# Alpha-Win Company Research Report

# CUBE SYSTEM INC.
## (2335 TSE First Section)

Issued: 6/28/2019

● Summary

**Research Dept., Alpha-Win Capital Inc.**
**http://www.awincap.com/**

**Business Description**

・CUBE SYSTEM INC. (hereinafter, the "Company") is an independent, mid-tier system integrator (SI) listed on the First Section of the TSE. Its main customers include Nomura Research Institute and Fujitsu Group. It provides services and develops systems mainly for the finance, distribution, and telecommunications industries. Founded in 1972, it has 47 years of history.

**Current Financial Performance**

・With the exception of one fiscal year, the Company has been continuously increasing sales YoY for the past 18 years. During this period, its annual sales growth rate (simple average of the rate of increase in sales) was +6.4% and its annual recurring profit growth rate (simple average) was +6.0%; the Company has been steadily expanding its business and keeping its business in the black over many years. Thanks to its committed efforts in business development and management reform, the recurring margin has been stable at around 7% and the increase in sales has been contributing directly to increases in profit, dividend, and market capitalization.

・Last fiscal year's results were mostly in line with the Company's plan; sales increased by 5.6% and operating profit increased by 7.8%. Record-high sales were achieved for the sixth consecutive year and the profits have also recovered to levels close to their record highs. This fiscal year, the Company plans to increase sales by 8.2%, achieve a double-digit profit growth, attain record highs for sales and each of the profits, and raise dividend by Y2. With a generally positive business environment, the Company's efforts up until now have paid off, leading to a strong growth of the orders received. Comparison of the Company and its two competitors' financial forecasts for this fiscal year indicates that the Company's business is also strong on a relative basis. Given the current situation and the Company's estimates, Alpha-Win Research Department predicts that this fiscal year's financial performance will be mostly at the same level as predicted by the Company and believes that record-high sales and profits are possible.

**Competitiveness**

・Its strengths are its excellent customer base, extensive experience, strong trust from its customers, and the skill and know-how that it has built up over the years. Along with the development of business content and domain, the Company has been improving its capacity to meet the needs of more projects, thus becoming more competitive.

**Business Strategy**

・The Company has established a medium- to long-term management vision. With the "creation of a new service lineup" as its goal, the Company currently aims for management targets of Y18.5 billion in sales, Y1,776 million in operating profit (9.6% in O.P. margin), and 13% in ROE by FY 2021. Also, it is focusing on new business fields such as blockchain, AI, and IoT, as well as steadily laying out the foundation for future business expansion through alliances, etc. Going forward, the key points would be the continued improvement of profit margins, monetization of businesses in new business domains, acquisition of new customers, acquisition and training of human resources, M&A and alliance strategies, globalization, and incorporation of new technologies.

**Forecast on Medium-Term Financial Results**

・The Company's business is affected by the financial performance and system investment trends of its domestic corporate customers. However, Alpha-Win Research Department believes that the Company will be able to continue to steadily increase both sales and profits by about 6-10% per year over the medium to long term due to the expected growth of the Enhancement business (the Company's strength), acquisition of new customers, overseas development, and productivity improvement through various measures.

### Shareholder Return

・The Company has been proactive in returning profit to shareholders. In fact, it has bought back its shares, performed stock splits, and raised dividend in steps. When benefits from the shareholder benefit program are added to dividend, the actual dividend yield is about 2.9% at maximum. The forecasted dividend payout ratio is about 36%, which is around the average of its industry. With strong financial performance and ample cash, we believe that the Company may decide to raise shareholder return in the future through various means such as share buyback, increase in dividend, and enhancement of the shareholder benefit program.

### Stock Characteristics and Stock Price

・The Company's stock is a domestic-demand-related, defensive, stable growth stock, most likely to be seen as a medium- to long-term investment target. Its valuation is about average for the industry. In the past ten years or so, its stock price has increased by about four times and has been largely outperforming the TOPIX. Regarding stock price, we should watch the Company's development of new technologies and businesses, alliances with other companies, M&As, and increased shareholder return in addition to how it makes progress with its financial performance during this FY, in the next FY, and onward.

【 2335 CUBE SYSTEM Sector: Information & Communication 】 Figure A

| FY | | Sales (Y mil) | YOY (%) | O.P. (Y mil) | YOY (%) | R.P. (Y mil) | YOY (%) | N.P. (Y mil) | YOY (%) | EPS (Y) | BPS (Y) | Dividend (Y) |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 2017 | | 12,899 | 2.2 | 781 | -17.7 | 811 | -15.5 | 551 | -12.3 | 39.15 | 346.47 | 14.0 |
| 2018 | | 13,559 | 5.1 | 855 | 9.5 | 892 | 10.0 | 567 | 2.9 | 40.59 | 372.23 | 16.0 |
| 2019 | | 14,325 | 5.6 | 921 | 7.8 | 959 | 7.5 | 596 | 5.1 | 43.25 | 393.29 | 16.0 |
| 2020 | CE | 15,500 | 8.2 | 1,090 | 18.3 | 1,090 | 13.6 | 684 | 14.6 | 49.58 | - | 18.0 |
| 2020 | E | 15,400 | 7.5 | 1,080 | 17.3 | 1,080 | 12.6 | 680 | 14.1 | 50.17 | 427.45 | 18.0 |
| 2021 | E | 16,500 | 7.1 | 1,200 | 11.1 | 1,200 | 11.1 | 750 | 10.3 | 55.33 | 464.78 | 18.0 |
| 2022 | E | 17,800 | 7.9 | 1,320 | 10.0 | 1,320 | 10.0 | 825 | 10.0 | 60.86 | 507.65 | 20.0 |

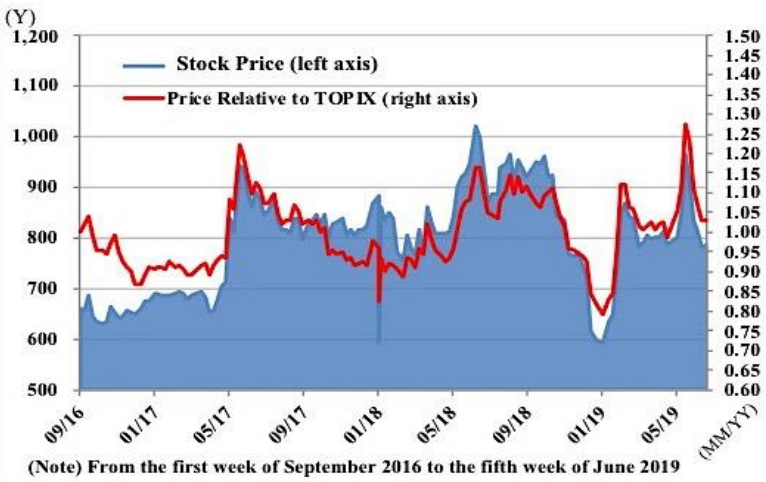
(Note) CE= the Company's estimate/forecast. E = Alpha-Win Research Dept.'s estimate/forecast. All fiscal years in this document are March-ending.

【 Stock Price and Valuation Indicators: 2335 CUBE SYSTEM 】 Figure B

| Item | as of 6/28/2019 | Item | P/E | P/B | Dividend Yield | Dividend Payout Ratio |
|---|---|---|---|---|---|---|
| Stock Price (Y) | 785 | Last FY (actual) | 18.2 | 2.0 | 2.0% | 37.0% |
| Shares Outstanding (thou.) | 15,280 | This FY (est.) | 15.6 | 1.8 | 2.3% | 35.9% |
| Market Capitalizatoin (Y mil) | 11,995 | Next FY (est.) | 14.2 | 1.7 | 2.3% | 32.5% |
| Dilutive Shares (thou.) | 0 | Equity Ratio at Last FY-End | 65.4% | Last FY's ROE | | 11.4% |

(Note) Estimates/forecasts were made by Alpha-Win Research Dept.

【 Stock Chart (end-of-week prices): 2335 CUBE SYSTEM 】 Figure C




(Note) From the first week of September 2016 to the fifth week of June 2019

[Performance]

| Period | Return | vs. TOPIX |
|---|---|---|
| 1 month | -14.0% | -16.2% |
| 3 months | -1.8% | 0.8% |
| 6 months | 31.7% | 26.9% |
| 12 months | -16.0% | -6.2% |

(Note) Reflects stock price and index values up to the end of June 2019.

# Contents



Note: Upon translating to English, when the page numbers differed from the original Japanese version, they were adjusted to those of the English version of the Report.

# 1. Company Overview

◆ An independent system integrator with 47 years of history in the industry. Specialized and mid-tier. Stable customer base with several blue-chip companies among its customers.

(1) System integrator: a company that conducts system integration. Abbreviated as "SI" or "SIer." A general term for companies that plan, design, develop, operate, and provide other solutions for the IT operation systems of customers including companies and the government.

◆ The Company's group is made of the Company and three subsidiaries. Consolidated-to-parent-company sales ratio has stayed around 1.1. Total profit and loss of the three consolidated subsidiaries has also stably been a surplus.

(2) Offshore development: providing services that meet customer needs, from system development to maintenance, at a low cost using overseas/offshore sites

◆ All fiscal years discussed in this Report are March-ending, unless otherwise noted. For example, FY 2020 ends in March 2020.

## ◆ Independent, Mid-Tier System Integrator

CUBE SYSTEM INC. (hereinafter, the "Company") is an independent system integrator[1] (a.k.a. SI). It is listed on the First Section of the TSE and is a mid-tier player in the system integration industry. Often as a subcontractor of major SIs, the Company mainly develops the systems of large companies in the finance, telecommunications, and distribution industries, as well as of the government. Its customer base is firm, having expanded its business with its main customers over many years. The Company has technological expertise and has earned strong trust from its customers, with the four corporate groups Nomura Research Institute, Fujitsu, Aeon, and Mizuho as its main customers and receiving outsourced jobs from the Tokyo Stock Exchange as well.

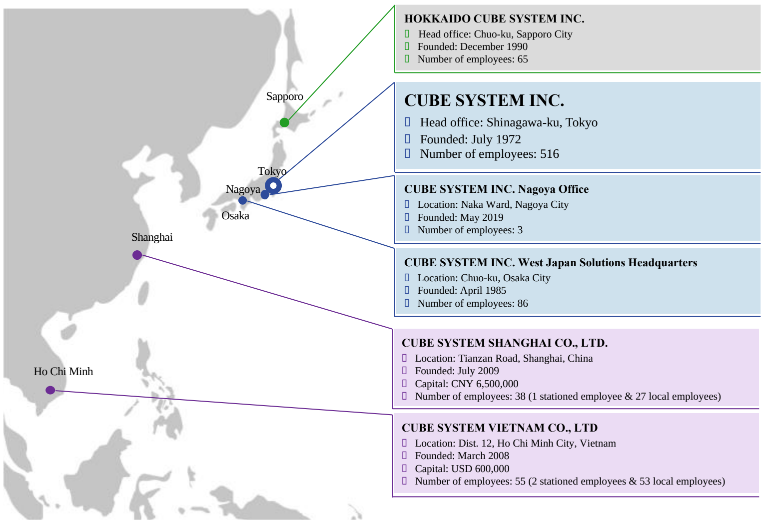
Founded in 1972 at the outset of the software industry, the Company has 47 years of history. The current president is one of the founding members.

The Company's group consists of four companies: the Company and three consolidated subsidiaries. The consolidated subsidiaries are as follows (Figure 1).

1. HOKKAIDO CUBE SYSTEM INC.
(Located in Sapporo, Hokkaido; founded in 1990 by the Company, which owns 90.9% of the shares, for system development and sales reinforcement in the Tohoku and Hokkaido regions)
2. CUBE SYSTEM VIETNAM CO., LTD.
(Ho Chi Minh City, Socialist Republic of Vietnam; founded by the Company in 2008 as a 100% owned subsidiary)
3. CUBE SYSTEM SHANGHAI CO., LTD.
(Shanghai, China; the Company established CUBE SHENYA SYSTEM SHANGHAI CO., LTD., as a joint company in 2009, and then acquired all shares in Dec. 2017 upon which the name was changed to the current one.)

The overseas subsidiaries were founded mainly to cut down on cost, to acquire human resources, and as system development sites (offshore development[2]).

**[Figure 1] Locations of CUBE SYSTEM Group's Subsidiaries and Offices**

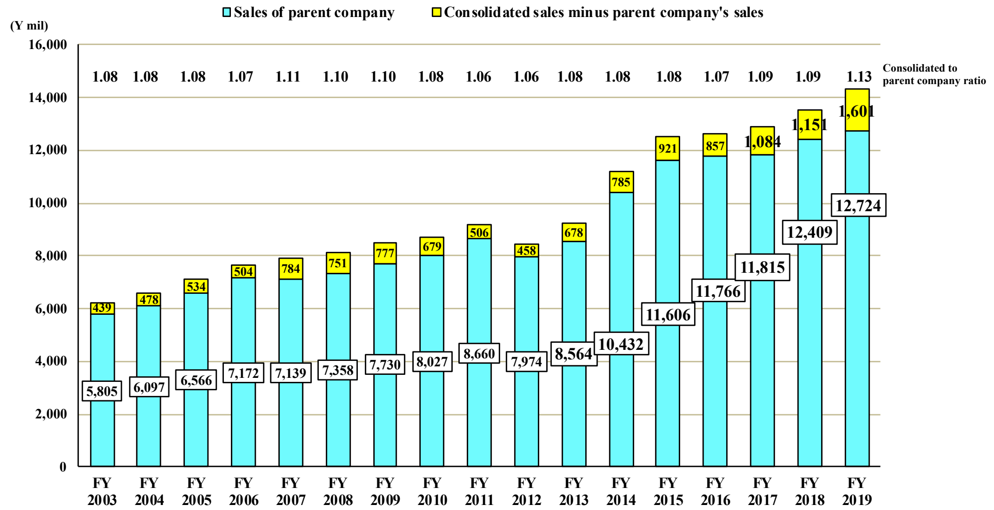



(Ref) The Company's materials and data

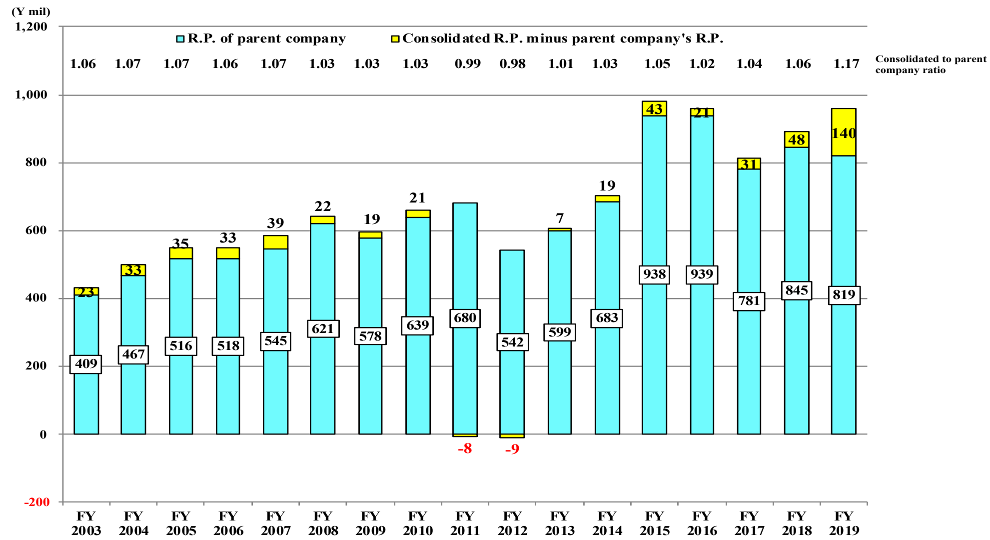
◆ Consolidated subsidiaries' as well as the consolidated financial performance has been on the rise with regards to sales and profits. Consolidated-to-parent-company ratios are greater than 1x for both sales and profits.

The consolidated-to-parent-company sales ratio has stayed around 1.1 for the past 17 years, indicating that the parent company's financial result is significantly larger (Figure 2). Although the individual subsidiary's profit and loss are not disclosed, the consolidated-to-parent-company recurring profit ratio has been around 0.98 to 1.17 during the same period. Moreover, the total profit and loss of the three subsidiaries, calculated by subtracting the parent company's recurring profit from the consolidated recurring profit, has been a surplus with the exception of the two periods FY 2011 and FY 2012 (Figure 3). In the last three fiscal years, the overall financial performance of the subsidiaries has also on the rise with regards to sales and profits.

**[Figure 2] Ratio of Consolidated to Parent Company Sales** **(ratios shown on upper portion of graph)**




**[Figure 3] Ratio of Consolidated to Parent Company Recurring Profit** **(ratios shown on upper portion of graph)**




(Ref) Both Figures 2 and 3 were prepared by Alpha-Win Research Dept. based on the securities report.
**(Note) The estimates/forecasts are, unless otherwise noted, from the Company's plan/forecast. Since we generally round off the decimal place, certain values may slightly differ from the Company's official disclosed values and other values. These apply to the rest of this document.**

◆ The Company's wish is embedded in its name.

The company name CUBE comes from the first letters of "CU=Customer (customer first as the motto)," "B=Brain (exert high-level intellect and knowledge)," and "E=Emotional mind (solutions that move the heart). Also, CUBE also has the meaning of a geometrical cube – it reflects the wish to grow as a company with a cube-like multi-dimensionality (the six faces are innovation, humanity, vitality, internationality, technology, and youthfulness).

◆ Essentially debt-less, firm management. Rich in cash.

The Company's finance is strong with essentially no debt. Its free cash flow (FCF) has also been stable and positive, and the cash and deposits are gradually accumulating (Figure 4). The Company has approximately Y3.1 billion in cash and deposits in addition to more than Y1 billion in high-liquidity stocks and foreign bonds, totaling about Y4 billion in highly liquid assets. In comparison, its debt is Y240 million (total assets = Y8.1 billion, market capitalization = Y12.2 billion, and sales = Y14.3 billion). Its financial ratios are also high and stable, with an equity ratio of 65% and current ratio of 273% (all values are those as of the end of March 2019).

**[Figure 4] Transition in Cash Flow (CF)** **(Note: FCF stands for free cash flow. Unit = Y mil)**

| Unit: Y mil | FY 2010 | FY 2011 | FY 2012 | FY 2013 | FY 2014 | FY 2015 | FY 2016 | FY 2017 | FY 2018 | FY 2019 |
|---|---|---|---|---|---|---|---|---|---|---|
| Operating CF ① | 283 | 622 | 101 | 451 | 317 | 503 | 534 | 936 | 388 | 773 |
| Investing CF ② | -1 | 309 | 54 | -321 | -172 | -307 | 25 | 94 | 28 | 46 |
| Financing CF | -144 | -173 | -125 | -151 | -188 | -439 | -241 | -610 | -392 | -531 |
| FCF (①+②) | 282 | 931 | 155 | 130 | 145 | 196 | 559 | 1,030 | 416 | 819 |
| Cash and Cash Equivalents | 1,618 | 2,375 | 2,405 | 2,382 | 2,338 | 2,098 | 2,407 | 2,822 | 2,845 | 3,130 |

(Ref) Prepared by Alpha-Win Research Dept. based on the financial results summary
**(Note) "Cash and cash equivalents" are not equivalent to "cash and deposits" on the B/S but are values from the "Statements of Consolidated Cash Flows" in the financial results summary.**

## ◆ Business Philosophy and Basic Management Policy

◆ The business philosophy / goal is to "create a world-class company."

