesses with user companies.

Forecast for FY3/18

(¥mn)

	FY3/17 results		FY3/18				YoY	
			Initial forecast		Revised forecast		Initial forecast	Revised forecast
		% of sales		% of sales		% of sales		
Net sales	6,941		7,500		7,000		8.0%	0.8%
Cloud Business	458	6.6%	600	8.0%	520	7.4%	31.0%	13.5%
Product Business	2,629	37.9%	2,832	37.8%	2,630	37.6%	7.7%	0.0%
Solutions Business	1,747	25.2%	2,100	28.0%	1,620	23.1%	20.2%	-7.3%
Mainframe Business	2,105	30.3%	1,968	26.2%	2,230	31.9%	-6.5%	5.9%
Cost of sales	1,830	26.4%	-	-	-	-	-	-
SG&A expenses	3,654	52.6%	-	-	-	-	-	-
Operating income	1,455	21.0%	1,620	21.6%	1,380	19.7%	11.3%	-5.2%
Ordinary income	1,555	22.4%	1,700	22.7%	1,460	20.9%	9.3%	-6.1%
Profit attributable to owners of parent	1,056	15.2%	1,170	15.6%	1,000	14.3%	10.7%	-5.4%

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

Growth strategy

Aiming to realize customers' digital reforms as a co-creation partner

The Company changed its management structure in conjunction with the changes to its representative directors as a generational transfer of leadership to accelerate the reforms to its business structure. In the new system, on the axis of the UNIRITA Smart Formation Service, it is taking the direction of supporting the smooth realization of digital reforms at its customers. Particularly, there has been in an increase in the number of competing players due to the acceleration of cloud computing usage and changes to the relationships with customers (specifically, on the one hand, the trend toward in-house manufacturing in the IT field that is the source of its competitiveness, but on the other hand, in the highly versatile IT field that includes systems operations, the movement toward outsourcing and shifting the IT budget from the information systems division to the business division). In this situation the aim is to evolve from the provision of methods to the solving of problems (integration with solutions) from the support provided by the Group as a whole, from upstream (consulting) through to the construction of foundations, the implementation of functions, and operations and BPO, and to progress the collaboration model with the partner companies. Going forward, the Company will actively form alliances and conduct M&A necessary to achieve this aim. Also, it is aiming to be a co-creation partner to realize customers' digital reforms by combining the software development technologies of the companies in the Group, its expertise in systems operations, and its digital platform technologies in order to make effective use of its customers' business expertise and accumulated data.

At FISCO, we are focusing on the direction that the Company is taking to further evolve the reforms to its business structure that it has implemented so far (including constructing a business structure that integrates offense and defense and replacing IT skills in the new and growth businesses), and placing greater emphasis on the provision of solutions (directly solving customers' problems and creating new businesses). In other words, in addition to selling stand-alone products, we expect that the Company will be able to increase its appeal and competitive advantages for customers (especially those with a budget) and also expand the possibilities in terms of development potential and development capabilities for businesses by utilizing the collaborations between all of the Group companies, and from joining with customers, partner companies, and alliance partners, to create new value.

Particularly in the case of the Company, while on the one hand it has a rich customer base (points of contact) that it has accumulated in systems operations up to the present time, it has also established a system to provide a wide range of products (services) from both the aspects of offense and defense, including from its subsidiaries that have high levels of expertise and mobility, and we think there is great potential to combine these aspects to create a variety of solutions.

Corporate history and business performance

Management integration with Beacon IT in April 2015. Made a new start as UNIRITA

1. Corporate history

The Company was established as Three B, Inc. in 1982 in Tokyo's Chuo Ward as a subsidiary of Business Consultant, Inc., a provider of programs for HR and organizational development. Business Consultant was the origin for Software AG of Far East, which changed its name to Beacon IT in August 1996. Software AG of Far East had been selling A-Auto software for automating the scheduling of complicated computer systems jobs and enhancing the efficiency of IT systems administration in Japan, with Three B, Inc. being set up to sell this software in the U.S.

Subsequently, in 1987, Three B, Inc. changed its name to BSP. The turning point for BSP was when it took over the systems management operations of Software AG of Far East in 1993 and commenced full-scale operations as a specialist in systems administration package software. After that it steadily strengthened its operational platform, while benefiting from increased investment in IT systems in Japan, and built a track record chiefly in software for core mainframe systems, mainly for financial institutions and large corporations.

In 2001, the Company established BSP Solutions Inc. and commenced full-scale consulting solutions operations. In 2006, it listed its shares on the JASDAQ Securities Exchange, currently TSE JASDAQ.

