Japan System Techniques | 4323

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Sessa Investment Research

Reflecting the recent trend in profit growth and the 50th anniversary of the company's foundation, the year-end dividend for FY23/3 is increased by ¥7 to ¥32.

Earnings Result Summary

- **Key Points:** Japan System Techniques(JAST) announced its 3Q results for FY23/3 after the close of the market on February 10 (Friday). As in the 2Q, The DX&SI business was the main driver of the double-digit in sales and profit growth. On 26 January (Thursday), the company also announced "A dividend increase and a commemorative dividend for its 50th anniversary", resulting in an annual dividend of ¥32 per share at the end of FY23/3, an increase of ¥7 over the previous year.
- **DX & SI business drove growth:** The 3Q operating profit margin was 9.4%, up 0.7 percentage points from 8.7% in the previous year's 3Q. It also improved by 0.3 percentage points from 9.1% in 2Q. **DX & SI business**, which drove the growth, saw an increase in sales and orders for large prime projects (first-tier contracts) from both new and existing customers, with sales of ¥10,392 mn (+10.6% YoY) and an operating profit of ¥1,614 mn (+33.0% YoY). In the **Package business**, sales were ¥2,996 mn (-0.9% YoY) and operating profit ¥736 mn (-23.6% YoY). Program Product sales in BankNeo, the integrated information system for financial institutions increased from the previous year, but sales of the GAKUEN series strategic university management system declined. **Medical Big Data business** recorded an operating profit of only ¥171 mn (-18.8% YoY) on sales of ¥1,185 mn (+4.2% YoY). The decline in profits in this business was due to a reactionary drop as a result of the timing of the booking of sales of highly profitable analysis services being concentrated in the 3Q of the previous year. **Global Business** recorded sales of ¥2,060 mn (+44.5% YoY) and an operating profit of ¥277 mn (+606.1% YoY), with earnings expanding significantly due to strong SAP implementation support projects and the weak yen.
- **Continued record-breaking performance:** The company's forecasts for FY23/3 remain unchanged from the initial forecasts and as per the performance summary in the table below. Representing the 10th consecutive year of record-high sales and the 4th consecutive year of record-high recurring profits. The annual dividend has been revised to ¥27 per share, an increase of ¥2 from the previous forecast of ¥25 per share, reflecting the continuing rise in profit. In addition, as the company will celebrate its 50th anniversary on 26 March 2023, the company has A commemorative dividend of ¥5 per share was decided to be paid at the end of the current financial year. As a result, the annual dividend per share at the end of FY23/3 will be ¥32, an increase of ¥7 from the previous year.

FY ¥mn,%	Net Sales	YoY	Oper. Profit	YoY	Ord. Profit	YoY	Net Profit	YoY	EPS ¥(3)	DPS ¥(3)
2018/3	15,630	9.9	742	29.9	785	25.8	579	40.9	55.2	14.0
2019/3	16,869	7.9	856	15.4	870	10.8	318	-45.1	10.0	14.0
2020/3	18,020	6.8	971	13.4	1,022	17.5	-31	-	-2.9	14.0
2021/3	18,789	4.3	1,216	25.2	1,310	28.2	579	-	54.0	14.0
2022/3	21,400	13.9	2,001	64.6	2,053	56.7	1,331	129.9	112.4	20.0
2023/3 CE(1)	22,400	4.7	2,120	6.0	2,160	5.2	1,370	3.0	111.7	32.0
2022/3 3Q(2)	14,985	-	1,297	-	1,331	-	914	-	78.1	-
2023/3 3Q(1)	16,635	11.0	1,559	20.3	1,605	20.6	1,167	27.7	95.2	-

Source: SIR from the company materials
Note(1): A two-for-one stock split of common stock was conducted on October 1, 2022.
Note(2): The percentage change from the previous year is not shown due to the adoption of the "Accounting Standard for Revenue Recognition" from the beginning of 1Q FY3/2022.
Note(3): EPS and DPS are retroactively adjusted to reflect a 1-for-2 stock split.