The Company's business philosophy is as follows:
・A company flourishes with the people's support. We must continue to exist to promise the well-being of the people including our employees. Root of continuity and development is profit, and profit is brought by customers. Under this philosophy, we will "create a world-class company."

◆ The basic management policies are "Customer First," "Focus," and "All-Employee Sales."

The following are the Company's three basic management policies:
・Customer First: All decisions are based on our customers' values and it is our standard to think from our customers' perspectives.
・Focus: The four main elements of a company are its people, assets, money, and time. In order maximally utilize these elements, we will focus our business resources on the most important matters that have been decided based on our customer-first policy.
・All-Employee Sales: In order to provide user-oriented services, each employee will work toward the development of the Company's business as independent business persons. (⇒has established a unique all-employee sales system[3])

(3) All-employee sales system: a system where there is no dedicated department for sales but instead each project is managed as a whole from receiving an order to delivering the product and confirming the payment. The system engineer, who is in charge of responding to customers, will materialize the systemization needs of customers through dialogues and carry out projects with responsibility and authority under a sales goal.

◆ Management goals and results are shared among all employees.

Moreover, numbers such as sales, profits, and progress rate toward a goal for the entire company as well as for each department are disclosed to all employees. Thus, information is being shared in an open management system.

# 2. Business Description and Business Model

## ◆ Three Lines of System Service

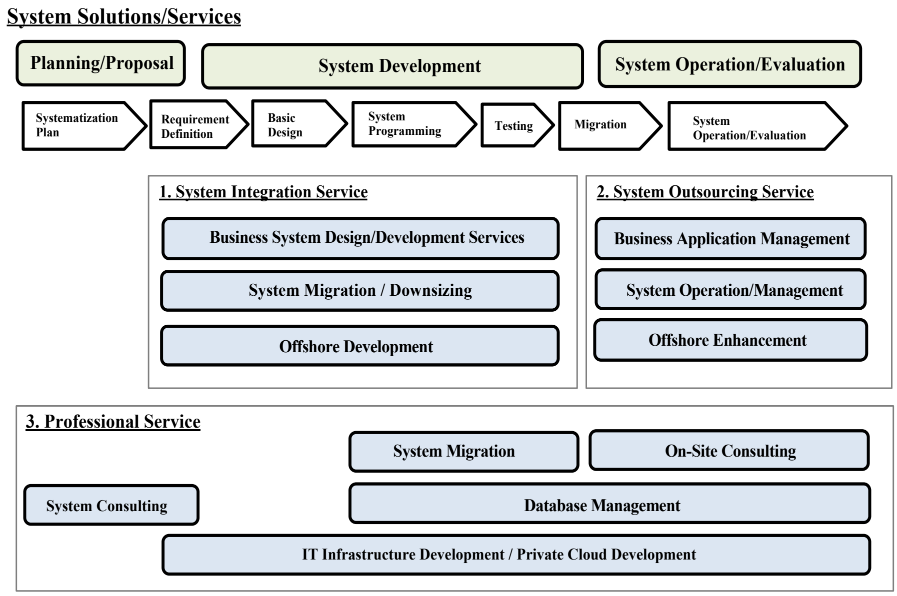
- Business is classified into three categories. The System Integration Service, which is mainly system development, accounts for 70% of the sales. Profit margins of the three categories are about the same.

As its business, the CUBE SYSTEM Group provides system solutions[4]. Specifically, the Company provides a series of services dealing with the planning/proposal, design, manufacture (by programming), testing, operation, and evaluation of systems for other companies or the government. Since this is the Company's single business, the business is further classified by the informatization cycle of the customer into the following three categories (services lines).

1. System Integration Service (SIS)
2. System Outsourcing Service (SOS)
3. Professional Service (ProS)

(4) System solution: solving issues related to systems through hardware, software, and services

**[Figure 5] Overview Diagram of the Processes in Each Service**




(Ref) Prepared by Alpha-Win Research Dept. based on the securities report

(5) Requirement definition: defining the scope and target of systemization

(6) Basic design: also called external design, a part of the upstream process where the basics of the functions necessary for a system from the user's perspective are designed (screen, method of operation, security, etc.). The workflow is as follows: basic design → internal design → detailed design → manufacture (also called programming or implementation).

1. System Integration Service (SIS)

- Projects are diversified.

・The Company's main business. Develops business operation systems that meet the needs of end users such as companies and the government (hereinafter collectively referred to as "corporate users"). Includes requirement definition[5], basic design[6], programming, and testing (Figure 5).

・While the time it takes from receiving an order to delivering the product can range from a few months at the shortest to about three years, most projects are completed in the order of several months. Most orders are received and delivered during the same fiscal year. The price can also range from several million yen to several hundred million yen, but projects priced less than Y50 million are by far the most common.

・In general, engineers are stationed at the corporate user's site and conduct system development for each project in teams. However, to cut down on cost and secure the necessary number of engineers, a part of the development is outsourced to domestic and overseas subsidiaries or other companies in the same business under supervision of the Company's project manager.

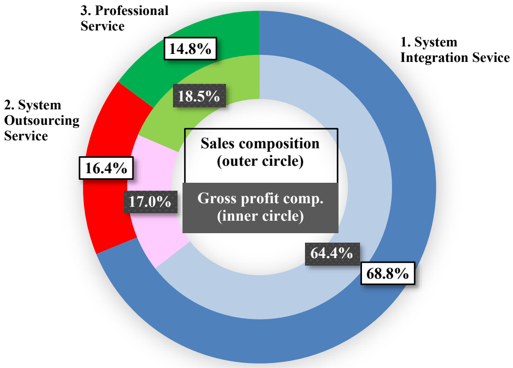
- System Integration Services are based on contracts. Project management of the risks and the profit/loss is important.

(7) Standard development framework F@CE: The Company's unique general framework for standardizing and streamlining application development. A tool for carrying out projects efficiently by preventing operation errors or omissions.

(8) Enhancement Service: Providing not just system maintenance, management, and development services but also improving system performance and quality to increase the value of the system. Or proposing ideas for new businesses. Improves customer satisfaction through these means. For the Company, this service means continued business with the customer.

(9) Business related to Oracle Cloud: Cloud-related services and proposals based on Oracle's database. The Company plans to continue to strengthen this business by increasing the number of certified employees. Current sales are several hundred million yen.

**[Figure 6] Composition of Sales (outer circle) and Gross Profit (inner circle) by Service Category in FY 2019**




(Ref) Prepared by Alpha-Win Research Dept. based on the financial results summary

・Since the system development business is, in general, based on contract agreements, the SI (the Company), who is the contractor, bears responsibility for the products (systems). Therefore, management of the risks and the profit/loss of projects and products is important.

・Projects are often obtained through proposals or by bidding. Estimates are generally calculated based on [number of staff] x [number of months]. After receiving an order, in developing a system, the Company employs knowledge, know-how, and fundamental technologies pertaining to various industries, companies, and businesses that it has accumulated over the years, as well as its standard development framework F@CE[7], to reduce the risk and improve quality, profitability, and efficiency.

・Since unexpected changes in specifications, additional work exceeding the initial estimate, etc., would negatively affect profitability and may make the project unprofitable, the Company is especially keen on improving its project management skills. The Company is also active in providing the Enhancement Service[8], where the Company works closely with corporate users to make various proposals that will lead to new businesses (compact system development).

2. System Outsourcing Service (SOS)

・Services related to the operation and evaluation of systems. It provides two solution services: System Operation & Management (development, management, and evaluation of components of a system such as hardware, basic software, database, network environment, etc.) and Business Application Management (maintenance, management, and improvement of business applications and evaluation of management processes). The Company also has a seamlessly linked service structure where new challenges found and proposed during system maintenance and operation (SOS) can lead to a new Enhancement Service project (SIS).

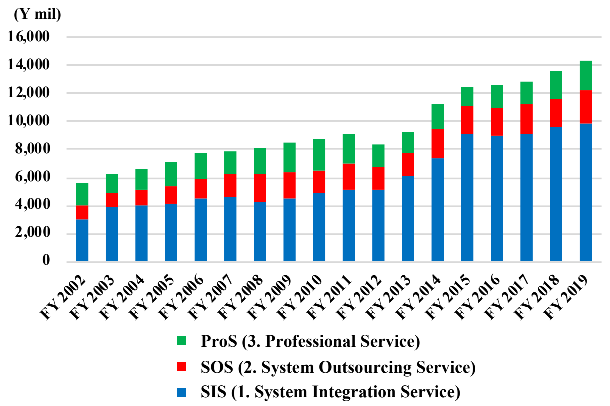
3. Professional Service (ProS)

・Services that utilize the Company's technologies to solve everything related to the informatization cycle from planning, designing, and developing infrastructure to operating/monitoring systems, such as consulting, database improvement for greater efficiency, system monitoring, management support, and IT strategies. High performance is realized by development tools and the skills of certified experts. The Company is especially strong in database technologies, for which it has expert engineers (business related to Oracle Cloud[9]).

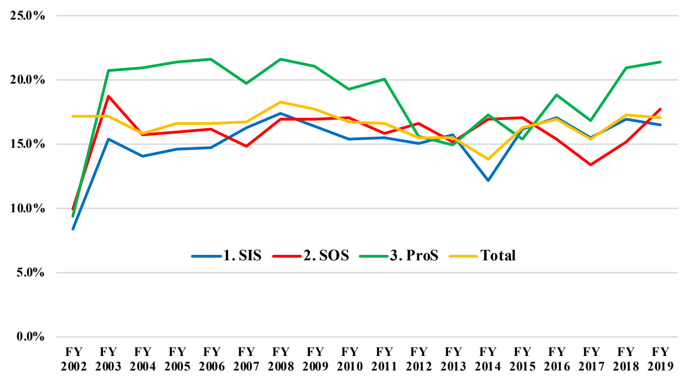
Breakdown of sales and gross profit by each of the three categories and their transition over the years are shown in Figures 6-8. The sales breakdown shows that SIS accounts for about 70% of the total, and SOS and ProS almost equally share the remaining 30% (outer circle of Figure 6). Over the past 18 years, total sales grew by 2.6x. Specifically, sales of SIS grew by 3.3x, SOS grew by 2.3x, and ProS grew by 1.4x; SIS has been the main driver of business growth (Figure 7 on page 9).

Breakdown of gross profit is shown in Figure 6 (inner circle). The breakdown is not very different from that of sales. Also, as indicated by the transition in gross margin shown in Figure 8 on page 9, although some years were marked by a 5% difference at maximum, each category has generally stayed within the range of 15% to 17%. However, the gross margin of ProS, which creates high added-value, is 4-5 points higher than the other two categories. The overall gross margin, though, depends on the gross margin of SIS since SIS accounts for an extremely large percentage of the total sales (Figure 8).

**[Figure 7] Sales by Service Category**




**[Figure 8] Transition in the Gross Margin of Each Service Category**




(Ref) Prepared by Alpha-Win Research Dept. based on the securities report

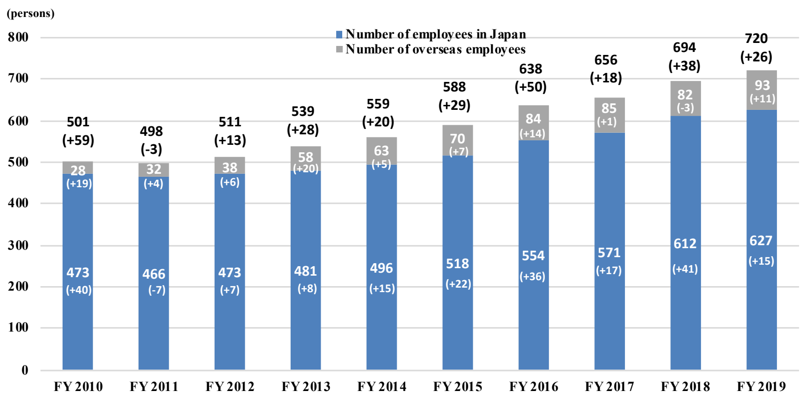
## ◆ Labor-Intensive Business Model Where Human Resources Are the Key

• Labor-intensive business. Acquisition and training of talented personnel is the key to growth.

Since most of the Company's business is based on order-made system development contracts, its business is strongly characterized as a labor-based, single-product production model. Therefore, the acquisition and training of talented personnel are key factors since human resources are the source of competitive advantage and growth potential. Especially since systems are becoming more advanced and complex, talented employees for roles such as project managers in charge of overall project management and system engineers are crucial in order to manage system quality, cost, deadlines, and profit/loss. Currently, the Company has about 260 project managers, but this number is somewhat short – this shortage is a bottleneck to further growth.

The change in the number of employees for the entire CUBE SYSTEM Group is as shown in Figure 9. Every year, the Company has been adding up to several dozens of new employees in preparation for business expansion. However, due to the labor shortage in recent years, it seems to not have been able to acquire enough employees for its business expansion (in FY 2019 in Japan, the employee turnover rate was 9.8%, the retention rate was 76.8%, the net increase in the number employees compared with the previous fiscal year was 15, and the rate of increase was 2.5%).

**[Figure 9] Change in the Number of Employees in the Group**




(Ref) Prepared by Alpha-Win Research Dept. based on the securities report

With regards to cost structure, labor cost and subcontracting cost paid to business partners (basically, mostly personnel expense) account for over 90% of the cost of sales (stand-alone percentage for FY 2019) (share of sales for each cost is 26% and 51%, respectively). Therefore, the Company's skill in controlling these two costs may affect profitability, making project management crucial.

(10) Agile development: an approach to project development. Unlike the conventional waterfall development, it divides a system into short phases and conducts repeated implementation (programming) and testing to cut down on development time. "Agile" means dexterous and quick.

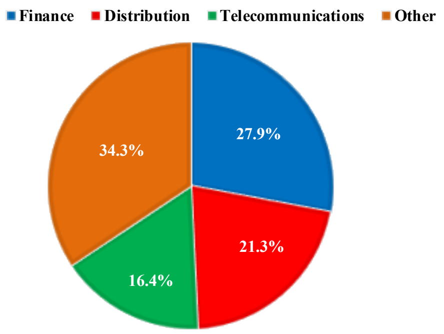
Generally, the system integration business is one where rapid expansion by unique products and services is difficult. Additionally, although the sharing and utilization of know-how is possible to some extent, currently there is a limit to improving productivity due to the reliance on manpower. This difficulty with profit margin improvement is a characteristic of the industry rather than just the Company. Faced by this challenge, the Company plans to continue to improve its profit margins by carrying out various measures that do not rely heavily on manpower such as the adoption of agile development[10], use of a standard platform, project management reinforcement of the organization as a whole, utilization of overseas subsidiaries, and reviewing of contracts (negotiating and proposing to change from payment based on the number of staff and months to payment in return for services).

- Sales breakdown by industry shows that the top three industries are other > finance > distribution > telecommunications. The "other" industries beat finance as the largest.
- Acquisition of new customers and diversification of industry are in progress.

## ◆ Sales Composition that Is Well-Balanced by Industry

Sales breakdown by industry is shown below (Figure 10). Sales for the finance industry, which must process a massive amount of data and must to be secure and reliable, had been the largest by industry type. However, while the sales for the finance industry declined, sales for the "other" industries (industries excluding the three industries of finance, distribution, and telecommunications) grew significantly, reversing the share of sales in FY 2019 (Figure 11 on page 11). After these two industries, the distribution industry and the telecommunications industry follow, in the order of decreasing share of sales. HIMACS (TSE First Section: 4299) and Toho System Science (TSE First Section: 4333), competitors whose business is especially similar to the Company, specialize in business for the finance industry, with sales for the finance industry being over 70% or 80% of the total, respectively. On the contrary, the Company is becoming more diversified through the expansion of business for the non-finance industries.

**[Figure 10] Sales Breakdown by Industry in FY 2019**



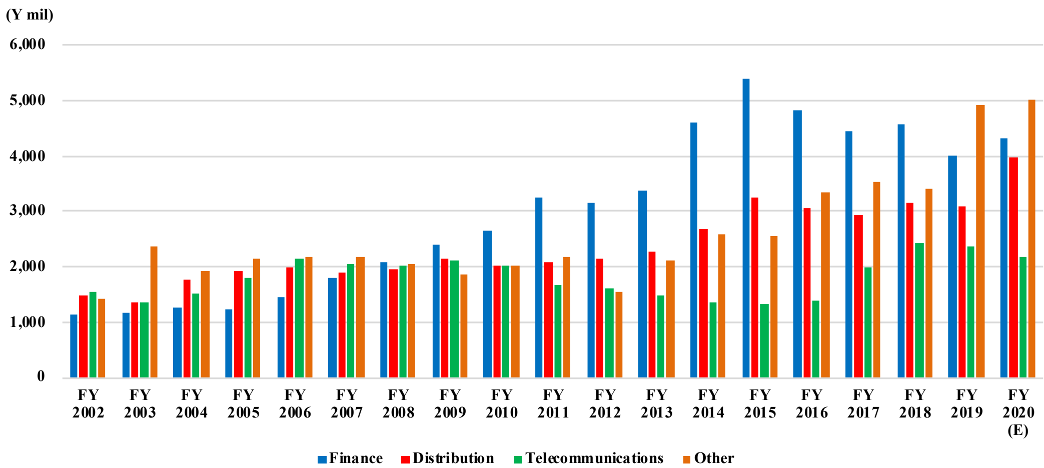

(Ref) Prepared by Alpha-Win Research Dept. based on the financial results summary, etc.

Concerning business for the finance industry, systems demand from mostly megabanks had been the financial growth driver for many years, but in the last few years, this demand is beginning to level off due weak earnings and the completion of consolidations and alliances in the finance industry. Meanwhile, the sales for telecommunications have been generally increasing, although with some fluctuations, under the influence of the system investment cycle of telecom carriers, etc.

In the past few years, the "other" industries have become the most significant growth driver since the business with the manufacturers, the government, energy-related industries such as electricity, and the cloud-consulting-related industry grew largely with the acquisition of new customers and new contracts. As a result, the Company appears to have become more balanced and diversified with regards to industry type, leading a greater stability in management (Figure 11 on page 11).

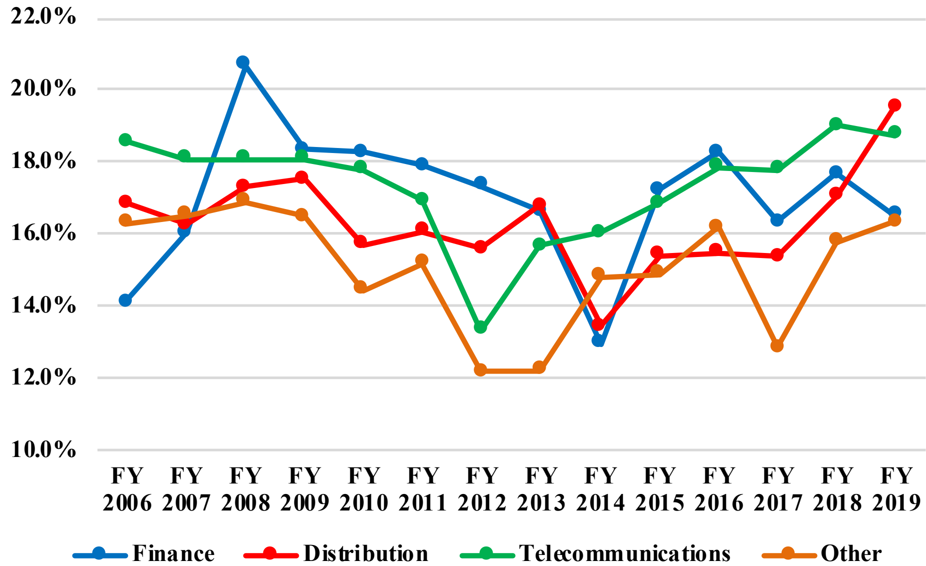
The breakdown of gross margin by industry changes somewhat every year. It was somewhat high for the telecommunications and distribution industries in the recent fiscal year, but there is no significant trend or difference in margin (Figure 12 on page 11). We believe that this is because the differences in the profitability of each individual project, rather than the differences in the characteristics of each industry, are being reflected in the gross margin.