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

By consolidating Beacon IT in January 2014, BSP, as well as incorporating growth areas such as data utilization, began reforming its business structure.

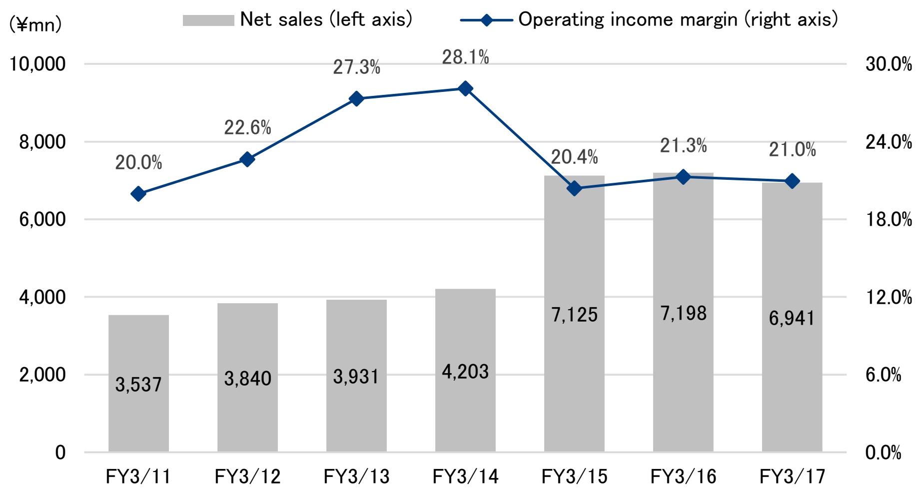
With the merger of Beacon IT in April 2015, the Company changed its name to UNIRITA Inc. The new company name embodies the concept of aspiring to contribute to the development of customers and society with "unique ideas" to create value and an "altruistic" spirit ("rita" being the Japanese word for altruism).

2. Past business performance

Looking at the Company's results trends, while net sales declined YoY from FY3/09 to FY3/10 due to the impact of the economic recession resulting from factors such as the collapse of Lehman Brothers, from FY3/12 onward, amidst a shift to open architecture systems, there has been continued underlying growth in sales, led by sales growth in the systems operations business, which is now part of the Product Business. Also, as a result of the consolidation of Beacon IT in FY3/15, the Company's operational scope expanded significantly.

From a profitability perspective, despite there still being a high degree of reliance on the Mainframe Business for income, the Company's operating income margin trended upward with improving profitability in the Product Business and reached 28.1% in FY3/14. However, this margin has declined since FY3/15 due to upfront expenditure in line with its structural business reforms and other factors. Notwithstanding, the Company has maintained it at levels exceeding 20%.

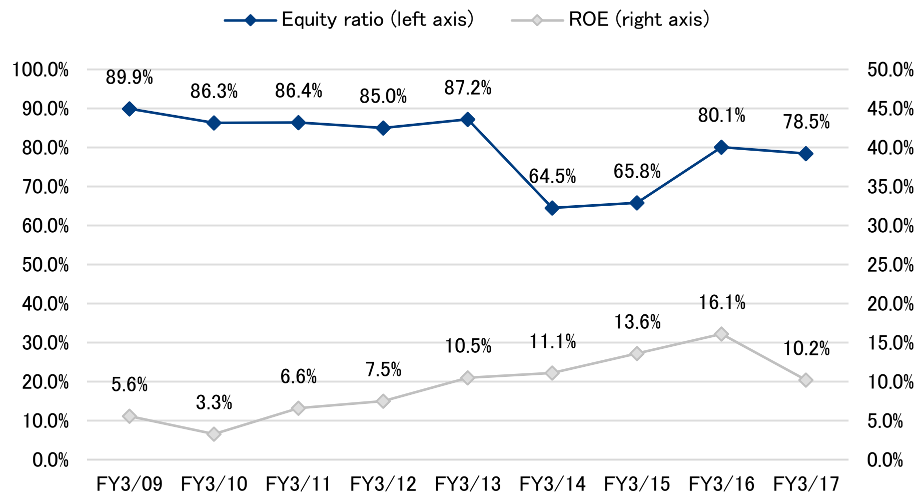
Net sales and Operating income margin



Source: Prepared by FISCO from the Company materials

From a financial perspective, the Company arguably has an extremely conservative financial strategy. While the Company's shareholders' equity ratio, which represents the stability of the fiscal platform, suffered a one-off decline in FY3/14 as a result of the consolidation of Beacon IT, in FY3/16, in line with its merger with Beacon IT (and parent equity adjustment), the ratio rose to 80.1%. Further, the current ratio also, which represents its ability to meet short-term payments, reflecting an ample balance of cash and deposits, is trending at high levels, being 429.8% at March 31, 2017. However, we may view the strength of its financial platform as underpinning the Company's growth, at times when it is necessary to invest in future growth fields. ROE, a measure of capital efficiency, moves in lock step with the Company's profit margins, and has been above 10%.

