

ID Holdings Corporation

(4709, TSE 1st Section)

December 17, 2019

Progress in Improving Profitability through Strengthened Project Management

Update Report

Quick Corporation
Toshiaki MaedaKey benchmarks as of
December 13, 2019

Share price	¥1,447
Year-to-date high	¥1,522 (2/6)
Year-to-date low	¥1,016 (6/4)
Shares outstanding	12,044,302 shares
Trading units	100 shares
Market capitalization	¥17,428 million
Projected dividend (Company)	¥50.00
Projected EPS (Analyst)	¥115.17
PBR (Results)	1.90

Issuance date of preceding reports

Research Note	September 9, 2019
Basic	July 5, 2019

58% increase in operating income in H1 is a tangible result of strengthened project management.

In the first half of the 2019 fiscal year (H1 FY2019: April 1 to September 30, 2019), consolidated operating income of the ID Group was ¥1.16 billion (+58% over the same period of the previous fiscal year (YoY)). Though net sales were little changed YoY at ¥13.2 billion, the Group succeeded in a number of efforts, including strengthening its project-management framework and shifting engineers into high-value-added fields related to cybersecurity and digital transformation (DX). Some major, high-earning software-development projects continued, contributing directly to the large increase in income. Regarding the ID Group's targets for H1 announced at the beginning of the fiscal year (net sales of ¥13.3 billion and operating income of ¥740 million), net sales fell just short, but operating income increased greatly.

The ID Group forecasts a slight increase in revenue and 20% growth in operating income in FY2019.

In its forecast of the Group's consolidated business results for FY2019, QUICK Corporation is maintaining its net sales forecast of ¥26.6 billion (a slight increase YoY) but raising its forecast of operating income from ¥1.67 billion to ¥2.0 billion (+20% YoY). Although the Group struggled to find growth in system operation management and software development in H1, in H2 public-sector-related projects are expected to rally and the Group's cybersecurity, consulting and training service is growing. We therefore judge that the Group will meet its existing forecast for net sales. In earnings, the Group is making progress in boosting profitability, through efforts such as strengthening its project-management framework, which resulted in a higher-than-expected income level in H1. Though training and other expenses geared to future growth are on the rise, operating income will be much higher than originally forecast. We forecast that the ID Group will post new highs in both net sales and operating income.

The Group is implementing a three-year Mid-term Management Plan.

The Group's current three-year Mid-term Management Plan, "Next 50 Episode I : Awakening!" of which FY2019 is the first year, is now under way. As the Group celebrated its 50th anniversary in October 2019, it is positioning the current Mid-term Management Plan as a springboard from which to leap into the next 50 years and is implementing a strategy to prepare for future growth. The Group is improving enterprise value while delivering stable and continuous returns to shareholders. The Group's main targets for the new Mid-term Management Plan are to attain net sales of ¥30 billion, operating income of ¥1.85 billion and operating income margin of 6.2% by FY2021, the final year of the Mid-term Management Plan.

Results		Net sales ¥ million	YoY %	Operating income ¥ million	YoY %	Ordinary income ¥ million	YoY %	Net income ¥ million	YoY %	EPS ¥
FY2018	Results	26,515	14.3	1,667	32.9	1,724	35.3	1,028	65.2	93.15
FY2019	Company estimates (Announced May 2019)	26,800	1.1	1,670	0.2	1,710	-0.8	1,060	3.1	95.37
	Analyst estimates	26,600	0.3	2,000	19.9	2,040	18.3	1,280	24.4	115.17
FY2020	Analyst estimates	27,400	3.0	2,100	5.0	2,140	4.9	1,340	4.7	120.57

Business Environment

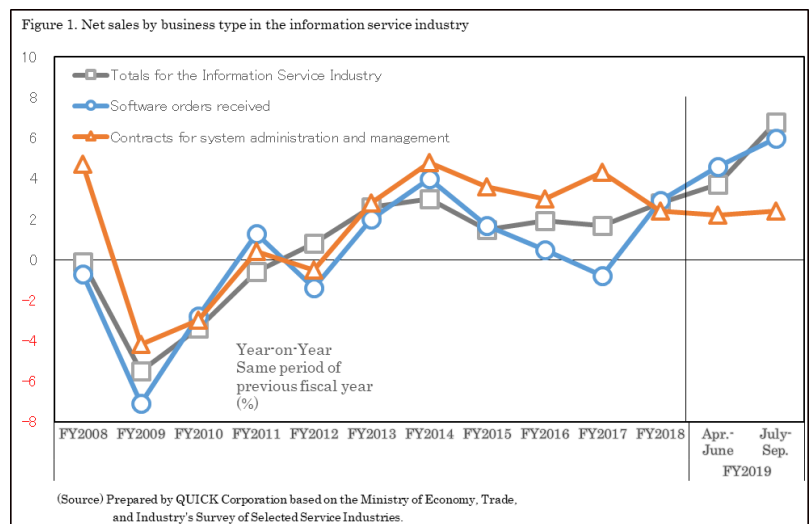
Increasing trend in contracts for system administration and management