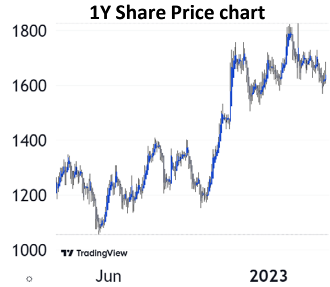
3Q Follow-up

JAST

Focus Points:
Fully independent DX provider. High operating margins on own-brand packaged software. New business portfolio and growth strategy will continue to generate the highest profits.

Key Indicators	
Share price (3/22)	1,655
YH (2/13)	1,826
YL (3/16)	1,570
10YH (23/2/13)	1,826
10YL (16/2/15)	296
Shrs out. (mn shrs)	12.418
Mkt cap (¥ bn)	20.4
EV(¥bn)	13.31
Shr equity ratio (22/3/31)	58.94%
23.03 P/E (CE)	14.8x
22.03 P/B (act)	1.7x
22.03 ROE (act)	16.7%
23.03 DY (CE)	2.0%

1Y Share Price chart



Source: Trading VIEW

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Overview of 3Q FY3/23 results

Continuing improvement in operating profit margin

Key consolidated 2Q performance results were sales of ¥16,635 mn (+11.0% YoY), operating profit of ¥1,559 mn (+20.3% YoY), recurring profit of ¥1,605 mn (+20.6% YoY), and net income of ¥1,167 mn (+27.7% YoY. The increase in 3Q sales and profit was mainly driven by growth in earnings from the DX & SI business just like in the 1Q and 2Q. Furthermore, the company's operating profit margin rose 0.7 percentage points year on year to 9.4%, continuing its growth from 5.1% in the Q1 to 9.1% in the 2Q. The following is an overview by business segment.

DX & SI business drives earnings growth

The DX & SI business reported sales of ¥1,0392 mn (+10.6% YoY) and operating profit of ¥1,614 mn (+33.0% YoY). Growth in both sales and profit was the result of a dramatic increase in the profitability of the overall business on account of large prime orders from both existing and new customers.

In **the Packaged Software business**, the company reported sales of ¥2,996 mn (-0.9% YoY) and operating profit of ¥736 mn (-23.6% YoY). Even though sales of program products (PP) for BankNeo, an information integration system for financial institutions, rose year on year, sales of PP and post-introduction support service for GAKUEN RX and GAKUEN UNIVERSAL PASSPORT RX, part of the company's strategic university management system GAKUEN series, declined, which was the main reason for the fall in sales and profit.

The Medical Big Data business posted sales of ¥1,185 mn (+4.2% YoY) and operating profit of ¥171 mn (-18.8% YoY). Despite overall firm orders for the business, sales primarily fell as a result of a fall-off from strong sales of items such as highly profitable analysis services in the 3Q FY22/3.

The Global business recorded sales of ¥2,060 mn (+44.5% YoY) and operating profit of ¥277 mn(+606.1% YoY). Profitability rose substantially, which was primarily the result of orders and inquiries regarding SAP introduction support projects in Malaysia from not only existing core customers but also new customers, and contributions from overseas subsidiaries due to the weaker yen.

Extremely stable financial foundation

SG&A expenses, which are company-wide expenses not attributed to a particular segment, totaled ¥1,239 bn (+9.6% YoY), which was mainly the result of an increase in labor costs as the number of employees increased. The company's capital ratio hit a record high of 65.7% at the end of the 3Q, a dramatic increase from 58.9% at the end of FY22/3. Furthermore, the company continues to boast zero interest-bearing debt, giving it an extremely stable financial foundation.