Equity Ratio and ROE trends



Source: Prepared by FISCO from the Company materials

Industry environment

High growth in fields relating to big data and workstyle reforms

According to a survey by International Data Corporation Japan, in 2016, the software market in Japan was worth approximately ¥2.6957 tn (up 2.2% YoY). The market's growth is being driven by the fact that measures for big data have become fully fledged and the high growth of the data management software and analytics software markets. Also, in the applications market, the field relating to workstyle reforms in companies is growing. Elsewhere, the systems management software market, which is the Company's core area, performed strongly and was worth around ¥327.9bn (up 4.6%). It seems that an increasing number of companies are introducing software to monitor the operations of new systems, such as to monitor IT resources and performance and for log analysis, in order to respond to the increasing complexity of IT systems resulting from virtualization and the transition to the cloud computing.

The main developers of software in Japan are vendors affiliated with large Japanese computer makers, such as Hitachi, Ltd. <6501>, FUJITSU LIMITED <6702>, and NEC Corporation <6701>, and vendors affiliated with foreign computer makers, such as IBM Corporation and Hewlett Packard Company. However, UNIRITA holds a large share of the Japanese market for software for mainframe computers and remains positioned to receive survivor benefits. Furthermore, there is no other listed software vendor specializing in IT systems operation and data utilization in Japan. That is, there is no other listed company producing its own package software.

There is an increasing trend for users to invest in IT areas that contribute directly to their business expansion. Thus, they are acquiring digital technologies, such as big data utilization, artificial intelligence (AI), and IoT. They are also building business models based on the perspectives of their customers in order to create new corporate value.

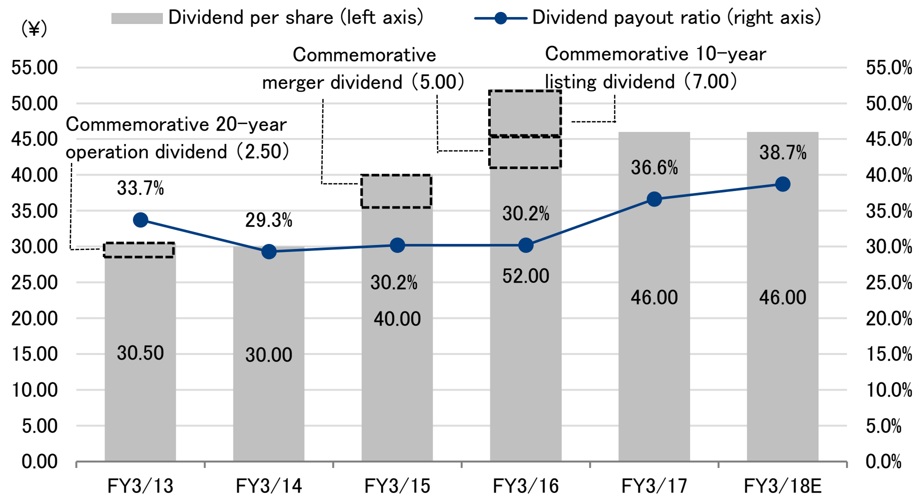
Shareholder returns

The forecast annual dividend in FY3/18 is again ¥46 (interim dividend ¥23, year-end dividend ¥23)

The Company's policy toward shareholder returns is to maintain a consolidated dividend payout ratio of 30%. For FY3/18, it has left its initial forecast unchanged of an annual dividend of ¥46 (interim dividend ¥23, year-end dividend ¥23), which is the same as in the previous fiscal year (for a forecast dividend payout ratio of 38.7%). Given the Company's profitability and growth potential, at FISCO, we think it is highly possible that the dividend will increase in the future alongside the profit growth in the medium term.

Further, the Company has deployed a shareholder incentive scheme to increase the number of individual shareholders and enhance liquidity. Under this scheme, all shareholders as of March 31 each year will be presented with JCB gift cards corresponding to the number of shares they hold.

Dividend per share and Dividend Payout Ratio



Source: Prepared by FISCO from the Company materials

Disclaimer