- Business Environment

IT investment delays and project cancellations were prominent in the information service industry after the collapse of Lehman Brothers in 2008. Industry growth stagnated for years. However, there has been a gradual recovery in the past few years. This trend is evident based on the information service sales figures reported in the Survey of Selected Service Industries published by the Ministry of Economy, Trade, and Industry. The net sales for each type of business within the information service industry are shown in Figure 1. The breakdown of system administration and management contracts and software orders received by industry are categorized as net sales for industries related to the company's system operation management business and software development business, respectively.

The company's software orders experienced negative growth in FY2008 and slumped severely in FY2009. Although contracts for system administration and management also experienced negative growth in FY2009, this business did not slump as severely as software orders, and it continued to grow thereafter, exceeding the performance of the software orders business. In FY2017, software orders failed to reach values from the previous fiscal year for the first time in 5 years, while contracts for system administration and management achieved a greater growth percentage than in FY2016. Contracts for system administration and management continue to grow steadily in FY2018. Software orders received also entered a slightly profitable area.

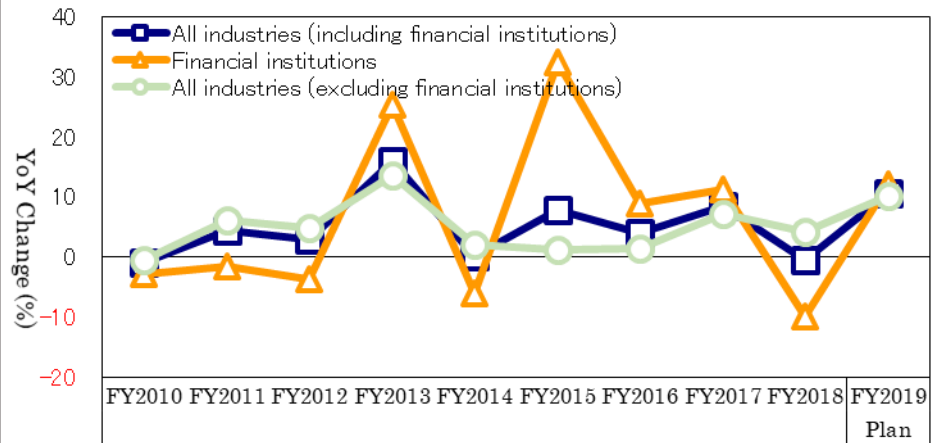
Growth in software orders received started accelerating at the beginning of FY2019 and stable growth in system administration and management is continuing.



Increase of 10.6% in private-sector software development investment from the Bank of Japan's December 2019 Tankan Survey to FY2019

According to the Bank of Japan's latest Tankan survey, conducted and published in December 2019, software investment in all industries (including finance) is planned to increase 10.6% in FY2019 over the previous fiscal year (see Figure 2). Perhaps in reaction to the negative growth in FY2018, growth in software investment in FY2019 is expected to be on the high side. This figure was revised 2.2 points downward from the previous Tankan, conducted in September, with declines seen in the finance, manufacturing and non-manufacturing sectors. Financial institutions reported a 12.0% planned increase, while in banking, which is of particular importance to the ID Group, a rise of 18.1% is expected. Recovery from the significant drop in the previous fiscal year is expected.

Figure 2. Software development investment by private companies



(Source) Prepared by QUICK Corporation based on the Tankan Survey. Plan for FY2019.

Results

Net sales in H1 are little changed YoY, but operating income grew 58%

- Results Analysis

In H1 FY2019, consolidated operating income of the ID Group was ¥1.16 billion (+58% YoY). Though net sales were little changed YoY at ¥13.2 billion, the Group succeeded in a number of efforts, including strengthening its project-management framework and shifting engineers into high-value-added fields related to cybersecurity and digital transformation (DX). Some major, high-earning software-development projects continued, contributing directly to the large increase in income. Regarding the ID Group's targets for H1 announced at the beginning of the fiscal year (net sales of ¥13.3 billion and operating income of ¥740 million), net sales fell just short, but operating income increased greatly.