**[Figure 11] Transition in Sales for Each Industry**




(Ref) Figures 11 and 12 were prepared by Alpha-Win Research Dept. based on the securities report and financial results briefing materials

**[Figure 12] Transition in Gross Margin by Industry**



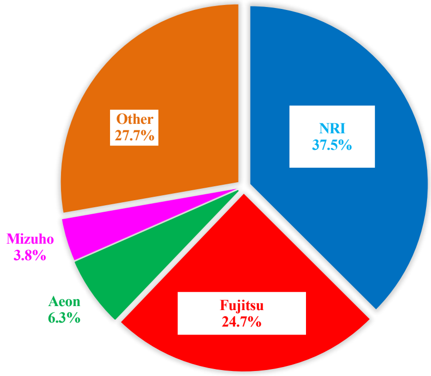

## ◆ Stable Customer Base and Business with High Continuity

- Stable business where repeated contracts with the existing customers comprise a majority of the business

Since the Company's customers and end users are Japan's leading corporate groups and its business deals with mission-critical operations, the Company must be reliable, stable, user-friendly, secure, and continuously in business. Moreover, for system development and operations, the Company must accumulate business knowledge and know-how. Consequently, the Company has a high contract continuity with its existing customers. The prime ratio (percentage of direct contracts made with end users in system development) is 20 to 30% and many projects are outsourced from major SIs.

**[Figure 13] Sales Breakdown by Customer Group in FY 2019**

- Sales breakdown by customer shows that Nomura Research Institute is the largest, followed by Fujitsu, Aeon, and Mizuho. These four groups account for greater than 70% of the total.




(Ref) Prepared by Alpha-Win Research Dept. based on the securities report.

As shown by the sales breakdown by customer group (Figure 13), Nomura Research Institute (hereinafter, "Nomura Res. Inst." or "NRI") is the largest customer, followed by Fujitsu, Aeon, and Mizuho. These four corporate groups account for greater than 70% of the total. Thanks to the success of the "account" strategy (a strategy where marketing activities are conducted in a concentrated manner by a person in charge) toward the four main client groups, total sales for the four groups have been great, having increased by 2.8% YoY to Y10,351 million (increase of Y281 million).

In addition, sales for clients other than the four main groups have been increasing at a high rate in recent years (increased by 13.9% or Y484 million YoY in FY 2019). As a result, the share of sales of the four groups is gradually decreasing (Figure 14 on page 13).

Looking at the long-term changes, we can see that the sales for Nomura Res. Inst. Group had increased by approx. Y4.5 billion from approx. Y900 million in FY 2002 to approx. Y5.4 billion in FY 2019 thanks to the expansion of business field from the initially focused distribution industry to other industries such as finance. During this period, the Company's overall sales grew by approx. Y8.7 billion from approx. Y5.6 billion to approx. Y14.3 billion, owing to the NRI Group for greater than half of this growth (52%). Similarly, Fujitsu Group contributed slightly less than Y1.8 billion in sales, which is 21% of the total, thanks to its expansion of telecommunications, electrical power infrastructure, and government-related businesses. Having raised sales over the long term for each of the major corporate groups, the Company has excellent trust from its customers and great contract continuity.

In fact, the Company is one of the few companies that are partnered with Nomura Res. Inst. (NRI) as an e-e Partner[11]. In this partnership, the Company is in a close relationship with NRI, partnered not only in business but also making mutual investments and exchanging human resources. Looking at the transaction with each company, we can see that NRI is also the largest by transaction size, at approx. Y4 billion or 27.7% (share of sales for FY 2019). Second largest is the transaction with Fujitsu at Y2.9 billion or 20.2% (share of sales for FY 2019).

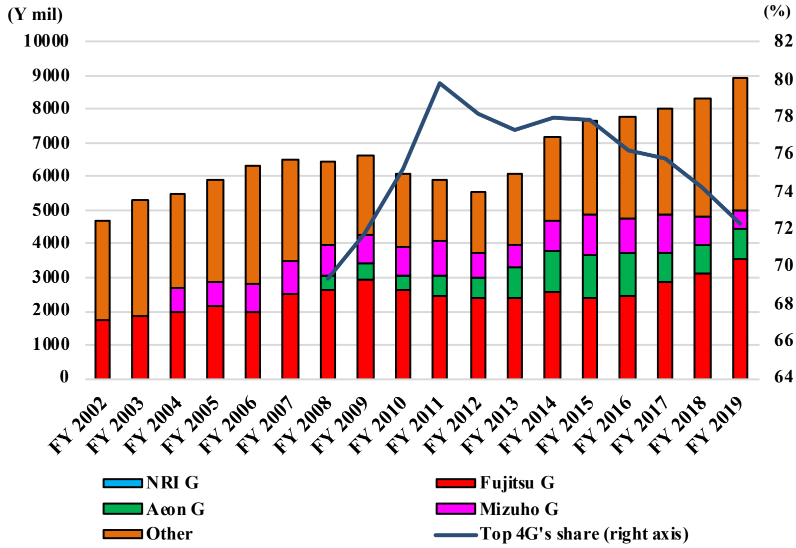
In addition, in February 2019, the Company was awarded the Best Partner Award by AEON IBS, whose share of sales is third from the top (Y850 million or 6.0%) and with whom the Company has been in a business relationship for 30 years. Indeed, the Company's customer satisfaction level is high (it has also been awarded by several other business partners). Transactions with Hitachi, Ltd., the fourth largest partner regarding the share

(11) e-e Partner: an especially close partner among all partners of NRI. Of the "e Partners" (approx. 150 companies) with highly specialized business know-how and IT skills and high-level IT security, e-e Partners cooperate with NRI not only in the operation of specific projects but also in the cooperative promotion of innovative activities in the Enhancement business; in the strategic reinforcement of HR, quality, and IT security; and in the creation of a mutually prosperous business model that takes advantage of each other's expertise. NRI has only announced three companies (the Company, HIMACS, and Toho System) as its e-e Partners.

of sales, has also increased significantly, by about five times from the previous fiscal year to Y830 million (5.8% of total sales).

**[Figure 14] Transition in Sales by Customer Group (G) and Shares of the Top 4 Groups**

(Note: information on sales of Mizuho G before FY 2003 and of Aeon G before FY 2007 is not available)




(Ref) Prepared by Alpha-Win Research Dept. based on the securities report and financial results briefing materials

## ◆ Future Areas of Growth and Foundation for Next-Generation Technologies

Alongside its own R&D activities, the Company has been forming alliances with companies with advanced, new technologies (Figure 15 on page 14). Thus, the Company is steadily building the foundation for developing businesses that use next-generation technologies. The total R&D cost in FY 2019 was Y68 million, which may appear small since it is only approx. 0.5% of sales. However, the R&D cost is also actually separately recorded as "personnel expense for developers" under "periodic profit and loss."

◆ **Upfront investment in growth areas of focus such as blockchain, cloud, agile development, AI, and IoT**

The Company is especially focused on technology investment in cloud solution services[12] including Oracle-related services; participation in proof experiments of the Blockchain[13] Collaborative Consortium; capital and business alliances with companies with know-how on AI technology[14], IoT technology[15], and blockchain; alliance in agile development; development of a corporate currency platform using blockchain technology; and creation of new solutions. These investments are aimed at acquiring and sharing knowledge and information on advanced technologies, human resources development, joint development and proposals, and creation of new businesses.

Furthermore, the Company created the Technology Strategy Office within its organization in 2016. Members of the Office are both dedicated members and members who also work for the marketing department. The role of the Office is to catch up to leading-edge technologies and conduct R&D and business development based on the newest core technologies. Although it may take several years for those technologies and new businesses to begin to make substantial contribution to the financial results, their progress should be followed.

(12) Cloud solution service: a type of service where applications are used as a "service" via web browsers, etc.

(13) Blockchain: distributed network where information is synchronized, recorded, and accumulated among many computers

(14) AI: artificial intelligence

(15) IoT: Internet of things. A system that connects all devices around us by the Internet.

**[Figure 15] Summary of News Release Related to Recent New Technologies, Alliances, and Key Businesses**

| Date announced | Announcement | Details |
|---|---|---|
| May 2018 | Agile development with CA Technologies Japan | Formed an alliance with CA Technologies Japan, the Japan subsidiary of CA Technologies (NASDAQ: CA) of USA, and began agile development using the products and services of the CA Group. Will thus establish a more high-speed and high-quality software development method and create a new service model. |
| July 2018 | Capital and business alliance with Tripleize Co., Ltd. | Cooperation in proposal activities making use of know-how and techniquqes related to AI, IoT, and blockchain, etc. Through third party allotment, the Company acquired 4.7% of Tripleize's shares. |
| August 2018 | Service related to Oracle Cloud | The Company won 1st place in the "Oracle Cloud Platform (Paas/Iaas) Certification" section of the 2018 Oracle Cloud Certification Award which acknowledges companies that made great efforts to acquire Cloud certifications. In addition, for the monitoring of the Oracle Cloud system, the Company began providing monitoring system development services using Zabbix. |
| January 2019 | The Company's consolidated overseas subsidiary in Shanghai formed a business alliance with iVision, a local company | Cube System Shanghai Co., Ltd., the Company's consolidated subsidiary, signed a core-partner contract with iVision, a major business partner for business toward local Japanese companies. This alliance will strengthen the cooperation between the two companies in their aim toward further expanding both of their businesses toward local Japanese companies, which have been in progress in parallel with the offshore business. |
| April 2019 | Certified as Cybozu, Inc.'s official partner | The Company was certified as Cybozu's official partner. In order to meet the customer needs for cloud-based business solutions, which are rapidly becoming popular, the Company plans to provide a solution service to its customers that merges a new business scheme based on Cybozu's cloud service *kintone* (cloud service for creating business apps) with the Company's Enhancement Service (its strong point) and offshore service based on overseas sites of its corporate group. |

(Ref) Prepared by Alpha-Win Research Dept. based on the news release on the Company’s website

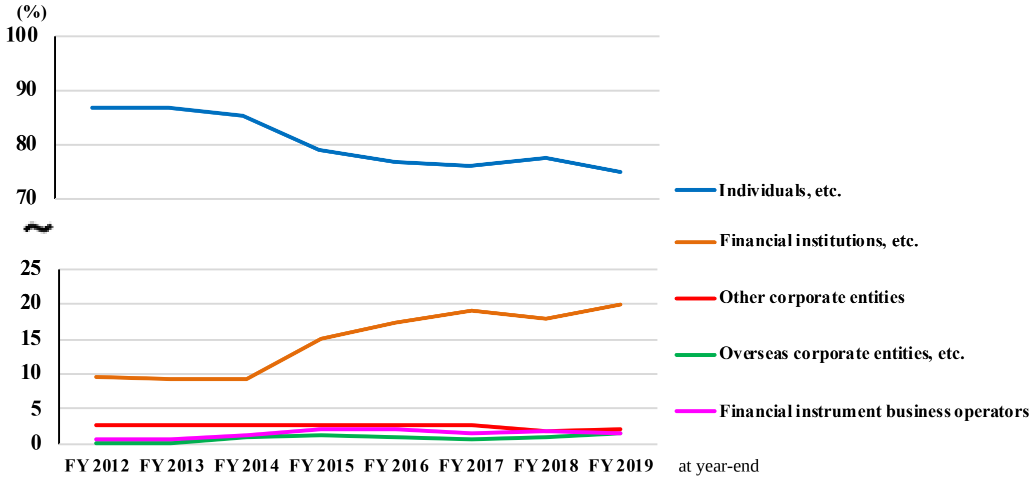
# 3. Shareholder Composition

## ◆ Change in Composition by Type of Shareholder

- "Individuals, etc." own slightly less than 80% of all shares.

With regards to shareholder composition by type of shareholder as of the end of March 2019 (Figure 16), "individuals, etc." is by far the largest, owning approx. 77% of the total. Second to this is "financial institutions, etc.," owning 18%. Together, these two types of shareholders own 95% – most of the outstanding shares. "Foreign corporate entities, etc." is low, owning 1.5%. Over the years, shares of "individuals, etc." have somewhat decreased and shares of "financial institutions, etc." have increased.

**[Figure 16] Change in Shareholder Composition by Type of Shareholder (unit: %)**




(Ref) Prepared by Alpha-Win Research Dept. based on the securities report

## ◆ Major Shareholder Composition

The Company's major shareholder composition has been stable and has not greatly changed. The major shareholders as of the end of March 2019 are shown in Figure 17 on page 16. The following is supplemental information.

- The employee stock ownership plan and current and former directors are the most significant by size among the major shareholders.
- Through share buyback, the treasury shares rose to about 11% of all shares.

・Since the amount of shares owned by the employee stock ownership plan decreased, the first and second place in the shareholder ranking switched, and the current president Sakiyama became the largest shareholder. Possessing a little less than 12% of all shares, he owns slightly more than the employee stock ownership plan at second place.

・The third largest shareholder Ms. Onuki is the Company's previous president. The fifth largest shareholder Mr. Uchida is the Company's current director.

・The purpose and identity of the investor under the name of a trust bank who has risen up the ranking through purchases to fourth place are unknown.

・The sixth largest shareholder The Master Trust Bank of Japan is the BIP trust account for the Company's director remuneration (stock-remuneration-type director incentive plan).

・The eighth largest shareholder is the Company's former executive managing director Mr. Sato.

・The ninth largest shareholder Mizuho Bank probably owns shares for the purpose of cross-shareholding.

・The tenth largest shareholder MUFJ Bank is a correspondent financial institution.

・Of the top ten shareholders, the employee stock ownership plan and the directors/employees (including former members), plus the treasury shares, add up to about 40% of the total. The Company has been actively buying back its shares. Its treasury shares, including the BIP trust account, are approx. 11.3% of the total as of the end of FY 2019.

**[Figure 17] Major Shareholders' Status**

| Shareholder Name (unit: thou. shares) | FY 2015 year-end | FY 2016 year-end | FY 2017 year-end | FY 2018 year-end | FY 2019 year-end | % of Total Shares | Ranking |
|---|---|---|---|---|---|---|---|
| Osamu Sakiyama (indiv.): CUBE SYSTEM's president | 1,775 | 1,675 | 1,655 | 1,646 | 1,639 | 11.77 | 1 |
| CUBE SYSTEM Employee Stock Ownership Plan | 1,641 | 1,672 | 1,663 | 1,668 | 1,565 | 11.24 | 2 |
| Akemi Onuki (indiv.): CS's former president | 401 | 401 | 401 | 401 | 401 | 2.88 | 3 |
| The Master Trust Bank of Japan, Ltd. (trust account) | - | - | - | 321 | 394 | 2.83 | 4 |
| Toshio Uchida (indiv.): current director | 475 | 415 | 403 | 393 | 377 | 2.71 | 5 |
| The Master Trust Bank of Japan (director renumeration BIP trust: 75,824 account) | - | 270 | 270 | 262 | 369 | 2.65 | 6 |
| Masatsugu Sakurai (indiv.): general individual investor | 316 | 316 | 316 | 316 | 316 | 2.27 | 7 |
| Toshikuni Sato (indiv.): CS's former exec. managing director | 380 | 340 | 300 | 300 | 304 | 2.18 | 8 |
| Mizuho Bank, Ltd. | 276 | 276 | 276 | 276 | 276 | 1.99 | 9 |
| MUFJ Bank, Ltd. | 258 | 258 | - | - | 258 | 1.85 | 10 |
| CUBE SYSTEM INC. | 682 | 458 | 1,035 | 1,236 | 1,356 | - | - |
| Japan Trustee Services Bank, Ltd. (trust account 5) | - | - | 348 | 324 | - | - | - |
| Resona Bank, Limited | 241 | - | - | - | - | - | - |
| (CUBE SYSTEM's Actual Treasury Shares) | 682 | 728 | 1,306 | 1,498 | 1,725 | | |
| (Percentage of Treasury Shares) | 4.5% | 4.8% | 8.5% | 9.8% | 11.3% | | |

Note: "-" indicates that there were no data available on the major shareholder in the securities report, and does not necessarily mean zero.
: (CUBE SYSTEM's Actual Treasury Shares) includes the BIP trust account for director renumeration.

(Ref) Prepared by Alpha-Win Research Dept. based on the securities report

◆ Uses a portion of treasury shares as an incentive for directors

Twice in the past, the Company has issued a portion of its treasury shares to its directors as an incentive. In FY 2016, the Company terminated its old director retirement benefit plan and instead started the stock-remuneration type (BIP trust) director incentive plan where the Company's treasury shares are issued and granted according to his or her position and achievement rate with respect to the medium-term management goals. The plan is renewed every three fiscal years, or the span of a medium-term management plan, and the actual right to the shares is granted upon a director's retirement.

Also, in September 2018, when the Company made a transition to a new step in the medium-term management plan, it issued another portion of the treasury shares to its directors as limited-transfer stock-based remuneration as part of the new system. Prior to this, direct ownership of shares by the current management team members was limited. Therefore, this new stock remuneration system should be effective in raising the incentives of directors with regards to management and financial results and aligning their directions with the shareholders' profit.

◆ Bought back approx. Y300 million's worth of its own shares

In addition, in February 2019, the Company bought back approximately 348 thousand of its shares (equivalent to 2.8% of outstanding shares excluding the treasury shares) for a total of approximately Y300 million (average acquisition price: Y863). The purpose of this buy-back was to improve capital efficiency and margins and to maintain the ROE at 10% or greater over the long term. As a side note, the total return ratio in FY 2019 was 91.3%, including the share buyback in addition to the dividend.

The Company has not decided on how to make use of the remaining treasury shares, but some possibilities include using them for stock remuneration as another director incentive, for stock cancellation, or for a stock-swap in a tie-up or an M&A.

# 4. ESG

## ◆ Environment

- Works on continual improvement of environmental performance (energy and resource conservation)

Although the Company's business does not harm the environment, under the policy of "practicing environment-friendly management through continual improvement in environmental performance (energy/resource conservation)," the Company engages in environment-friendly activities (obtained ISO14001 certification). Specifically, the Company works on reducing electricity and paper usage, reducing waste, implementing "cool biz" and "warm biz," promoting green purchasing, and planting trees in Vietnam.

## ◆ Society

As a key industry necessary for the infrastructure supporting the economy and the society, the CUBE SYSTEM Group believes its mission is to contribute to the further development of the IT society and the strengthening of its customers' competitiveness. It aims to create a more prosperous and convenient society through the power of IT systems.

- Actively engaged in activities that support the development of the next generation of human resources

To help develop the next generation, the Company holds the "Donated Seminar on Local Region, IT, and Energy" (Toyo University) to support the development of individuals with problem-solving skills who can contribute to globalization and the local region. It also holds the "Family Day" as an opportunity for its employees' family members to learn about companies and careers. Additionally, the Company supports cleanup and beautification activities and activities where children of the local region can visit the workplace to nurture ideas about the meaning of work and their future careers.