Net sales and Profit for each segment (3Q FY3/2023, ¥mn)

	DX&SI business	Package business	Medical big data business	Global business	Total	Adjustment (1)	Amount recorded on PL(2)
Net sales							
1. External sales	10,392	2,997	1,185	2,061	16,635	-	16,635
2. Inter-segment sales and transfers	66	42	-	35	143	-143	-
Total	10,458	3,039	1,185	2,096	16,779	-143	16,635
Segment profit	1,614	736	171	277	2,799	-1240	1,559

Source: Compiled by SIR from company data.
Note 1: Adjustments are corporate expenses, etc. not allocated to any reportable segment, and are included in general and administrative expenses
Note 2: Segment operating profit is the same as operating profit shown on the quarterly income statement

To continue posting record earnings

Full-year FY3/23 earnings forecast

For the full fiscal year ending March 2023, the company forecasts net sales of ¥22.4 bn (+4.7% YoY), operating profit of 2.120 bn (+6.0 YoY), ordinary profit of ¥2.160 bn (+5.2% YoY), and net profit of ¥1.370 bn (+3.0% YoY). This would be record-high profit for the 10th consecutive fiscal year and record-high ordinary profit for the 4th consecutive fiscal year. There were no changes in the company's initially released forecasts.

Quarterly Earning and Progress (FY23/3, ¥mn)

	FY2023/3				% of progress
	1Q	2Q	3Q	FY(CE)	(as of 3Qend/FY)
Net sales	5,119	11,004	16,635	22,400	74.3%
Op. profit	261	1,003	1,559	2,120	73.5%
OPM	5.1%	9.1%	9.4%	9.5%	-
Ordinary profit	289	1,037	1,605	2,160	74.3%
Net profit	223	737	1,167	1,370	85.2%

Source: Compiled by SIR from company data

Extremely high achievement of initial earnings forecast

The following figure shows the progress the company has made as of 3Q in reaching its earnings forecasts for the full fiscal year ending March 2023. The company has already achieved 74.3% of its net sales forecast and 73.5% of its operating profit forecast. The company records most of its earnings in the second half, and a look at a breakdown of quarterly net sales over the five years through FY23/3 reveals strong seasonality because for each fiscal year, 4Q net sales were the greatest for the year. The reason the company records most of its earnings in the second half is that many of its customers have a relatively strong public nature. The company's order backlog, which it announces each half, shows that the order backlog for the DX & SI business has grown since the end of September 2022. Despite having recorded a year-on-year decline in 3Q segment operating profit, the overall Package Business has firm orders according to the company. Considering the above, it is very likely that JASTwill achieve its earnings forecasts for the full fiscal year ending March 2023, and thus, SIR speculates that it is extremely likely that earnings will surpass initial forecasts.

Order backlog (end-March 2019 ～ end-September 2022, ¥,mn)

Business/As of	2019/3	2019/9	2020/3	2020/9	2021/3	2021/9	2022/3	2022/9
DX&SI business	2,738	2,622	2,937	3,099	2,766	3,121	3,857	4,138
Package business	1,237	1,251	1,349	2,764	2,301	2,423	1,902	2,521
Medical Big Data business	619	549	532	782	692	900	727	1,095
Global business	0	0	0	0	0	0	0	0
Total Oder back log	4,595	4,423	4,818	6,645	5,760	6,446	6,486	7,754

Source: Compiled by SIR based on the company financial results presentation materials

Valuation

Compared to its high for the year of ¥1,826 (February 12), the company's stock price has recently fallen 9.5% to ¥1,653, near its low for the year of ¥1,623. The company's PER is 14.8x, assuming an EPS of ¥111.7, which is based on the company's earnings forecasts for the full fiscal year ending March 2023. The following figure compares PER of other companies in the same industry, which was provided by SIR. There are 363 companies in the subsector centered on system software outsourcing service and development companies, a NIKKEI category, excluding those that have a market capitalization of ¥9.0 bn or more and have posted a loss or do not release EPS forecasts for the current fiscal year, there are 115 companies, and their average PER based on expected EPS for the current fiscal year is 24.0x. There are many companies in the system integration industry, and they face very different business environments because they undertake commissioned development of system software used for different purposes for customers in various industries. On the other hand, the company is forecast to post record-high net sales for the 10th consecutive fiscal year and record-high operating profit for the 4th consecutive fiscal year. Considering not only that but also the company's announcement of an increase in its year-end dividend of ¥7, Japan System Techniques' valuation is expected to change.

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