Table 1. Results

¥ million

	FY2018	FY2019		
	H1	H1		
	A	B	B/A	B-A
Net sales	13,171	13,171	-0.0%	-0
System operation management	6,235	6,023	-3.4%	-212
Software development	4,601	4,558	-0.9%	-43
System infrastructure	1,188	1,183	-0.4%	-5
Cybersecurity, consulting and training	618	851	37.7%	233
Others	527	553	4.9%	26
Operating income	734	1,159	57.7%	424
(Operating income margin)	5.6%	8.8%	-	-
Ordinary income	786	1,168	48.6%	382
Net income	450	738	63.8%	288

(Source) Prepared by QUICK Corporation based on ID Holdings Corporation's Summary of Financial Results (Tanshin) and other materials.

The Group revised the classification of its reporting segments

The ID Group reorganized as a holding-company structure as of April 1, 2019. At the same time, the Group revised the classification of its reporting segments. Hitherto system operation management and software development had been separate reporting segments, with non-reporting segments gathered under "others." From Q1 of the current fiscal year, the reporting segments were changed to provide only one reporting segment, the information services business, and to publish results separately for each service category. The Group now publishes results in five service categories: System operation management; software development; system infrastructure; cybersecurity, consulting and training; and others (see Table 2).

Table 2. Operations by service category

Category	Operations
System operation management	<ul style="list-style-type: none"> Management and operation of customer IT systems
Software development	<ul style="list-style-type: none"> System planning, design development, operational maintenance and project management support, based on each customer's management strategy
System infrastructure	<ul style="list-style-type: none"> Design, configuration, operation and maintenance of customer IT platforms
Cybersecurity, consulting and training	<ul style="list-style-type: none"> Sale of network and Web-application security products Configuration, introduction, support, assessment and advisory services with respect to security systems Consulting and training in business process reengineering (BPR), IT governance and IT management
Others	<ul style="list-style-type: none"> Sale of products other than network security and consulting Clerical services, personnel recruiting and training, local market surveying, information gathering, etc.

(Source) Prepared by QUICK Corporation based on ID Holdings Corporation's Quarterly Securities Report.

Results

The Group's mainstay operations of system operation management and software development performed poorly

A review of the Group's net sales by service type shows that its two mainstay fields of operation, system operation management and software development, performed poorly in the period under review. Net sales in system operation management were ¥6.0 billion (-3% YoY). The Group won some new projects from existing customers in the financial sector, but these were insufficient to offset the conclusion of certain large projects in that industry. Net sales in software development were ¥4.6 billion (-1% YoY). Some large projects in the public sector continued, while orders from existing customers in the financial sector expanded, but the ID Group remained severely impacted by the wrap-up of large projects in the public sector in the previous fiscal year. In system infrastructure, declines in sales to the shipping and financial sectors resulted in a slight decline in net sales to ¥1.2 billion. In contrast, net sales in cybersecurity, consulting and training were ¥900 million (+38% YoY), powered by growth in sales of cybersecurity products and in consulting. In others, consulting and overseas subsidiaries grew, and net sales were ¥600 million (+5% YoY).

The Group's FY2019 plan calls for a 1% increase in net sales and a slight increase in operating income

- Company Plan

In its own forecasts of consolidated business results for the full fiscal year FY2019, the Group expects net sales of ¥26.8 billion (+1% YoY) and operating income of ¥1.67 billion (up slightly YoY). As of this writing, the Group has not revised the plan it published at the beginning of the fiscal year, as numerous factors remain uncertain.

The Group's current three-year Mid-term Management Plan, "Next 50 Episode I : Awakening!" of which FY2019 is the first year, is now under way. As the Group celebrated its 50th anniversary in October 2019, it is positioning the current Mid-term Management Plan as a springboard from which to leap into the next 50 years and is implementing a strategy to prepare for future growth. The Group is improving enterprise value while delivering stable and continuous returns to shareholders. The Group's main targets for the new Mid-term Management Plan are to attain net sales of ¥30 billion, operating income of ¥1.85 billion and operating income margin of 6.2% by FY2021, the final year of the Mid-term Management Plan.