## ◆ Governance

As a company with auditors, the Company has set up the Nomination and Compensation Advisory Committee and the Integrated Risk Committee (which directly controls the Compliance Committee, the Internal Control Committee, the Security Committee, the Working Style Reform Committee, and other committees). The Company has also adopted the executive officer system in order to reinforce corporate governance. To deliberate on important matters related to the general management of the Company, a management meeting is held twice a month. The deliberated matters are communicated to each department via the Corporate Planning Office. The Company has also set up an internal hotline system for compliance-related matters. It has not adopted any anti-takeover measures.

- Of the 10 directors and auditors, five are from outside the Company.

The management team is made up of seven directors (of which two are outside directors) and three auditors (all are outside auditors from Mitsubishi Corporation and have overseas business experience). Four of the directors are dedicated members, two are from Nomura Research Institute, and one is a lawyer. All directors as well as executive officers are men, with no female member or member with a foreign nationality. Going forward, the Company plans to create opportunities for women and assign appropriate roles to appropriate individuals based on their skills and abilities.

Also, under the health management policy, the Company is working on improving and maintaining the mental and physical health of its employees and creating a comfortable working environment (won a silver award as a Health Management Outstanding Organization in May 2018). In April 2019, it newly created the Sustainability Promotion Committee and has been working on social issues such as the SDGs[16].

(16) SDGs (Sustainable Development Goals): International goals for the period from 2016 to 2030 described in "The 2030 Agenda for Sustainable Development" that was adopted at the UN Summit in September 2015. Consists of 17 goals and 169 targets and pledges to "leave no one (on earth) behind."

# 5. History of Growth

- Founded under the anticipation that the importance and potential of computer systems will grow. Specialized in the system integration business.
- Its main customers are the leading blue-chip companies of Japan.
- Changed its listing from TSE Second Section to the First Section in March 2014

## ◆ Company History

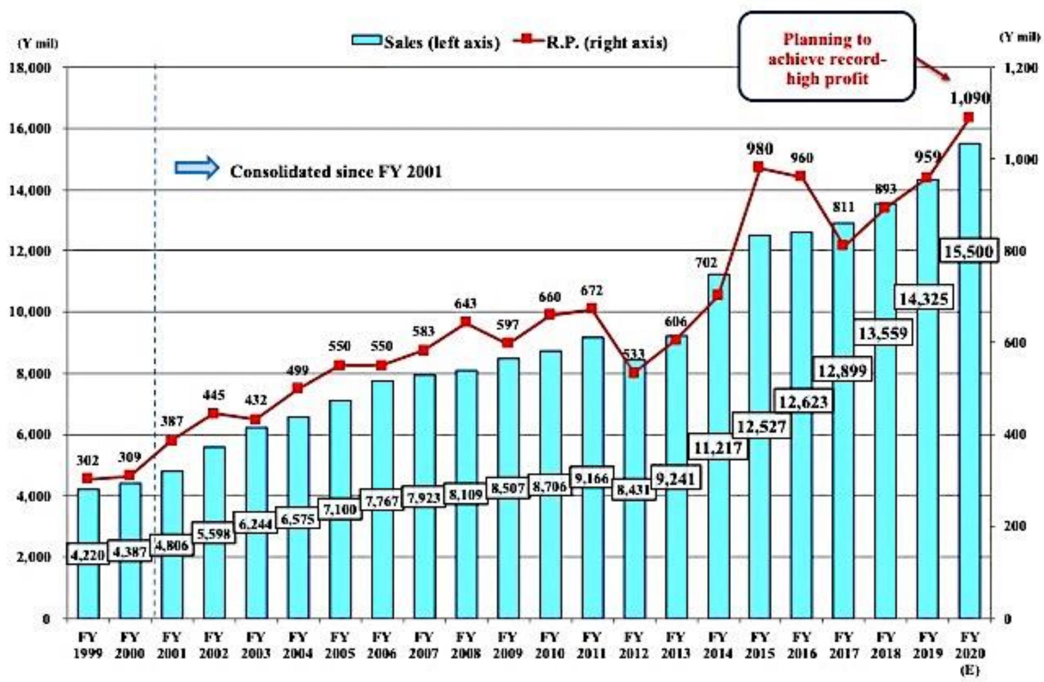
In 1972, the Company was founded as Customer Engineers Corporation by its founding members, which included the current president, for the purpose of software development and system operation/management (changed its name to the current one in 1990). As computers became popular in the Japanese society, IT investments increased and the system development market grew. The Company has been specializing in the system integration business and has been earning trust and building its track record. One after another, it has increased the number of contracts with leading Japanese companies – its current main customer group. As those companies increased their IT investment and outsourcing of system development/operation, the Company expanded its business domain as well as business in general at a steady pace.

Regarding stock, the initial offering was made in the JASDAQ market in 2002. In 2006, the Company became listed on the Second Section of the TSE, and then became listed on the First Section on March 2014.

## ◆ Past Transition in Financial Results

From foundation until now, the Company has been improving its financial performance as a specialist (SI) in the development and operation of systems outsourced from other companies and the government. Long-term transition in financial performance is shown in Figure 18. The following are details on the financial results in chronological order.

**[Figure 18] Long-Term Transition in Financial Results**




(Ref) Prepared by Alpha-Win Research Dept. based on the securities report and financial results summary. E = the Company's estimate/forecast.

◆Has been growing steadily and continuing to increase sales over many years. Profit margins have stayed about the same.

◆Sales decreased only for one fiscal year during the past 18 years.

◆Rate of change in financial results has been low and stable.

・ On a consolidated basis, with the exception of only a single fiscal year (FY 2012), the Company has achieved an year-on-year increase in sales every fiscal year for the past 18 fiscal years. This stable growth trend is noteworthy.

・During this period, the annual sales growth rate (simple average of the annual rate of increase in sales) was +6.4% and similarly the recurring profit growth rate was +6.0%, showing how the Company has been steadily improving its financial performance over the long term.

・Although recurring profit decreased in five out of the 18 fiscal years, the largest annual drop stayed within the range of approx. -20%, and the Company has been able to always stay in the black with regards to net profit for the year.

・As for the statistical analysis, the Company’s standard deviation for the rate of change in financial result and variation coefficient (= standard deviation / average; shows relative dispersion; also called relative standard deviation) are low, indicating that the volatility of the Company’s fundamentals is low (see Figure 19 for a comparison with similar-sized competitors for the most recent 15 fiscal years).

・Furthermore, because the Company’s operating margin has been stable at around 7% (Figure 20 on page 20), an increase in sales has been directly correlated with increases in profit, dividend, and market capitalization.

**[Figure 19] Performance Volatility Analysis for the Most Recent 15 Years (% YoY change for sales and R.P.)**
Note: non-consolidated for Toho System only, actual values for FY 2005 - FY 2019

| Target of Analysis | % Change in Sales (YoY %) | | | % Change in Recurring Profit (YoY %) | | |
|---|---|---|---|---|---|---|
| FY 2005 - FY 2019 | Cube | HIMACS | Toho System | Cube | HIMACS | Toho System |
| Market: TSE 1st sec. | 2335 | 4299 | 4333 | 2335 | 4299 | 4333 |
| n=15 fiscal years | CS | HM | TSP | CS | HM | TSP |
| Standard deviation | 6.20 | 8.05 | 17.81 | 13.72 | 32.67 | 333.48 |
| Average | 5.51 | 3.09 | 9.39 | 5.37 | 6.05 | 100.26 |
| Coefficient of variation | 1.13 | 2.60 | 1.90 | 2.56 | 5.40 | 3.33 |

(Ref) Prepared by Alpha-Win Research Dept. based on the securities report and financial results summary

◆Increased transaction with the major four groups has helped the Company grow significantly.

◆Even right after the Lehman shock, sales were increased for three consecutive fiscal years.

◆In FY 2012, due to the Great East Japan Earthquake, sales decreased for the first time since becoming listed. Operating profit decreased by 20%.

External environmental factors, such as active IT investments by Japanese companies and the government, were not insignificant to the Company’s growth to date. However, much of the Company’s success is thought to have been brought by its efforts to improve its expertise, earn trust from its customers, build a strong customer base, and consistently produce results. Although it is an independent company, it has strengthened its relationship with the four major groups NRI, Fujitsu, Aeon, and Mizuho and succeeded in developing long-term business relationships; this success was its major growth driver.

The financial performance for the most recent 11 years or so is as follows.

・In FY 2009 when the Lehman shock occurred, the economy was sluggish and customers became more cautious about IT investments. However, the Company was able to continue to increase its sales owing to the continued business with the existing customers mainly for systems in the finance and distribution industries, as well as the entry of companies into the bank business leading to projects for operation expansion.

・The economic recession continued into FY 2010 and FY 2011. System development plans continued to be postponed, terminated, or shrunk down, companies continued to hold off on IT investments, and competition over price and between companies became intense. However, thanks to the business with the existing customers and the expansion of business with life insurance companies, banks, and manufacturers, the Company continued to increase its sales. With increased sales, fluctuation in the operating profit for the three fiscal years following the Lehman shock stayed within a small range.

・On the contrary, the Great East Japan Earthquake had a large negative impact on the Company in FY 2012. Amidst the difficult situation, sales decreased by approx. 8%. Sales of all industries excluding telecommunications declined, with an especially large decline for the business toward manufacturers and the government. This was the single instance in which sales had decreased in the history of the Company from FY 2002 to the previous fiscal year. Similarly, during this period, the Company experienced the largest drop of -20.9% YoY in operating profit, but a net profit was maintained.

◆ Business environment improved thanks to Abenomics and the Company began to increase sales again.

・Then, IT investments by companies and the government recovered from their previous inclination to hold off or postpone thanks to factors such as the economic recovery brought by Abenomics since December 2012, recovery of company employment and performance, redevelopment of IT infrastructure due to M&As, smartphone-related telecommunications infrastructure, business related to the liberalization of electrical power retail, and increased investment in the field of social securities. With this recovery, the Company's return to a trend of rising sales became a more definite one.

◆ Record highs achieved for both operating profit and recurring profit in FY 2015

・Regarding profit, in FY 2015, since sales increased due to the development of businesses with existing customers and the acquisition of new customers and productivity improved due to the reinforcement of project management, etc., a record-high operating profit and a recurring profit of Y964 million and Y980 million were recorded, respectively (net profit for the year also hit a record high in the following year or FY 2016, at Y629 million).

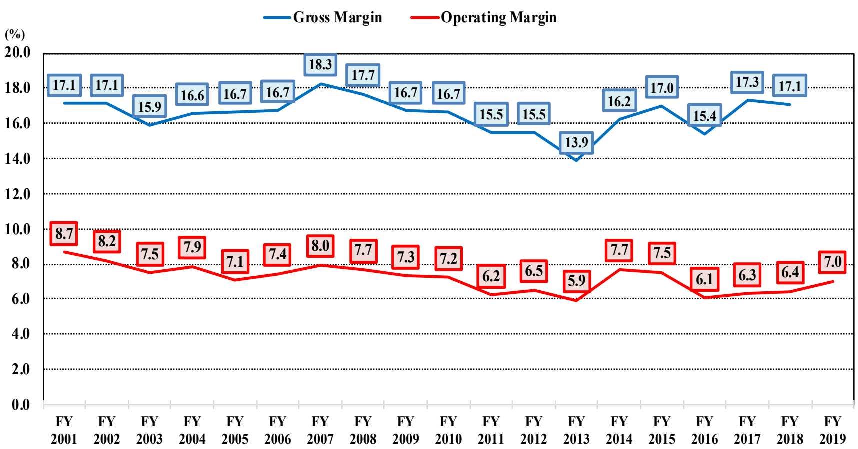
・Since then, the Company has been consecutively posting new record-high sales every fiscal year. However, due to increased cost and intensified price competition, the Company's gross margin and operating margin have been gradually decreasing over the long term (Figure 20).

◆ Sales have been hitting record highs for six fiscal years in a row, but profit has been fluctuating inside a boxed range due to increased cost.

・The operating margin especially decreased due to the increased cost of sales (subcontracting cost and labor cost), upfront investment cost, and SG&A expenses (especially personnel expense; as a reference, the SG&A expenses ratio changed from 7.9% in FY 2014→8.5% in FY 2015→9.5% in FY 2016→9.3% in FY 2017→11.0% in FY 2018→10.6% in FY 2019), but it began to improve in FY 2018. In the previous fiscal year (FY 2019), although none of the profits quite reached their all-time-highs, they have recovered to a close level.

・However, even with an improving economic environment, the Company has not yet been able to improve its profit margins beyond a boxed range.

**[Figure 20] Long-Term Transition in the Company's Gross Margin and Operating Margin**




(Ref) Prepared by Alpha-Win Research Dept. based on the financial results summary. E = the Company's estimate/forecast.

# 6. Business Environment

## ◆ History of the System Integration Business

The system integration business is said to have begun in the 1960s when the US military industry outsourced its system development. In the US, companies (users) tended to use packaged software or, when they needed to develop their own systems, conduct everything from system development to operation in-house. Meanwhile, the system integration business began in Japan when Nippon Telegraph and Telephone Public Corporation DATA Communications Bureau (now known as NTT DATA) was founded in 1967 and conducted system development for the Regional Bank Association of Japan, large-scale system development projects for the government, etc.

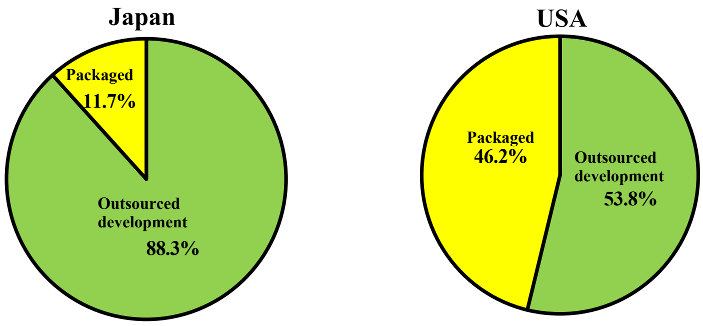
- As the outsourcing of system development became popular, SIs grew by taking those outsourced system development jobs.

Previously, the IT system department of each company was in charge of system integration. However, as systems became more advanced and were required to be more efficient and rational, their in-house operation and management became difficult. Consequently, more companies started to outsource all or a part of the planning, development, management, and operation of systems. As a result, system integration outsourcing became popular and, as the contractor, system integrators (SIs) expanded their business.

- Order-made system development is popular in Japan.

In Japan, the proportion of outsourced system development is much higher than packaged software compared to the US (Figure 21).

**[Figure 21] Ratio of Software Type in Japan and the USA**




(Source) Ministry of Internal Affairs and Communications: "Report on Current Status of Japan's ICT"

## ◆ Structure of the System Integration Industry

- The industry is in a mild oligopoly. Entry barrier is relatively high.

Japan's system integration industry has no monopolistic player but is instead often described as being in a mild oligopoly (the top five sellers account for about 40% of the total shares). This situation is probably due to the fact that since this business deals with order-made system development, unlike the manufacturing and sales of products (general-purpose, mass-produced goods), one cannot meet the requirements for a monopoly such as technology protection and differentiation by means of patents and expansion of shares through mass production. Additionally, because of the language barrier and the uniqueness of business, entry of foreign companies into the Japanese market has been limited. On the flip side, aside from offshore development, full-scale entry of Japanese companies into foreign markets is also difficult. While the competition is intense, there should not be large changes in the shares since the demands for system reliability and continuity make the entry barrier relatively high.

- The system integration industry has a vertically layered structure.

This industry has a vertically layered structure where its players often share work, cooperate in work, and take contractor- or subcontractor-like roles among themselves. The players are mostly able to exist alongside one another by taking strong positions in niches differentiated by industry, size, and corporate group of the users including companies and the government, or by the business function of the system. Due to this structure, profitability as well as the risks generally tend to increase for direct contracts with end customers (prime contract) or as one moves further upstream in the development process.

Japanese companies (corporate users) prefer IT systems that are order-made and tend to outsource system development to other companies. Generally, the role of Japanese SI companies is to develop systems based on the requirements set by corporate users. Consequently, ownership of the intellectual property related to the system developed under an outsourcing contract belongs to the corporate user. This means that productivity cannot be easily boosted by selling the system to other customers or reusing it. Moreover, as described above, since the industry has a layered structure and is labor-intensive, profitability and global competitiveness are generally not high.

As a growth strategy, SIs may choose to secure human resources and expand business by means of M&As, capital and business tie-ups, and M&A following a carve-out of the systems division of clients. Indeed, alliances and mergers are increasing.

- SIs can be categorized into three types: independent (the Company belongs here), manufacturer, and user.

System integrators (SIs) can mainly be categorized into the following three types.

1. Independent: Founded as a system integrator. A fully independent company. If it is a mid-tier player or smaller, it often takes on development works, etc., as a subcontractor for other SIs in addition to its own business with end customers. The Company belongs to this type. Whether or not it can develop a firm relationship with growing blue-chip customers is the key to success (company examples: TIS, Fujisoft, Otsuka Corporation, NSD, etc.).

2. Manufacturer: Manufacturer in the business of producing and selling hardware such as computers, or a company that was previously such manufacturer's systems division or software development division but had been separated. Or a company belonging to a manufacturer's corporate group (e.g. Fujitsu, NEC, Hitachi, IBM Japan, their IT-specialized subsidiaries, etc.).

3. User: Founded as a system integrator by major corporate players in industries such as finance, telecommunications, and trading. Or the IT systems subsidiary of such major company that was previously that major company's IT systems division before it become independent. Sells mostly to capitally-tied companies within the corporate group (e.g. Nomura Res. Inst., NTT DATA, NS Solutions, SCSK, etc.).

(Reference) Other: category for those that do not fit into the above.
・Trading company: Started out as an equipment distributer, etc. Sells mostly to companies within the corporate group (e.g. Itochu Techno-Solutions, etc.).
・Telecommunications company: (e.g. NTT Communications, etc.)
・Accounting auditor or consulting company: (e.g. Accenture, etc.)

◆ Although slowly, the system integration market is growing. Meanwhile, elimination and enlargement of companies are in progress.

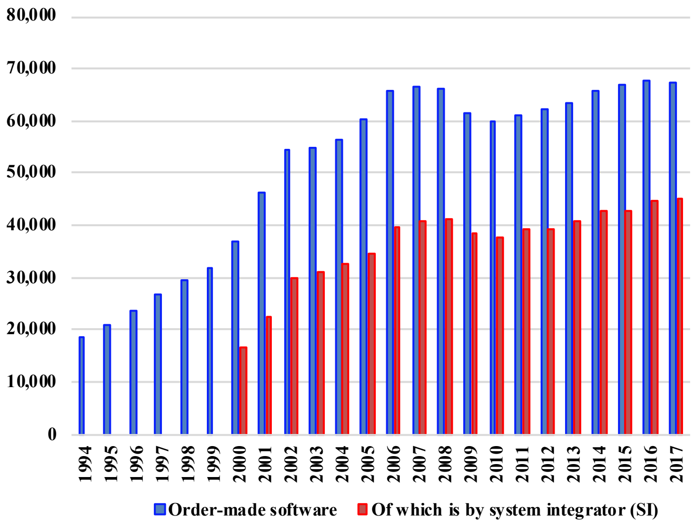
## ◆ Trends in Japan's System Integration Market

Looking at "Sales by category of business, number of establishments, and number of permanent employees for the information services industry," the survey result from the "Survey of Selected Service Industries"[17] by the Ministry of Economy, Trade, and Industry, we find that the sales of order-made software, as well as the sales of system integration which makes up more than half of order-made software, have been increasing with the exception of the few years after the Lehman shock (Figures 22 and 23).

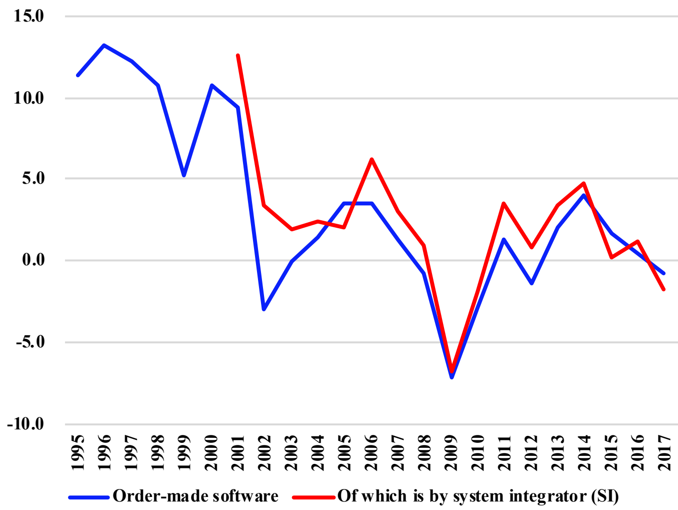
(17) Survey of Selected Service Industries: Nation-wide survey of companies on the current activity and business management status of industries in the service industry sector with high needs for statistics from both govt. and economic perspectives. Includes the IT services industry, which is further divided into software dev. (includes SI), assigned system management, etc.

According to the same data, from 2010 to 2017, sales for system integration had increased by about 2.1% per year (simple average). The current market size is about Y4.5 trillion. The number of establishments (mostly synonymous with the number of companies) in the IT services business has been gradually decreasing every year since 2003 (simple average of approx. -1.2% per year). In contrast, the number of permanent employees has been increasing with the exception of 2010 to 2012 (from 144 thousand in 1998 → 333 thousand in 2017), indicating that the elimination and expansion of companies are the industrial trend (the number of employees per establishment: 107.2 in 1998 → 135.5 in 2017).

**[Figure 22] Changes in the System Integration Market**
(annual sales: Y100 mil)




**[Figure 23] Rate of Change in the SI Market**
(rate of change in sales: %)




(Ref) Prepared by Alpha-Win Research Dept. based on data from 2017 Survey of Selected Service Industry by the Ministry of Economy, Trade and Industry

Since large-scale projects in system development (such as business combinations by megabanks) have reached their peak and are beginning to decline, cost control is becoming a prominent issue and competition is starting to intensify. However, IT investments by companies and the government should continue to steadily increase due to the structurally inherent lack of manpower, demands for improvement in operation efficiency, and great business conditions. In fact, we predict that the market size should grow at about 2-3% per year as companies strategically develop new businesses and technologies in various industries and fields in order to increase their competitiveness and as the demand for more advanced systems and DX[18] increases.

(18) DX (Digital Transformation): The transformation brought about by the penetration of IT (information technology) everywhere in the society. Not only the businesses, but the industrial structure and social infrastructure are said to also become affected.

## ◆ CUBE SYSTEM's Market Position and Comparison with Competitors

- Middle-ranking in the industry by sales, at 80th to 90th place from the top. Its share of sales in the entire system integration market is estimated to be about 0.3%.

- Its benchmark companies are HIMACS and Toho System. Both are Nomura Research Institute's e-e Partners and their market positions are very similar.

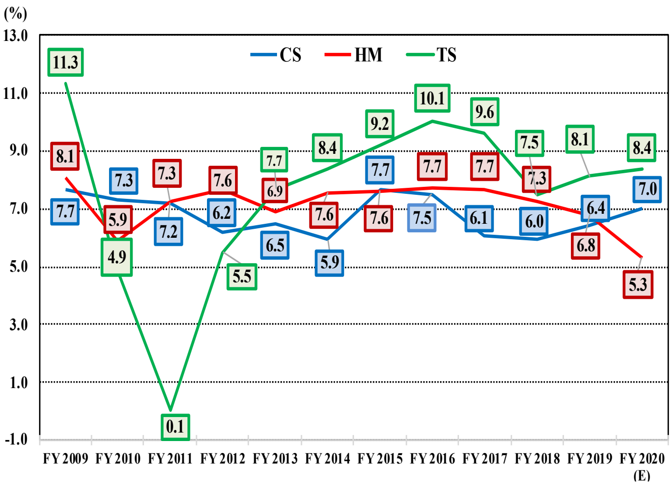
- No significant difference in each of the profit margins between the three companies. The Company's O.P. margin has not changed, but its ROE has greatly improved.

In the system integration industry, there are about 220 companies defined by general terms as a SI whose sales can be confirmed through disclosed securities reports, etc. Among them, the Company is estimated to be ranked at around 80th to 90th place from the top by sales volume. Additionally, the Company's share in the Japanese market is estimated to be approx. 0.3%.

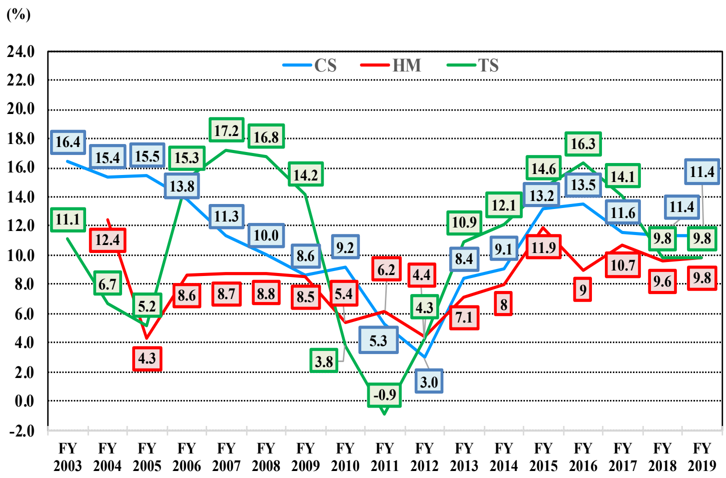
Some of the Company's competitors are HIMACS (TSE First Section: 4299) and Toho System (TSE First Section: 4333), which are similar in size and which the Company uses as its benchmark. They are both e-e Partners of Nomura Research Institute and are similar to the Company in market position and size. Meanwhile, several of the largest SI players such as Nomura Research Institute and Fujitsu are the Company's partners and allies rather than direct competitors.

Comparison of the long-term transition in the operating margin of the three major listed companies including the Company (hereinafter, the Company is abbreviated as CS in the graphs; similarly, HM for HIMACS and TS for Toho System) is shown in Figure 24. Compared to the other two companies, the Company's operating margin is stable and is in no way inferior. Similarly, comparison of ROE (Figure 25) shows that the Company's ROE has been the highest of the three companies during the most recent two years, having recovered greatly from one point in time and maintaining the target ROE value of greater than 10% for five consecutive fiscal years.

**[Figure 24] Comparison of O.P. Margin for Three Mid-Tier Listed Companies (the Company, HM, and TS)**




**[Figure 25] Change in ROE for the Three Companies**




(Ref) Figures 24 and 25 were prepared by Alpha-Win Research Dept. based on the financial results summary

**[Figure 26] Company Overview and Management Indicator Comparison for Three Mid-Tier Listed Companies (the Company, HM, and TS)**

| Company Name | CUBE SYSTEM (CS) | HIMACS (HM) | Toho System Science (TS) |
|---|---|---|---|
| Code | 2335 | 4299 | 4333 |
| Characteristics | Independent. Mainly sys. dev. for finance, distribution, telecom, and other industries (makers & gov. excluding the above 3 industries). Sales for finance are a little less than 30% of total sales. Sharp growth of "other industries" category. | Independent. 70% of sales comes from the finance industry. Sales for insurance companies are espcially high - greater than 40%. | Began as Toho Mutual Life Insurance Co.'s affiliate but is now indep. Specialized in software dev. for finance (insurance, securities, etc.) - greater than 80% of total sales. Also develops software for the telecom industry. |
| Founded | July 1972 | May 1976 | June 1971 |
| Listed Date (JASDAQ→TSE 2nd→TSE 1st) | 10/2002→11/2006→03/2014 | 03/2001→03/2004→03/2015 | 06/2001→03/2007→03/2014 |
| Sales Categories/Breakdown (FY 2019) | ･System Integration 68.8%<br>･System Outsourcing 16.4%<br>･Professional 14.8% | ･System Solution 53.7%<br>･System Maintenance 46.3% | ･Software Development 97.4%<br>･IT System Service, etc. 2.6% |
| Director Composition | ･Directors (7; 2 outside)<br>･Auditors (3; all outside)<br>･Executive officers (13; no woman = 0.0%) | ･Directors (7; 3 outside)<br>･Auditors (4; 2 outside)<br>･Executive officers (10; 1 woman = 10.0%) | ･Directors (5; 2 outside)<br>･Auditors (4; 2 outside)<br>･Executive officers (9; 1 woman = 11.1%) |
| Major Clients/Customers (Y mil, % of sales) | 1. NRI 3,979 (27.8%) | 1. NRI 6,292 (42.4%) | 1. NRI 3,506 (27.4%) |
| | 2. Fujitsu 2,903 (20.3%) | - | 2. SCSK 1,425 (11.1%) |
| Sites (including consolidated subsidiaries) | ･Head office: Shinagawa-ku, Tokyo<br>･West Japan Solutions Headquarters: Osaka & Nagoya<br>･3 subsidiaries | ･Head office: Yokohama, Kanagawa<br>･Minatomirai Office: Yokohama<br>･1 subsidiary | ･Head office: Bunkyo-ku, Tokyo |
| Management Goals (indicators) | ･ROE: ≥10%<br>･Consolidated O.P. margin: ≥10.0%<br>･Consolidated sales per domestic employee: ≥Y25 mil<br>･O.P. (same as above): ≥Y2.5 mil<br>Mid-term goal: Sales Y18.5 bil, O.P. margin 9.6%, ROE 13% in FY 2021 | Medium term management plan, final FY: In FY 2023,<br>･Sales Y22 bil<br>･O.P. margin ≥10%<br>･ROE ≥12% | Medium-term management plan, final FY: In FY 2023,<br>･Sales Y20 bil<br>･O.P. Y2 bil<br>･O.P. margin ≥10%<br>･ROE ≥15% |
| Management Policy/Strategy (summary) | ･As a key industry necessary for infrastructure supporting economy and society, contribute to further dev. of the IT society and enhancement of the customers' competitiveness<br>･Become "a company selected as its customers' best partner" and create "a corporate culture where employees and the company grow together and share happiness and wealth"<br>･Business dev. in Japan or overseas<br>･Invest in new businesses and tech<br>･Strengthen business foundation to promote growth | ･Contribute to the dev. of the IT society by enhancing the customers' competitiveness as their best partner<br>･Further dev. the existing and related biz, focusing on main clients<br>･Further enhance & expand business toward the 6 main industries (goal: sales share of business with non-finance industries ≥30%)<br>･Increase transaction with end users (goal: business with end-users ≥30%)<br>･Create new biz & overseas biz<br>･Conduct M&As and create capital alliances for business expansion | ･A company that works together with customers to create and realize values needed by the customers<br>･Traditional IT business (maintain & expand SI business)<br>･Digital IT business (a challenge)<br>･Create-IT business (dev. a service-providing business)<br>･Strengthen business foundation (HR, work satisfaction, internal control) |
| *Sales (Y mil) CE for FY 2020* | *15,500* | *15,000* | *13,500* |
| *Sales Growth Rate, YoY (%) CE for FY 2020* | *8.2* | *1.1* | *5.4* |
| *Operating Profit (Y mil) CE* | *1,090* | *800* | *1,130* |
| *O.P. Growth Rate, YoY (%) CE* | *18.3* | *-18.9* | *9.6* |
| *EPS (CE) for FY 2020, YoY (%)* | *14.4* | *-25.0* | *18.7* |
| DOE (%) Actual | 4.2 | 3.3 | 4.6 |
| Past 10 Years' Sales Growth Rate (FY 2019 result div. by FY 2009 result: %) | 68.4 | 62.8 | 57.8 |
| O.P. Growth Rate (same condition as above) | 41.3 | 34.5 | 12.2 |
| Equity Ratio (%) Actual | 65.4 | 74.5 | 65.6 |
| # of Domestic/Overseas Employees, Actual | 766 | 820 | 534 |
| Est. Sales Per Employee (Y mil / person) | *20.2* | *18.3* | *25.3* |
| Est. O.P. Per Employee (Y mil / person) | *1.4* | *1.0* | *2.1* |
| ROE (%) Actual for FY 2019 A=B×C×D | 11.3 | 9.7 | 9.8 |
| N.P. Margin (N.P. for the year / sales : %) B | 4.2 | 4.8 | 5.1 |
| Total Asset Turnover Ratio (sales / ave. total asset) C | 1.8 | 1.5 | 1.3 |
| Financial Leverage (ave. total asset / ave. owner's equity) D | 1.5 | 1.3 | 1.5 |
| ROA (R.P. / total asset : %) E=F×G | 12.9 | 10.1 | 10.2 |
| R.P. Margin (%) Actual F | 7.1 | 6.7 | 8.1 |
| Total Asset Turnover Ratio (sales / ave. total asset) G | 1.8 | 1.5 | 1.3 |

***Italics show each company's estimates/forecasts (CE) for FY 2020. Others are actual values for FY 2019.***

(Ref) Prepared by Alpha-Win Research Dept. based on each company's securities report, financial results briefing, briefing materials, website, interviews, etc.

# 7. Last Fiscal Year's Results and This Fiscal Year's Forecast by the Company

◆ Last fiscal year, the results were slightly below the Company's initial plan and our forecast, but sales increased for the seventh consecutive fiscal year and profit increased for the second consecutive fiscal year.

## ◆ Full-Year Financial Results for FY 2019 (last fiscal year)

Consolidated financial results for FY 2019 (hereinafter referred to as "the previous fiscal year" or "last fiscal year") were as follows: sales of Y14,325 million (+5.6% YoY), an operating profit of Y921 million (+7.8% YoY), a recurring profit of Y959 million (+7.5% YoY), and a net profit attributable to owners of the parent of Y596 million (+5.1% YoY; hereinafter "net profit"). As the first year of the medium-term management plan "V2020 3rd STEP" (2018 - 2020), it appears to be a generally good start.

Sales have been increasing and hitting record-high values for seven consecutive fiscal years since FY 2013. Each of the profits has also been growing for two consecutive fiscal years and has recovered to a level close to their all-time-highs. Sales were 2.6% lower and net profit was 6.9% lower than the ambitious targets set in the Company's initial plan (= first year's plan for the medium-term management plan) (Figure 27).

◆ Sales hit a record high for another consecutive fiscal year. Profits also approached their record highs.

Our forecast on last fiscal year's sales was Y14,600 million, which was a somewhat cautiously made prediction compared to the Company's forecast (Y14,700 million), but the actual results were below our prediction. Also, we had predicted that each of the profits will be about the same as the Company's forecast. The largest difference between our profit forecast and the actual result was for the gross margin; we had predicted that it will improve by 0.1 point from 17.3% in FY 2018 to 17.4% in FY 2019, but it actually worsened by 0.2 point to 17.1%. This decline is explained by the recording of a temporary but unexpected unprofitable project(s) and rising labor and subcontracting costs as part of the manufacturing cost.

◆ Both the orders and the order backlog increased.

Meanwhile, orders received increased by Y1,106 million (8.1%) from Y13,643 million → Y14,750 million (from last fiscal year to the current fiscal year; the same order applies below). The order backlog similarly increased by Y345 million (9.5%) from Y3,650 million → Y3,996 million.

**[Figure 27] Comparison of Initial Forecast and Actual Result for FY 2019 (last FY)**

| Unit: Y mil | Initial Forecast by the Company | Forecast by Alpha-Win | Actual Result | Difference from the Company's forecast | Percent Achieved Compared to the Company's Initial Forecast |
|---|---|---|---|---|---|
| Sales | 14,700 | 14,600 | 14,325 | -375 | 97.4% |
| Gross Profit | | 2,540 | 2,449 | | |
| Gross Margin | | 17.4% | 17.1% | | |
| SG&A Expenses | | 1,540 | 1,527 | | |
| SG&A Expenses Ratio | | 10.5% | 10.7% | | |
| Operating Profit | 1,010 | 1,000 | 921 | -89 | 91.2% |
| O.P. Margin | 6.9% | 6.8% | 6.4% | -0.5pt | |
| Recurring Profit | 1,010 | 1,000 | 959 | -51 | 95.0% |
| Net Profit | 640 | 635 | 596 | -44 | 93.1% |

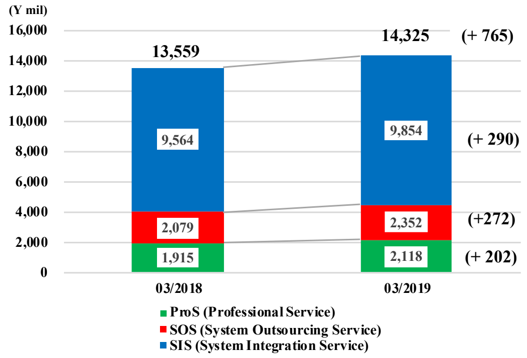
(Ref) Prepared by Alpha-Win Research Dept. based on the financial results summary

The Company's overall increase in sales was Y765 million YoY. Sales increased for each of the three service categories by Y200 to 300 million each (Figure 28 on page 27).

As for the gross margin of each service category, the gross margin of SIS decreased by 1 point from 17.0% → 16.0% due to decreased profitability as a result of the project scale down for supermarkets, banks, and life insurance.

On the other hand, SOS's gross margin improved from 15.2% → 17.7% thanks to projects for convenience stores, etc., and ProS's gross margin improved from 21.0% → 21.4% due to the strong performance of cloud consulting. As SIS's sales account for about 70% of the total, the overall gross margin fell from 17.3% → 17.1%. However, thanks to increased sales, the gross profit itself increased by Y104 million (4.4%) from Y2,344 million → Y2,448 million.

**[Figure 28] Contribution of Each Service Category to Sales in FY 2019 (last fiscal year)**




**[Figure 29] Contribution of Each Service Category to Profit in FY 2019**

| | | FY 2018 | FY 2019 | Diff. | % Diff. |
|---|---|---|---|---|---|
| Gross Profit (unit: Y mil) | Total | 2,344 | 2,448 | 104 | 4.4% |
| | SIS | 1,625 | 1,577 | -48 | -3.0% |
| | SOS | 316 | 417 | 101 | 32.0% |
| | ProS | 402 | 453 | 51 | 12.7% |
| Gross Margin (unit: %) | Total | 17.3% | 17.1% | -0.2% | |
| | SIS | 17.0% | 16.0% | -1.0% | |
| | SOS | 15.2% | 17.7% | 2.5% | |
| | ProS | 21.0% | 21.4% | 0.4% | |

(Ref) Figures 28 and 29 were prepared by Alpha-Win Research Dept. based on the financial results supplemental reference materials

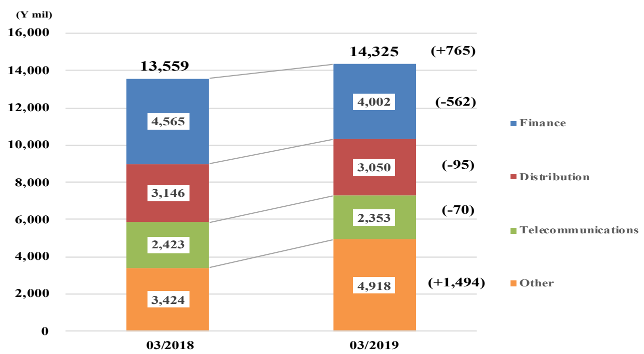
◆ Weak toward the finance industry, but strong business with the "other" industries – contributing to sales and gross profit.