Table 3. Results estimates

¥ million

	FY2018 Results A	FY2019 projections			FY2020 projections	
		Company	QUICK		QUICK	
			B	B/A	C	C/B
Net sales	26,515	26,800	26,600	0.3%	27,400	3.0%
System operation management			12,100	-	12,400	2.5%
Software development			9,300	-	9,600	3.2%
System infrastructure			2,370	-	2,470	4.2%
Cybersecurity, consulting and training			1,730	-	1,800	4.0%
Others			1,100	-	1,130	2.7%
Operating income	1,667	1,670	2,000	19.9%	2,100	5.0%
(Operating income margin)	6.3%	6.2%	7.5%	-	7.7%	-
Ordinary income	1,724	1,710	2,040	18.3%	2,140	4.9%
Net income	1,028	1,060	1,280	24.4%	1,340	4.7%

Note: From Q1 FY2019, the Group has changed its reporting segments, although results for the previous term are not disclosed.

(Source) Prepared by QUICK Corporation based on ID Holdings Corporation's Summary of Financial Results (Tanshin) and other materials.

Results

QUICK forecasts a slight increase in net sales and a 20% increase in operating income for the full year FY2019

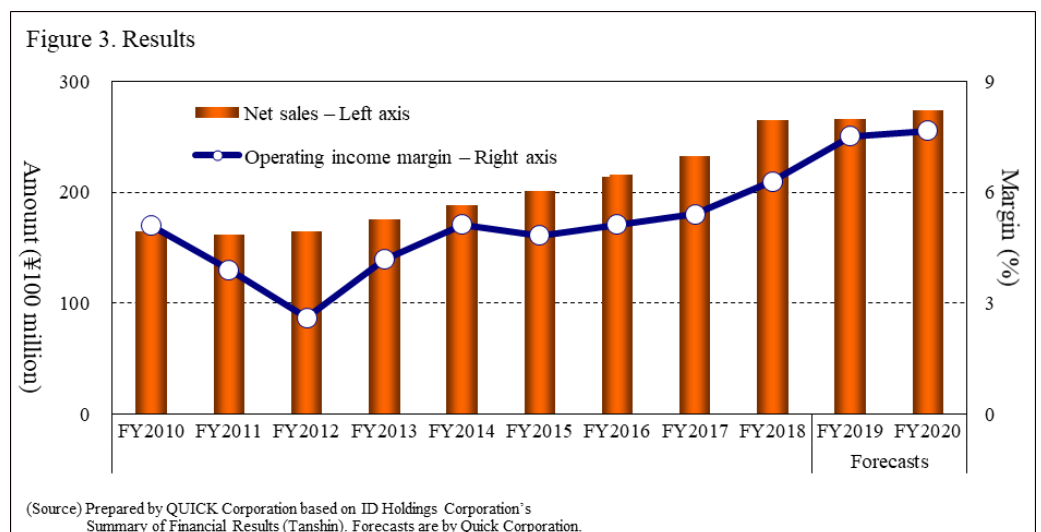
Projecting increases in net sales (+3%) and operating income (+5%) in FY2020

- Forecasted Results

In its forecast of the Group's consolidated business results for FY2019, QUICK Corporation is maintaining its net sales forecast of ¥26.6 billion (a slight increase YoY) but raising its forecast of operating income from ¥1.67 billion to ¥2.0 billion (+20% YoY). Although the Group struggled to find growth in system operation management and software development in H1, in H2 public-sector-related projects are expected to rally and the Group's cybersecurity, consulting and training service is growing. We therefore judge that the Group will meet its existing forecast for net sales. In earnings, the Group is making progress in boosting profitability, through efforts such as strengthening its project-management framework, which resulted in a higher-than-expected income level in H1. Though training and other expenses geared to future growth are on the rise, operating income will be much higher than originally forecast. We forecast that the ID Group will post new highs in both net sales and operating income.

The ID Group plans to invest vigorously in constructing a new business model. To develop engineering personnel in AI, advanced cybersecurity, information technology information libraries (ITIL) and RPA, the Group will have to increase outlay on expenses, as expenses for education and training and construction and introduction of personnel management systems will mount.

For the consolidated financial results of FY2020, we predict new performance records for the company, with net sales reaching ¥27.4 billion (+3% YoY) and operating income reaching ¥2.1 billion (+5% YoY) (see Figure 3). We expect growth in both system operation management and software development. While we anticipate continued growth in expenses such as training expenses, changes such as strengthening of the project management framework should drive continued improvement in profitability, so we forecast an increase in operating income.