・ By industry, compared to the overall sales increase of Y765 million (YoY), the "other" industries increased by Y1,494 million (+43.6%) YoY. This increase largely contributed to the total sales, compensating for the decrease in the sales of finance by Y562 million, distribution by Y95 million, and telecommunications by Y70 million due to a reduction in the number of major system development projects.

・ Similarly, the gross profit decreased for both finance and telecommunications by Y146 million and Y19 million, respectively, but was offset by the Y263 million increase for the "other" industries.

・ The strong sales of the "other" industries are a result of the Company's consistent efforts in achieving results, accumulating know-how, and improving sales that have led to a successful acquisition of new customers and orders for large projects. Increased sales from the system development for manufacturers such as construction machinery and food manufacturing companies and from the increased number of orders for the consulting business had especially contributed to the increase in profits.

**[Figure 30] Contribution of Each Industry to Sales in FY 2019 (last fiscal year)**




**[Figure 31] Contribution of Each Industry to Profit in FY 2019**

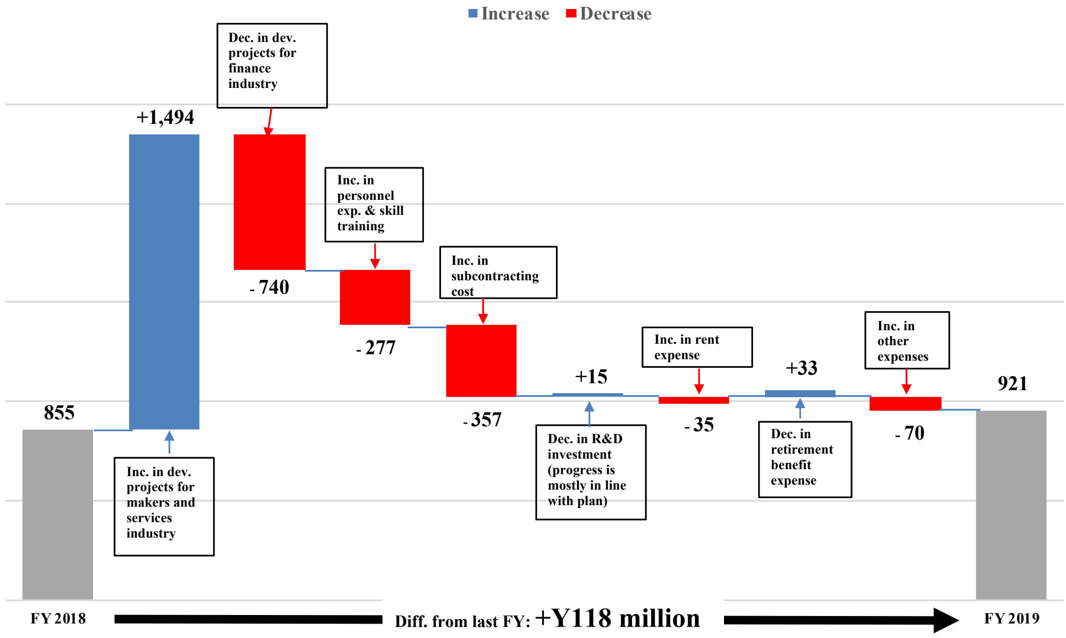
| | | FY 2018 | FY 2019 | Diff. | % Diff. |
|---|---|---|---|---|---|
| Gross Profit (unit: Y mil) | Total | 2,344 | 2,448 | 104 | 4.4% |
| | Finance | 806 | 660 | -146 | -18.1% |
| | Dist. | 536 | 543 | 7 | 1.3% |
| | Telecom. | 460 | 441 | -19 | -4.1% |
| | Other | 540 | 803 | 263 | 48.7% |
| Gross Margin (unit: %) | Total | 17.3% | 17.1% | -0.2% | |
| | Finance | 17.7% | 16.5% | -1.2% | |
| | Dist. | 17.0% | 17.8% | 0.8% | |
| | Telecom. | 19.0% | 18.7% | -0.2% | |
| | Other | 22.3% | 34.1% | 11.8% | |

(Ref) Figures 30 and 31 were prepared by Alpha-Win Research Dept. based on the financial results supplemental reference materials

An analysis of the factors contributing to the change in the overall operating profit is as shown in Figure 32. An increase in the number of projects for manufacturers and the services industry in the "other" industries category contributed significantly to the increase in profit, compensating for the decreased number of projects for finance as well as increased personnel and engineer training expenses (+Y277 million YoY) and subcontracting costs (+Y357 million YoY).

The SG&A expenses ratio improved by 0.3 point from 11.0% to 10.7%, as the SG&A expenses had been suppressed to an increase of only 2.6% YoY. This improvement offset the 0.2-point decline in gross margin, resulting in a slight improvement in the operating margin from 6.3% to 6.4%. Combined with the effect of the sales increase, operating profit rose by 7.8%. As for non-operating profit and loss, a profit of Y38 million was recorded, which is about the same as the previous fiscal year. There was no extraordinary profit or loss, and net profit increased by 5.1%.

**[Figure 32] Reasons for Increased Profit in FY 2019 (last fiscal year) (unit: Y mil)**




(Ref) Financial results supplemental reference materials

◆ This FY, planning to keep increasing sales and profits and achieve record highs in sales and profits. Will again aim for Y1 billion in both operating and recurring profit.

## ◆ CUBE SYSTEM's Financial Results Forecast for FY 2020 (this fiscal year)

This fiscal year, the Company is predicting a consecutive achievement of record-high sales as well as an achievement of record highs for each of the profits (operating, recurring, and net); it predicts sales of Y15,500 million (+8.2% YoY), an operating profit of Y1,090 million (+18.3% YoY), a recurring profit of Y1,090 million (+13.6% YoY), and a net profit of Y684 million (+14.6% YoY). In continuation from the previous fiscal year, the Company will again aim to raise operating and recurring profit so that they each exceed Y1 billion for the first time (Figure 33).

**[Figure 33] Forecast for FY 2020 (this FY)**

| Unit: Y mil | Full-year Forecast (FY 2020) | % YoY Change |
|---|---|---|
| Sales | 15,500 | 8.2% |
| Gross Profit | Not disclosed | |
| Gross Margin | | |
| SG&A Expenses | | |
| SG&A Exp. Ratio | | |
| Operating Profit | 1,090 | 18.3% |
| O.P. Margin | 7.0% | up 0.6pt |
| Recurring Profit | 1,090 | 13.7% |
| Net Profit | 684 | 14.6% |

(Ref) Prepared by Alpha-Win Research Dept.

In general, by making full use of its strength, the Company plans to increase sales through the following measures.

1. Expand the existing business domain by strengthening its sales capability toward major accounts (clients).
2. Develop businesses in new markets, channels, and areas (utilization of new technologies, central Japan, energy business, industrial sectors, DX-related businesses).
3. Create new services (sophistication, expansion, and continuation of new services)

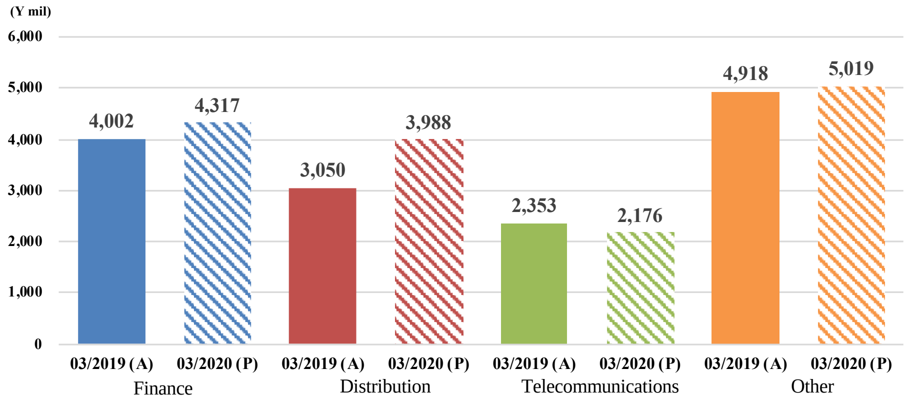
◆ By industry, the distribution industry is expected to make a significant contribution to sales. Finance will bottom out. The "other" industries will continue to grow in new areas and domains.

・ By industry, the Company expects sales for telecommunications to decrease by Y177 million (-7.5%) YoY as projects for telecom carriers will be finished. On the contrary, regarding the distribution industry, new orders for large-scale projects, DX-related projects using AI technology, and new orders related to the adaptation to the consumption tax are expected to become the growth drivers. In fact, sales are expected to increase by Y937 million (+30.7%) YoY for this industry, contributing significantly to an overall increase in sales: 80% of the total increase of Y1,175 million.

・ Concerning the finance industry, sales are expected to bottom out and increase by Y314 million (+7.8%) through the acquisition of new projects or the expansion of existing projects related to Internet banking, credit, and direct life and non-life insurance.

・ For the "other" industries, business toward the government and the services industry is expected to be strong. In addition, the expansion of business in new areas such as blockchain and AI and new businesses developed through the establishment of the Nagoya Office (presumably related to automobiles and electric power) are expected. Consequently, sales are predicted to increase by Y100 million (+2.0%).

**[Figure 34] Predicted Contributions to Sales in FY 2020 (this fiscal year) by Industry (the Company's plan) (unit: Y mil)**




(Ref) Prepared by Alpha-Win Research Dept. based on the financial results briefing material. A = actual value. P = planned value.

◆ Planning to further improve margins

As for the gross margin, the Company expects a significant improvement during this fiscal year. The Company also expects its operating margin to improve to 7.0% and its operating profit to grow at a double-digit rate for the reasons listed below (reference: the operating margin was 6.1% in FY 2017 → 6.3% in FY 2018 → 6.4% in FY 2019). For operating profit, the Company has not disclosed targets for each industry or service category.

1. Improvement of profitability and ensuring of profit through a more advanced Enhancement Service for the existing businesses.
2. Cross-cutting functions across the Company, quality control on a per-project basis, and prevention of unprofitable projects from arising
3. Development of new business domains through continued active engagement in R&D (cloud service, agile, blockchain, AI, etc.)
4. Effect of the sales increase, in addition to improved productivity and transition from orders based on the number of staff and months to a service-providing business model (expansion of the consulting business, switching to orders based on the unit price per service, etc.)

For this fiscal year, no significant non-operating profit/loss or extraordinary profit/loss is expected.

In the first half (H1) of FY 2020, the Company plans to achieve sales of Y7,437 million (+8.5% YoY), an operating profit of Y424 million (+18.3% YoY), a recurring profit of Y424 million (+12.5% YoY), and a net profit of Y250 million (+10.9% YoY).

◆ Planning to increase sales and profits year on year in H1 as well as H2. The plan is highly dependent on H2, during which profitability is expected to largely improve.

Simply subtracting the forecasted values for H1 from the full-year forecast, the predicted values for the second half (H2) of this fiscal year are as follows: sales of Y8,063 million (+7.9% YoY), an operating profit of Y666 million (+18.2% YoY), a recurring profit of Y666 million (+14.2% YoY), and a net profit of Y434 million (+14.6% YoY).

The balance between H1 sales and H2 sales for this fiscal year is expected to be about the same as in FY 2019; the H1/H2 ratio is predicted to be 48/52. The ratio is expected to be 39/61 for operating profit. The operating margin is expected to improve by 0.5 point from 5.2% in H1 of last fiscal year → 5.7% in H1 of this fiscal year. Similarly, it is predicted to improve by 0.8 point from 7.5% → 8.3% for H2. The Company believes that, in H2, the strengthening of the Enhancement business, positive effects from the creation of services, contribution to results by large-scale projects, and the improvement of productivity are highly likely to be realized.

**[Figure 35] The Company's Financial Results Forecast for H1 and H2 and Comparison with the Previous Fiscal Year**

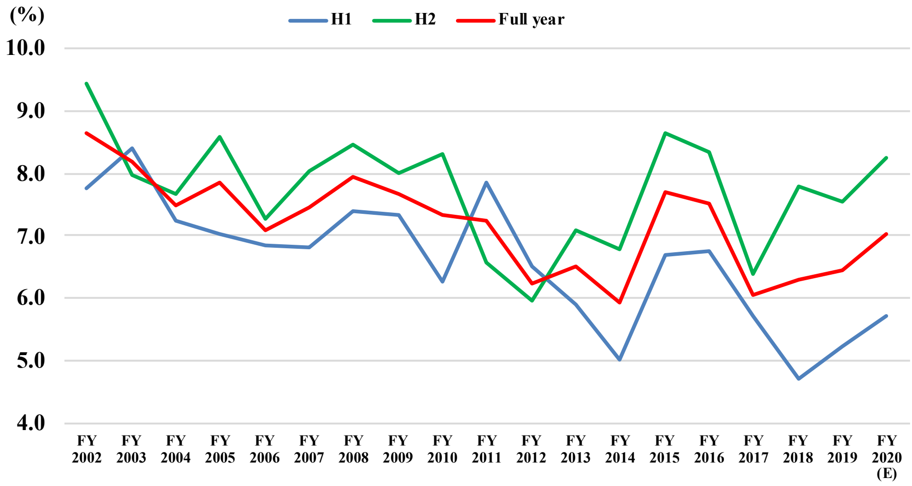
| Unit:: Y mil | Last FY (2019) H1 | Last FY (2019) H2 | This FY (2020) H1 Initial Forecast | % YoY Change | This FY (2020) H2 Initial Forecast | % YoY Change |
|---|---|---|---|---|---|---|
| Sales | 6,852 | 7,473 | 7,437 | 8.5% | 8,063 | 7.9% |
| Gross Profit | 1,131 | 1,318 | | | | |
| Gross Margin | 16.5% | 17.6% | | | | |
| SG&A Expenses | 773 | 754 | | | | |
| SG&A Expenses Ratio | 11.3% | 10.1% | | | | |
| Operating Profit | 358 | 563 | 424 | 18.3% | 666 | 18.4% |
| O.P. Margin | 5.2% | 7.5% | 5.7% | up 0.5pt | 8.3% | up 0.7pt |
| Recurring Profit | 377 | 582 | 424 | 12.5% | 666 | 14.4% |
| Net Profit | 225 | 371 | 250 | 10.9% | 434 | 17.1% |

(Ref) Prepared by Alpha-Win Research Dept. based on the financial results briefing materials

As a reference, the average H1/H2 ratio for the past 18 fiscal years on a consolidated basis is 48.2/51.8 for sales and 44.7/55.3 for operating profit. Similarly, the average operating margin for the same period is 6.6% for H1 and 1.1 point higher in H2 at 7.7% (see Figure 36 for recent half-yearly transitions in operating margin).

In the last seven fiscal years, the difference in operating margin between H1 and H2 has expanded to about 1-3%. This difference seems to have been caused by the fact that in recent years the deadlines of many project have been in March, leading to sales in H2 that are 12.7% greater on average than in H1 (during the same seven fiscal years) and greater profitability in H2. In addition, the dependence of the full-year results on the H2 results concerning profit tends to be high due to the seasonal variability of sales and the incurrence of costs in advance, such as the recruitment cost that is recorded in H1 and the upfront investment costs for R&D, etc.

**[Figure 36] Transition in Half-Year or Full-Year Operating Margin (this FY's values are from the Company's plan) (unit: %)**




(Ref) Prepared by Alpha-Win Research Dept. based on the financial results briefing materials and financial results summary

# 8. Growth Strategy

## ◆ Medium- to Long-Term Management Vision "VISION 2020"

The Company has established "VISION 2020," a medium- to long-term management vision for 2012 to 2020. This target span is divided into three strategy steps. The Company is currently in the final stage – the 3rd STEP (the three years from FY 2019 to FY 2021). The 1st STEP was focused on the enhancement of its strengths, and the 2nd STEP made progress with the creation of new SI businesses.

- Declared to expand its service lineup in the medium-term management plan

The goal of the 3rd STEP is to "maximize customer value by contributing to the growth of the customers' businesses through the expansion of service-providing and SI businesses, creation of a new service lineup, and development of the service business" (details are as shown in Figure 37).

- In the organizational reform, specialized departments were established for the areas of focus.

An organizational reform was conducted in April 2019 for the purpose of accelerating business development to achieve the goals and strengthening the business foundation. The DX Promotion Office, Financial Digital Strategy Office, Nagoya Office, Overseas Business Promotion Office, etc., were newly established, and a system was established to allocate management resources to the areas of growth.

**[Figure 37] Summary of the Medium- to Long-Term Management Vision "VISION 2020": Contents of the 3rd STEP**


(Ref) Prepared by Alpha-Win Research Dept. based on an excerpt from the financial results briefing material

## ◆ Management Indicator Targets and Areas of Focus

The following are the CUBE SYSTEM Group's long-term management indicator targets. Currently, only the ROE target has been achieved, but the other indicators are also beginning to improve. The Company plans to improve its productivity and profitability by streamlining its operation and reinforcing training/education.

- Of the four management indicator targets, the one for ROE has been achieved.

▪ROE: greater than or equal to 10% (FY 2018 → FY2019: actual results were both 11.4%. The same order applies below.)

▪Consolidated operating margin: greater than or equal to 10% (6.3%→6.4%)

▪Consolidated sales per employee in Japan (excludes employees of overseas subsidiaries): greater than or equal to Y25 million (Y22.2 million → Y22.8 million; progress rate of 88.6%→91.4%)

▪Consolidated operating profit for the same condition as above: Y2.5 million (Y1.40 million → Y1.47 million; progress rate of 55.9% → 58.8%)

- In the medium-term plan, the Company aims for consecutive increases in sales and profits and a new record-high profit. It aims to achieve sales of Y18.5 billion, O.P. margin of 9.6%, and ROE of 13% by FY 2021, the final fiscal year of the plan.

The Company has disclosed its forecast for the medium-term financial results up through FY 2021. As its goals, the Company aims to increase sales by approx. 10% per year and largely increase profit by 30% per year (Figures 38 and 39).

Additionally, the Company has disclosed its sales goals for each of its three business segments – existing businesses, growth field, and new businesses (however, actual sales for each segment in FY 2019 have not been disclosed). Sales of its existing businesses are expected to annually increase by 9.8%. The growth field's sales are expected to increase by 6% in FY 2020 and 20% in FY 2021. Sales of the new businesses are expected to annually increase by about 30%. Operating margin is predicted to improve by at least 1 point every year, eventually rising to about 10%, the Company's current goal, by the final year of the plan.

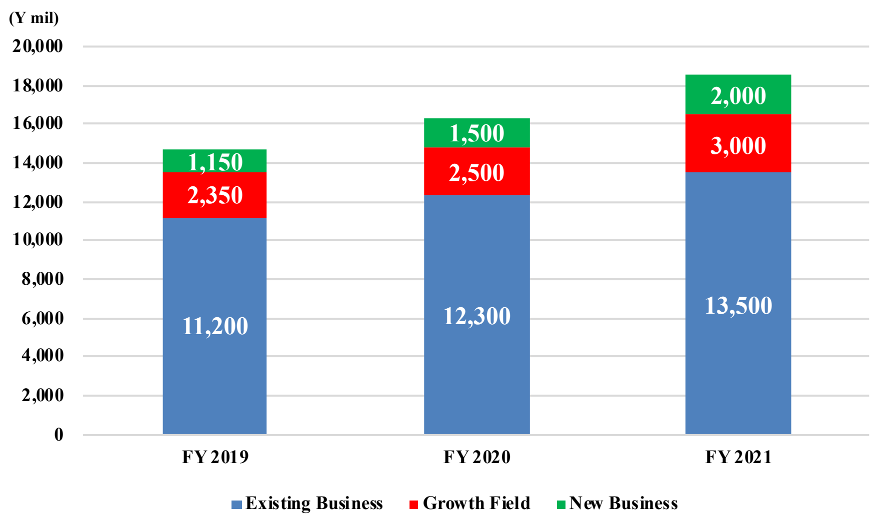
However, for the current fiscal year, which is the second year of medium-term plan, the Company has decided to revise its forecast upon evaluating last fiscal year's results and the current situation. At present, there is no change in the predicted values for FY 2021.

**[Figure 38] The Company's Medium-Term Plan, Actual Results, and Forecast**

| | FY 2018 | FY 2019 | | FY 2020 | | | FY 20201 |
|---|---|---|---|---|---|---|---|
| Unit: Y mil, % | Actual | Plan | Actual | Plan | Company forecast | Difference | Plan |
| Sales | 13,559 | 14,700 | 14,325 | 16,300 | 15,500 | -800 | 18,500 |
| Growth Rate | 5.1% | 8.4% | 5.6% | 10.9% | 8.2% | -2.7% | 13.5% |
| Operating Profit | 855 | 1,010 | 921 | 1,323 | 1,090 | -233 | 1,776 |
| O.P. Margin | 6.3% | 6.9% | 6.4% | 8.1% | 7.0% | -1.1% | 9.6% |
| ROE | 11.4% | 12.1% | 11.4% | 13.0% | - | | 13.0% |

(Ref) Prepared by Alpha-Win Research Dept. based financial results briefing material

**[Figure 39] Sales Breakdown in the Medium-Term (Company) Plan**




(Ref) Prepared by Alpha-Win Research Dept. based on the financial results briefing materials

## ◆ Alpha-Win Research Dept.'s Financial Results Forecast for FY 2020 (this fiscal year)

- Our previous financial results forecast for this FY was revised to about the same level as the Company's plan.

We revised our financial results forecast for the current and the next fiscal year and added a new forecast for FY 2022 as shown in Figure 40. We had previously predicted that the sales for this fiscal year will be Y15,800 million, but the new forecast has been revised to about the same level as the Company's forecast (Y15,500 million) (our forecast: Y15,400 million).

In terms of profit, the previous forecast was revised slightly downward to about the same level as the Company's forecast. Since the overall economy is increasingly unpredictable and various costs are on the rise, we reevaluated the SG&A expenses and the effect of improved gross margin slightly more strictly than in the previous forecast. Following these revisions, the forecast on the operating margin was revised from the initial 7.3% to 7.0%.

**[Figure 40] Alpha-Win's Forecast on Financial Results for This Fiscal Year and Over the Medium Term**
**(CE = the Company's estimate/forecast; E = Alpha-Win Res. Dept.'s estimate/forecast; A = Actual)**

| Unit: Y mil, % | FY 2019 A | FY 2020 CE | FY 2020 New E | *FY 2020 Old E* | FY 2021 New E | *FY 2021 Old E* | FY 2022 E |
|---|---|---|---|---|---|---|---|
| Sales | 14,325 | 15,500 | 15,400 | *15,800* | 16,500 | *17,300* | 17,800 |
| Gross Profit | 2,449 | | 2,700 | *2,800* | 2,930 | *3,100* | 3,180 |
| Gross Margin | 17.1% | | *17.5%* | *17.7%* | 17.8% | *17.9%* | *17.9%* |
| SG&A Expenses | 1,527 | | 1,620 | *1,650* | 1,720 | *1,760* | 1,900 |
| (% over sales) | 10.7% | | 10.5% | *10.4%* | 10.4% | *10.2%* | 10.7% |
| Operating Profit | 921 | 1,090 | 1,080 | *1,150* | 1,200 | *1,340* | 1,320 |
| (% over sales) | 6.4% | 7.0% | 7.0% | *7.3%* | 7.3% | *7.7%* | 7.4% |
| Recurring Profit | 959 | 1,090 | 1,080 | *1,150* | 1,200 | *1,340* | 1,320 |
| (% over sales) | 6.7% | 7.0% | 7.0% | *7.3%* | 7.3% | *7.7%* | 7.4% |
| Net Profit | 596 | 684 | 680 | *730* | 750 | *851* | 825 |
| (% over sales) | 4.2% | 4.4% | 4.4% | *4.6%* | 4.5% | *4.9%* | 4.6% |
| Sales (% YOY growth) | 5.7% | 8.2% | 7.5% | *10.3%* | 7.1% | *9.5%* | 7.9% |
| *Gross Margin (% YOY diff.)* | -0.2% | | *0.4%* | *0.6%* | *0.2%* | *0.2%* | *0.1%* |
| SG&A Expense (% growth) | 2.6% | | 6.1% | *8.0%* | 11.1% | *6.7%* | 10.5% |
| Operating Profit (% growth) | 7.8% | 18.3% | 17.3% | *24.9%* | 11.1% | *16.5%* | 10.0% |
| Recurring Profit (% growth) | 7.5% | 13.7% | 12.6% | *19.9%* | 11.1% | *16.5%* | 10.0% |
| Net Profit (% growth) | 5.1% | 14.8% | 14.1% | *22.5%* | 10.3% | *16.5%* | 10.0% |

(Ref) Prepared by Alpha-Win Research Dept. based on the securities report

- Average difference between the past 16 years' initial forecasts and actual results has been generally small.

As a reference, the differences between the Company's initial forecast and the actual results for the past 16 years have been analyzed and are shown in Figure 41 on page 35. During this period, on a simple average, the actual sales were 1.3% below the initial forecast and both the operating and recurring profits were 4 to 5% below the forecast. However, neither profit was ever more than 30% lower than the forecast. This company tends to announce ambitious forecast values that are within a generally realistic range.

- The macro environment is somewhat unpredictable, but the Company is receiving orders at a strong pace.

Since the Company is receivng orders at a strong pace, although the situation would also be affected by the project deadlines and the overall success of project management, at this point it seems unlikely that the results will deviate largely from the Company's initial forecast unless sudden changes in the environment occur or an unexpected large loss is recorded for a project. While there may be some fluctuations, we believe that increases and record highs in sales and profits are possible.

- We predict that increases and record highs in sales and profits are possible for this FY.

**[Figure 41] Comparison of (the Company's) Initial Forecast for Consolidated Financial Results with the Actual Results in Chronological Order**

| Consolidated | Sales | | Operating Profit | | Recurring Profit | | Net Profit Attributable to Owners of the Parent (N.P.) | | Sales | O.P. | R.P. | N.P. | Sales | O.P. | R.P. | N.P. |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Unit: Y mil | *Initial Forecast* | Actual | *Initial Forecast* | Actual | *Initial Forecast* | Actual | *Initial Forecast* | Actual | % Diff. from Initial Forecast | | | | % YoY Change for Actual Result | | | |
| FY 2001 | - | 4,806 | - | - | - | 387 | - | - | - | - | - | - | - | - | - | - |
| FY 2002 | - | 5,598 | - | 485 | - | 445 | - | 246 | - | - | - | - | 16.5% | - | 15.0% | - |
| FY 2003 | - | 6,244 | - | 510 | - | 432 | - | 235 | - | - | - | - | 11.5% | 5.2% | -2.9% | -4.4% |
| FY 2004 | *6,900* | 6,575 | - | 491 | *522* | 500 | *284* | 280 | -4.7% | - | -4.3% | -1.5% | 5.3% | -3.7% | 15.7% | 18.9% |
| FY 2005 | *7,000* | 7,100 | - | 558 | *532* | 551 | *287* | 315 | 1.4% | - | 3.5% | 9.7% | 8.0% | 13.6% | 10.2% | 12.5% |
| FY 2006 | *7,800* | 7,767 | - | 549 | *600* | 551 | *340* | 312 | -0.4% | - | -8.2% | -8.3% | 9.4% | -1.6% | 0.0% | -1.0% |
| FY 2007 | *8,300* | 7,923 | - | 590 | *570* | 584 | *330* | 324 | -4.5% | - | 2.4% | -1.8% | 2.0% | 7.4% | 5.9% | 3.9% |
| FY 2008 | *8,300* | 8,109 | *605* | 645 | *610* | 643 | *336* | 342 | -2.3% | 6.6% | 5.4% | 1.9% | 2.3% | 9.4% | 10.2% | 5.7% |
| FY 2009 | *8,500* | 8,507 | *680* | 652 | *685* | 597 | *350* | 308 | 0.1% | -4.1% | -12.8% | -12.1% | 4.9% | 1.1% | -7.1% | -10.1% |
| FY 2010 | *8,800* | 8,706 | *660* | 637 | *670* | 660 | *350* | 349 | -1.1% | -3.5% | -1.5% | -0.3% | 2.3% | -2.3% | 10.6% | 13.4% |
| FY 2011 | *9,200* | 9,166 | *675* | 662 | *680* | 672 | *263* | 208 | -0.4% | -1.9% | -1.2% | -20.9% | 5.3% | 4.0% | 1.8% | -40.4% |
| FY 2012 | *9,300* | 8,431 | *665* | 524 | *675* | 533 | *350* | 118 | -9.3% | -21.2% | -21.0% | -66.4% | -8.0% | -20.9% | -20.7% | -43.4% |
| FY 2013 | *9,000* | 9,242 | *620* | 601 | *630* | 606 | *350* | 338 | 2.7% | -3.1% | -3.8% | -3.5% | 9.6% | 14.8% | 13.7% | 186.7% |
| FY 2014 | *10,000* | 11,217 | *700* | 665 | *700* | 702 | *380* | 387 | 12.2% | -5.0% | 0.3% | 1.7% | 21.4% | 10.6% | 15.8% | 14.5% |
| FY 2015 | *12,000* | 12,527 | *840* | 964 | *840* | 981 | *480* | 594 | 4.4% | 14.8% | 16.7% | 23.8% | 11.7% | 45.0% | 39.7% | 53.7% |
| FY 2016 | *13,000* | 12,623 | *1,000* | 949 | *1,020* | 960 | *600* | 629 | -2.9% | -5.1% | -5.9% | 4.8% | 0.8% | -1.6% | -2.1% | 5.9% |
| FY 2017 | *14,000* | 12,899 | *920* | 781 | *940* | 811 | *450* | 551 | -7.9% | -15.1% | -13.7% | 22.4% | 2.2% | -17.7% | -15.5% | -12.4% |
| FY 2018 | *14,300* | 13,559 | *1,060* | 855 | *1,080* | 893 | *650* | 567 | -5.2% | -19.3% | -17.3% | -12.8% | 5.1% | 9.5% | 10.1% | 2.9% |
| FY 2019 | *14,700* | 14,325 | *1,010* | 922 | *1,010* | 960 | *640* | 597 | -2.5% | -8.8% | -5.0% | -6.8% | 5.7% | 7.8% | 7.5% | 5.2% |
| FY 2020 | *15,500* | | *1,090* | | *1,090* | | *684* | | | | | | | | | |
| Simple average of diff. (unit: %), calc. for longest period with data on both sales and profits→ | | | | | | | | | -1.3% | -5.5% | -4.1% | -4.4% | 6.4% | 4.7% | 6.0% | 12.5% |
| Green highlight: record-high value | | | Number of times revised up:down from init. forecast → | | | | | | 5:11 | 2:10 | 5:11 | 6:10 | ↑ Simple average for each FY | | | |

(Ref) Prepared by Alpha-Win Research Dept. based on the financial results summary

- Revised the financial forecast for the medium term, taking into account the changes in the macroeconomic environment
- Over the medium term, we believe that sales and profits will increase by 6-10% per year.

## ◆ Alpha-Win Research Dept.'s Financial Results Forecast for the Medium Term

Upon considering the Company's estimates/assumptions for this fiscal year, potential downturn of the domestic/overseas economy, and changes in the momentum of Japanese companies' financial performance, we revised our previous forecast slightly downward and prepared a forecast for the three fiscal years ending in FY 2022 (Figure 40 shown previously on page 34). We predict that, for the meantime, sales and profits will continue to increase by about 6-10% per year for the following reasons.

<u>Factors and assumptions for predicting increased sales</u>

・Development of the Enhancement business with the major customers based on the technological expertise and trust that the Company has built up over the years

・Strengthening and development of the capacity to complete large-scale projects

・Acquisition of new customers (acquire customers in the "other" industries such as manufacturers)

・Development of new businesses and new business fields – specifically, energy-related, consulting, and new solutions (cloud, blockchain, etc.) businesses

・Overseas development (mainly toward overseas Japanese companies)

・However, sales increase from large-scale M&As, etc., have not been reflected in the forecast (same for profit)

<u>Factors and assumptions for predicting increased profit</u>

・The gross margin is expected to gradually improve due to various measures (transition to service-based contracts, improved productivity, reviewing subcontracting cost, etc.), although at a slower pace than initially expected.

・Rise in profit from the new businesses have not been reflected in the forecast for the time being.

・General and administrative expenses are predicted to annually increase at a somewhat high rate (6 to 10%) due to the reinforcement of business foundation for future growth (expansion of HR, organization, and sites), the rise in costs (personnel expense, logistics expense, subcontracting cost, etc.), and continued upfront investment on new technology and business research.
・Consequently, the estimated improvement in the operating margin for next fiscal year and onward has been changed from 0.4-0.5 point per year (initial estimate) to about 0.1-0.3 point per year (current estimate).
・No expectation for extraordinary profit or loss

Compared to the Company's medium-term target values (FY 2021 as the final year), our predictions are conservative. While the Company's targets are somewhat ambitious, our prediction took into account the risk factors listed below. However, if the measures are carried out in line with the Company's plan and if business conditions are just right (orders for large-scale or new projects, overseas development, new business development, successful acquisition of companies, etc.), then the targets may be achievable over the medium to long term, although with some delays in the year achieved.

・For the macroeconomic environment, the uncertainty in the global economy due to the US-China trade war, etc., is a risk factor. We also anticipate an economic downturn and a decline in the financial performance of companies after the consumption tax rate is raised as planned in October 2019 and after the Tokyo Olympics in July to August of 2020.
・At this point, we cannot predict what will happen to the Company's main users' industry trends and situations, contribution of new businesess and business domains to results, M&A strategy, rate of rise in cost, recruitment, etc., in the future.

# 9. Analyst's View

## ◆ SWOT Analysis

The Company's SWOT analysis result is shown in Figure 42.

**[Figure 42] SWOT Analysis**

| | |
|---|---|
| Strength | ･Long history in the industry and extensive experience<br>･Stable and excellent customer base<br>･Technological expertise / unique know-how / staff with expertise / organization (business type / project management)<br>･Entry barrier actually high; business with high continuity<br>･Firm financial standing<br>･Consulting-based sales through direct sales activity; Enhancement<br>･Low-cost development system using overseas subsidiaries |
| Weakness | ･Relies heavily on certain customers<br>･Needs to secure and acquire more talented personnel<br>･Industry structure where profit margin is hard to improve<br>･Takes a long time for next-generation growth products and services to gain momentum<br>･Specialized in domestic demands; overseas development difficult |
| Opportunity | ･Increased demand for systems due to HR deficit and the need to streamline operation<br>･New products, new services, and technology innovations leading to increased demand for systems<br>･Upstream processes, niche areas, and shifting to large-scale dev. projects; reinforce Enhancement business<br>･Business expansion following the global entry of customers<br>･Strengthening of alliance |
| Threat | ･Reduced IT investment, less demand for renewed contract, and intensified price competition during recession<br>･Emergence of alternatives (popularization of AI or packaged software for business use), lagged product development, and product defects<br>･Risk of loss in project management<br>･Information management and leakage risks<br>･Increased personnel expense and subcontracting cost |

(Ref) Prepared by Alpha-Win Research Dept.

◆ Many years' worth of trust, track record, and technological expertise are its strengths. Acquisition of talented employees is the bottleneck to further growth.

Describing the strengths listed in Figure 42 in more detail, the Company has a high business continuity and stability because of its excellent customer base owing to its long years of business during which it has earned trust and built technological expertise. Moreover, the Company's strength lies in the fact that it is in a market position close to the end users, such that it can propose related or derived systems to customers and obtain new development and service jobs (Enhancement).

On the other hand, looking at its weaknesses in more detail, for the Company's industry in general, the profit margins do not change or are slightly decreasing over the long term, and the profits tend to not increase without an increase in the sales. New business domain development and new customer acquisition are indeed necessary to raise sales, but the Company is also experiencing a deficit in human resources, especially for project managers, which is a bottleneck to further growth. Due to the nature of the system integration business, since there are only limited ways to improve productivity or largely reduce cost, fundamental improvements in the profit margins would probably take a long time.

## ◆ Shareholder Return and Shareholder Benefit Program

- Proactive stance with regards to shareholder return

The Company's policy is to raise shareholder asset value by improving its financial results in order to conduct stable dividend payments and increase market capitalization. So far, it has been taking a proactive stance with regards to improving shareholder return, conducting incremental dividend hikes, share buyback, stock splits, enhancement of shareholder benefit program, etc.

- Actual annual (maximum) yield including the shareholder benefit program is about 2.9%.

- Have been gradually increasing dividend, raising it every few years

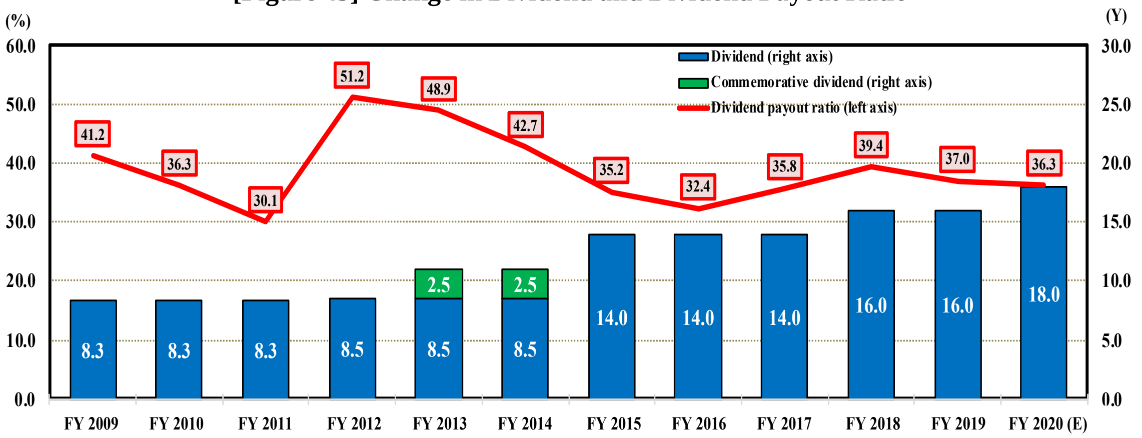
The Company's consolidated dividend payout ratio was 39.4% in FY 2018 and 37.0% in FY 2019 and is forecasted to be 36.3% in FY 2020 (the Company's forecast), all meeting the target of 35%. The Company raised its dividend from Y14 to Y16 in FY 2018 and kept it the same in FY 2019, but it has announced that it will raise the dividend by Y2 to Y18 in FY 2020 (Figure 43). Over the medium term, since profit growth is expected, we believe that incremental rises in the dividend at intervals of a few years are possible.