(Source) QUICK Corporation

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			FY2016	FY2017	FY2018	FY2019 (Analyst)
Share price	Share price (52-week high)	¥	1,260	1,636	1,782	-
	Share price (52-week low)	¥	527	1,047	1,125	-
	Average monthly volume	100's of shares	9,395	7,821	5,493	-
Results	Net sales	¥ million	21,554	23,207	26,515	26,600
	Operating income	¥ million	1,105	1,254	1,667	2,000
	Ordinary income	¥ million	1,133	1,274	1,724	2,040
	Net income	¥ million	654	622	1,028	1,280
	EPS	¥	60.13	56.84	93.15	115.17
	ROE	%	9.5	8.4	12.9	14.7
Main balance sheet items	Total current assets	¥ million	6,901	8,344	9,298	-
	Total non-current assets	¥ million	3,650	5,404	5,301	-
	Total assets	¥ million	10,552	13,748	14,600	-
	Total current liabilities	¥ million	2,890	5,923	5,293	-
	Total non-current liabilities	¥ million	340	207	964	-
	Total liabilities	¥ million	3,230	6,131	6,258	-
	Total shareholders' equity	¥ million	6,801	7,033	7,638	-
Main cash flow statement items	Total net assets	¥ million	7,321	7,617	8,342	-
	Cash flow from operating activities	¥ million	1,185	1,237	1,004	-
	Cash flow from investment activities	¥ million	-137	-2,129	-336	-
	Cash flow from financing activities	¥ million	-801	1,464	-126	-
	Cash and cash equivalent balance at end of period	¥ million	2,391	2,944	3,489	-

Note1: The company carried out a 1-for-1.5 stock split with an ex-rights date of December 28, 2016. The share price, average monthly volume, and EPS have been retroactively revised to reflect the stock split.

Note2: The Group has applied the "Partial Revision of Accounting Standard for Tax-effect Accounting" (Enterprise Accounting Standard No. 28, February 16, 2018) and other standards since the beginning of the fiscal year ended March 31, 2019. For the fiscal years ended March 31, 2018, the figures are retroactively adjusted to reflect the application of these accounting standards.

Risk Analysis

Business Risks

● Business Risks

▪ Risks in the Execution of Software Development and Infrastructure-Building Projects

The software development and infrastructure-building projects face ever-increasing levels of sophistication and complexity, as well as demands for shorter turnaround times. The ID Group has implemented the ISO 9001 quality management system to mitigate the risk of problems that may arise due to factors such as mid-project requirement changes, reduced quality levels, and delivery delays. In the project and systems division and quality management division, the company has been carefully reviewing the QCD (quality, cost, and delivery) status of each project, inspecting for and predicting abnormalities, and enacting countermeasures in the early stages, working to prevent projects from becoming unprofitable. In spite of this initiative, the company may not be able to prevent all problems, and it is possible that additional costs may make some projects unprofitable or affect the company's results.

▪ Risks in the Execution of System Operation Management Projects

System failures and service delays may arise due to operational errors in system operation management. To address this risk, the company has created a quality management division to prevent these errors and plan and implement initiatives, including training to prevent failures from happening. The division also implements analyzing and giving feedback on the causes of failures and conducts on-site inspections. The company received the ISO 9001 certification and is always striving to improve the quality of its services. However, if a service provided by the company leads to a major system failure, the company may be liable for damages, which could negatively affect results.

▪ Reliance on Specific Trading Partners

A large percentage of the ID Group's net sales is to companies affiliated with the Mizuho Financial Group. Changes to the orders from this group may negatively affect the company's results.

▪ Personnel Risks

Hiring talented personnel is critically important for the company to keep up with the latest information technology and improve customer satisfaction. The company is reevaluating its human resource system and devoting resources to hiring activities so that it can retain qualified personnel who will add value to the business. However, if the company cannot hire and train talented personnel or cannot fill positions that match its needs in a way that is aligned with the changing business environment, it could potentially harm the company's results.

▪ Bringing on Personnel from Partner Companies

The company is actively bringing on personnel from partner companies to flexibly match the needs of each project. It continues to progress on this path by both deepening cooperative relationships with its over 150 current partner companies and developing partner relationships with new companies. However, if the company is unable to successfully place personnel for projects, this may negatively affect its results.

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