Dividend yield is 2.3% when calculated based on a stock price of Y785 (closing price as of the end of June 2019). The Company conducts IR activities toward individual investors, one of its major types of shareholders. It has a shareholder benefit program where JCB Gift Cards are given to shareholders based on the number of shares they own (Figure 44 on page 39). When this benefit program is taken into account, the actual dividend yield increases to approx. 2.9% at maximum (for the optimum number of shares owned). The Company plans to continue to maintain its stable dividend payment and raise the EPS to enhance shareholder return. Under the same conditions, the actual annual yields of its competitors are approx. 2.8% for HIMACS (no shareholder benefit program) and approx. 3.1% for Toho System (shareholder benefit program taken into account).

- Has been proactive in conducting stock splits and share buybacks

Since becoming listed on the market, the Company has performed a total of six stock-splits, including a 1-to-2 split in April 2010, a 1-to-1.5 split in April 2011, and a 1-to-2 split in October 2014. It has also conducted six share buybacks, including the approx. 350,000 shares (Y300 million) bought back in February of this year, acquiring a total of approx. Y650 million's worth of shares (acquisition price at the time of acquisition). Since the Company has a great financial standing and is rich in cash, depending on the level of the stock price, additional share buybacks may be possible – we should keep an eye out for this.

**[Figure 43] Change in Dividend and Dividend Payout Ratio**




(Ref) Prepared by Alpha-Win Research Dept.

**[Figure 44] Shareholder Benefit Program and Actual Net Yield**

| Number of Shares Owned (greater than or equal to) | (less than) | Shareholder Benefit (JCB Gift Card: Y) | Dividend: Y | Actual Net Yield: % |
|---|---|---|---|---|
| 200 | 400 | 1,000 | 18 | 2.9 |
| 400 | 1,000 | 2,000 | 18 | 2.9 |
| 1,000 | | 3,000 | 18 | 2.7 |

Actual net yield* = (dividend + benefit value) / (stock price)

*Calculated for the min. (optimum) amount of stock owned in each range

Stock price assumed to be at: Y785 (closing price on the last day of June 2019)

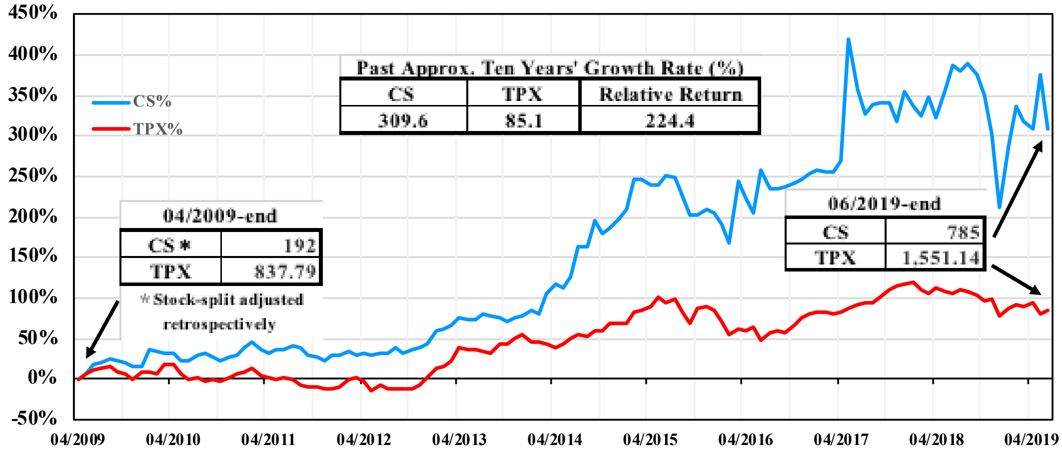
(Ref) Prepared by Alpha-Win Research Dept. based on the Company's website

## ◆ Stock Characteristics/Price and Factors that May Affect Stock Price

- A defensive, domestic-demand-related growth stock. Stock price increased by approx. four times over the past ten years or so, largely outperforming the TOPIX.

Over the past approximately ten years, the Company's stock price rose by about four times, largely outperforming the TOPIX by more than 200% (calculated with stock splits taken into account; as of the end of June 2019; Figure 45). This growth reflects the Company's strong fundamentals and firm growth in financial results over the long term. The Company is outperforming the TOPIX this fiscal year as well; this may be reflecting how the Company is becoming recognized as a domestic-demand-related growth stock with firm financial results despite the rising consumption tax, exchange rate fluctuations, trade war, and the increasing volatility of the stock market due to the anticipation of a downturn in corporate performance. Its stock price soared in February of this year when it announced a share buy-back and in May when it received reappraisal as an AI-related stock with a strong financial performance, but in the most recent period the stock price has stabilized to around Y800.

**[Figure 45] Long-Term Return on the Company's Stock (CS) and TOPIX (change in the past ten years' monthly stock prices)**




Note: CS stock price and TOPIX at the end of April 2009 set at 0% as the start point

(Ref) Prepared by Alpha-Win Research Dept.

The Company's stock is characterized as defensive with a relatively stable financial performance. This attribute of the Company may help it receive high evaluation in the stock market when the domestic or overseas economy faces a recession in the future.

◆ Stock valuation is on the high side relative to the average of the First Section of the TSE, but is about average or slightly low for its industry.

The major valuation indicators of the Company were compared to the averages of the First Section of TSE and the indicators of its competitors that are also listed on the First Section. The Company's dividend yield is 2.3%, which is close to the average of the First Section (the simple average is 2.1% and the weighted average is 2.5%). For P/E, the Company's P/E is approx. 15.8 (based on the Company's predicted EPS for FY 2020) while the Section's average is approx. 13.4. The Company's P/B, which is 2.0, is also greater than the average, which is 1.1, indicating that the Company is receiving appropriate evaluation from the market.

Compared to its competitors (HIMACS and Toho System), the Company's valuation is about the same or slightly high but not expensive (Figure 46). In addition, its liquidity is relatively high (trading value).

On the other hand, relative to a universe of the leading 33 SI companies listed mainly on the First Section of the TSE (including the Company; the total market cap of the 33 companies is Y9 trillion and total sales are Y6.8 trillion), the Company's stock valuation is about average or slightly low for the SI sector (Figures 47, 48, and 49 on page 41). Within the same sector, there seems to be a positive correlation between the forecast for this fiscal year's operating margin (from the companies' plans) and P/E and between sales and market capitalization (Figure 49 on page 41 and Figure 50 on page 42). In the future, we believe that if the Company's operating margin improves and its sales increase, then its valuation (P/E, etc.) may rise and the market capitalization may also increase.

◆ Looking at the valuation, we can see that the appropriate evaluation is being reflected in the stock price. Going forward, we should watch for this FY and next FY's financial performance, development of new businesses, and enhancement of shareholder return.

Going forward, we should keep note of the following factors or events that may affect stock price.

・Achievement rate toward targets during this fiscal year or FY 2020 and financial performance during next fiscal year or FY 2021 (especially the targets announced in the forecast at the beginning of the fiscal year)

・Progress with the growth strategy including the expansion of business domain, M&As, and tie-ups

・Progress in increasing new customers (at the Nagoya site, overseas, etc.)

・Fully committed start of new-technology businesses such as blockchain, cloud, AI, IoT, and agile development that are currently in the R&D or investment phase. The contribution of these businesses to sales and profit.

・ Share buyback, dividend hike, stock split, and enhancement of shareholder benefit program

**[Figure 46] Comparison of Valuation Indicators and Liquidity of Three Same-Business Companies**

(Ref) Prepared by Alpha-Win Research Dept. based on the financial results summary

| Company Name | CUBE SYSTEM (CS: consolidated) | HIMACS (HM: consolidated) | Toho System Science (TS: non-consolidated) |
|---|---|---|---|
| Code | 2335 | 4299 | 4333 |
| Stock Price (at 6/28 closing) | 785 | 1,795 | 964 |
| Market Cap (Y mil) | 11,995 | 11,141 | 13,367 |
| P/E (price-to-earnings ratio) | 15.8 | 16.3 | 15.1 |
| P/B (price-to-book ratio) | 2.0 | 1.1 | 1.7 |
| Dividend Yield (%) | 2.3 | 2.8 | 2.6 |
| EV/EBITDA | 9.1 | 5.5 | 5.6 |
| P/S (price-to-sales ratio) | 0.8 | 0.7 | 1.0 |
| Ave. Daily Traded Amount in Past 6 Months (Y mil) | 40 | 6 | 7 |

Market cap= (shares outstanding) x (market share price [at 6/28/2019 closing])
The companies' planned EPS and dividend values for FY 2020 were used in all P/E and dividend yield calculations.
Actual BPS values of FY 2019 were used in P/B calculations.
EV/EBITDA=(market cap + interest bearing debt - cash&deposits)/(O.P. + depreciation + intangible fixed asset amortization)
P/S=market cap / sales [the companies' forecasts for FY 2020]

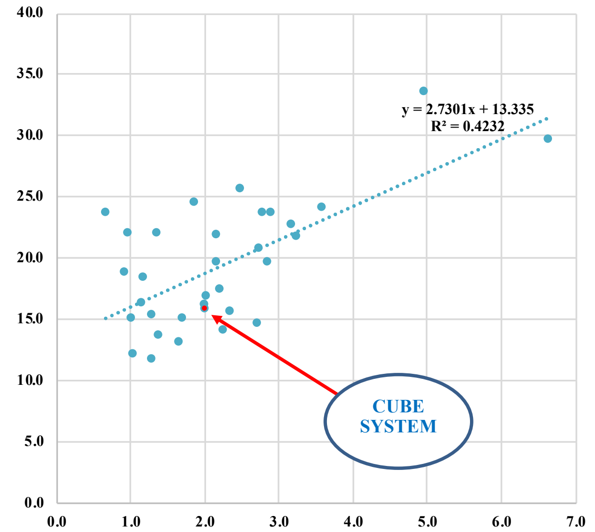
## [Figure 47] Comparison of Major Stocks in the SI Sector
**(Note: major companies that have disclosed a forecast for this FY and have not posted and are not expected to post a large extraordinary loss or profit during last FY or this FY)**

| Code | Company Name | Market Cap. | Stock Price | Sales | O.P. | O.P. Margin | Actual ROE (%) | Est. P/E | Actual P/B | Est. Dividend Yield | P/S |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 9613 | NTT DATA | 2,012,588 | 1,435 | 2,240,000 | 148,000 | 6.6% | 10.7 | 21.9 | 2.2 | 1.3% | 0.9 |
| 4307 | Nomura Research Institute | 1,301,778 | 1,727 | 530,000 | 76,000 | 14.3% | 12.3 | 22.0 | 1.0 | 1.7% | 2.5 |
| 4684 | OBIC | 1,215,120 | 12,200 | 80,000 | 41,000 | 51.3% | 15.5 | 33.6 | 5.0 | 1.1% | 15.2 |
| 4768 | Otsuka Corporation | 823,659 | 4,335 | 803,000 | 50,400 | 6.3% | 15.2 | 24.0 | 3.6 | 2.1% | 1.0 |
| 4739 | Itochu Techno-Solutions | 662,880 | 2,762 | 480,000 | 39,000 | 8.1% | 11.5 | 23.6 | 2.9 | 2.0% | 1.4 |
| 9719 | SCSK | 552,164 | 5,300 | 380,000 | 41,000 | 10.8% | 14.6 | 19.7 | 2.8 | 2.5% | 1.5 |
| 3626 | TIS | 481,962 | 5,490 | 425,000 | 40,000 | 9.4% | 11.5 | 16.9 | 2.0 | 1.5% | 1.1 |
| 8056 | Nihon Unisys | 396,434 | 3,615 | 307,000 | 23,000 | 7.5% | 13.1 | 22.7 | 3.2 | 1.8% | 1.3 |
| 2327 | NS Solutions | 323,890 | 3,420 | 280,000 | 27,200 | 9.7% | 12.3 | 17.4 | 2.2 | 1.8% | 1.2 |
| 9749 | Fujisoft | 159,064 | 4,720 | 210,500 | 11,700 | 5.6% | 6.2 | 22.0 | 1.4 | 0.8% | 0.8 |
| 9759 | NSD | 146,941 | 3,115 | 65,500 | 9,300 | 14.2% | 12.6 | 20.8 | 2.8 | 2.9% | 2.2 |
| 1973 | NEC Networks & System Int. | 136,828 | 2,749 | 295,000 | 13,000 | 4.4% | 8.7 | 15.3 | 1.3 | 2.9% | 0.5 |
| 9682 | DTS | 113,298 | 2,246 | 93,500 | 10,000 | 10.7% | 13.9 | 15.1 | 1.0 | 2.2% | 1.2 |
| 4812 | ISID | 111,951 | 3,435 | 93,000 | 8,500 | 9.1% | 10.5 | 19.7 | 2.2 | 2.0% | 1.2 |
| 4722 | Future | 101,191 | 2,123 | 43,500 | 6,400 | 14.7% | 15.7 | 21.8 | 3.3 | 1.8% | 2.3 |
| 9692 | CEC | 89,150 | 2,371 | 51,500 | 5,150 | 10.0% | 12.2 | 23.7 | 2.8 | 1.4% | 1.7 |
| 3844 | COMTURE | 61,823 | 3,835 | 20,000 | 2,880 | 14.4% | 26.0 | 29.6 | 6.6 | 1.5% | 3.1 |
| 4674 | CRESCO | 41,520 | 3,460 | 37,880 | 3,400 | 9.0% | 14.6 | 15.7 | 2.3 | 2.0% | 1.1 |
| 4719 | ALPHA SYSTEMS | 39,347 | 2,800 | 30,300 | 3,200 | 10.6% | 6.2 | 18.3 | 1.2 | 1.8% | 1.3 |
| 9739 | NIPPON SYSTEMWARE | 38,680 | 2,596 | 38,000 | 3,500 | 9.2% | 12.5 | 16.1 | 2.0 | 1.2% | 1.0 |
| 4725 | CAC Holdings | 30,792 | 1,499 | 52,000 | 2,000 | 3.8% | 4.4 | 18.8 | 0.9 | 3.3% | 0.6 |
| 9640 | SAISON INFORMATION | 29,468 | 1,819 | 24,000 | 2,500 | 10.4% | 16.5 | 14.0 | 2.3 | 4.7% | 1.2 |
| 3784 | VINX | 21,102 | 1,191 | 26,500 | 1,350 | 5.1% | 5.8 | 25.6 | 2.5 | 0.8% | 0.8 |
| 9600 | I-NET | 19,117 | 1,177 | 30,000 | 2,450 | 8.2% | 10.9 | 11.8 | 1.3 | 3.7% | 0.6 |
| 9717 | JASTEC | 17,812 | 974 | 17,005 | 2,060 | 12.1% | 9.9 | 12.1 | 1.0 | 3.1% | 1.0 |
| 4662 | Focus Systems | 13,751 | 844 | 21,800 | 1,420 | 6.5% | 9.6 | 13.7 | 1.4 | 2.4% | 0.6 |
| 4333 | Toho System | 13,367 | 964 | 13,500 | 1,130 | 8.4% | 9.8 | 15.1 | 1.7 | 2.6% | 1.0 |
| 4828 | Toyo Business Engineering | 12,210 | 2,035 | 16,000 | 1,330 | 8.3% | 21.7 | 14.6 | 2.7 | 1.9% | 0.8 |
| 2335 | CUBE SYSTEM | 11,995 | 785 | 15,500 | 1,090 | 7.0% | 11.4 | 15.8 | 2.0 | 2.3% | 0.8 |
| 4284 | SOLXYZ | 11,882 | 886 | 14,000 | 800 | 5.7% | 2.8 | 24.5 | 1.9 | 1.4% | 0.8 |
| 4299 | HIMACS | 11,141 | 1,795 | 15,000 | 800 | 5.3% | 9.8 | 16.3 | 1.1 | 2.8% | 0.7 |
| 4761 | SAKURA KCS | 10,427 | 931 | 23,000 | 610 | 2.7% | 2.5 | 23.7 | 0.7 | 1.3% | 0.5 |
| 9753 | IX Knowledge | 8,680 | 775 | 18,014 | 840 | 4.7% | 13.1 | 13.1 | 1.7 | 1.9% | 0.5 |
| Simple Average | | 273,394 | | | | 9.8% | 11.6 | 19.4 | 2.2 | 2.1% | 1.6 |
| Simple Average (excl. OBIC) | | | | | | 8.5% | 11.5 | 18.9 | 2.1 | 2.1% | 1.2 |

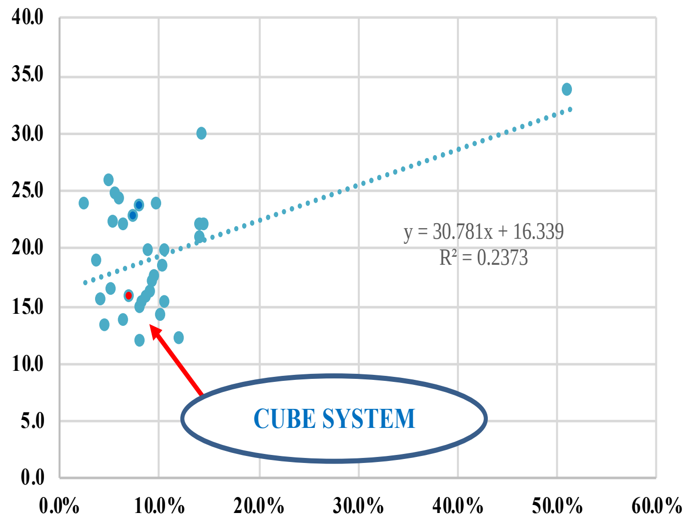
Note: Units for market cap., sales, and O.P.: Y mil
P/E, P/B, and P/S are ratios and are unitless Stock price is closing price on June 28, 2019

(Ref) Figures 47 to 50 were prepared by Alpha-Win Research Dept. based on the securities report and stock data

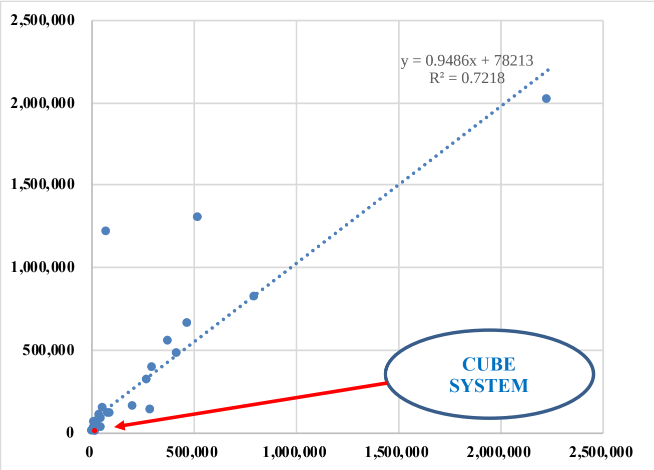
**[Figure 48] Valuation of Major Stocks in the SI Sector: Actual P/B (x-axis) vs. Predicted P/E (y-axis)**




**[Figure 49] This FY's Predicted Operating Margin (x-axis: unit = %) vs. Predicted P/E (y-axis) for Major Stocks in the SI Sector**



**[Figure 50] Sales (x-axis: unit = Y mil) vs. Market Cap (y-axis: unit = Y mil) for Major Stocks in the SI Sector**

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