

## Potential for a full-term dividend hike 4Q profits likely to overshoot initial full-term guidance

### SUMMARY

- The graph below highlights record order backlogs posted in the 3Q. High growth in focus initiative cloud service orders in the 1H are naturally a key factor, however backlogs for mainstay system development projects also posted a new high. Cloud service business, in its sixth year, turned profitable from the 2Q, on declining fixed costs and higher operating efficiency. Cloud GP appears on course to achieve a substantial overshoot from initial guidance for ¥80mn (1Q ¥19mn loss → 2Q ¥31mn → 3Q ¥84mn = ¥96mn FYTD). Based on high progress ratios and our follow-up interview, there appears to be high potential for an overshoot on full-term guidance.
- In cloud service, orders for IOASIS one-of-a-kind merchant acquiring startup core systems in the 1H came from a telecom carrier, major global manufacturer, major credit card company and a retailer (enterprise customers). The Company notes that as inbound demand is set to stage a comeback going forward, discussions with potential regional bank customers have picked up again.
- Over the last 18 months, IWI's share price has dramatically underperformed, in our estimation, largely due to confusion surrounding listing on the Prime Market and maintenance criteria for tradable market cap (free float) over ¥10bn, resulting in the ratio of foreign shareholders dropping 55% from 4.84% at the end of June 2020 to 2.19% at the end of June 2021. On technical indicators, the 13W MA recently surpassed the 26W MA, and on fundamentals, the current DY of 2.31% is now 27% above its historical average, with potential for a dividend hike on the overshoot.

### 3Q Follow-up



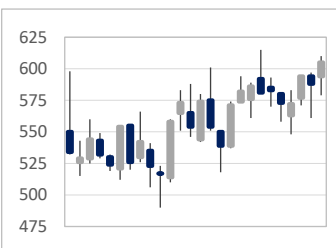
#### Focus Points:

Systems integrator boasting an overwhelming share with credit card companies in FEP systems development for nonstop secure datacenter connection packages.

#### Key Indicators

|                     |       |
|---------------------|-------|
| Share price (5/20)  | 605   |
| YH (22/4/5)         | 615   |
| YL (22/1/27)        | 490   |
| 10YH (18/10/24)     | 1,180 |
| 10YL (13/1/4)       | 173.0 |
| Shrs out. (mn shrs) | 26.34 |
| Mkt cap (¥ bn)      | 15.94 |
| EV (¥ bn)           | 12.33 |
| Shr equity ratio    | 68.0% |
| 22.6 P/E (CE)       | 16.9x |
| 22.6 EV/EBITDA (CE) | 5.8x  |
| 21.6 P/B (act)      | 2.07x |
| 21.6 ROE (act)      | 11.6% |
| 22.6 DY (CE)        | 2.31% |

#### 6M price chart (weekly)



Source: SPEEDA price data

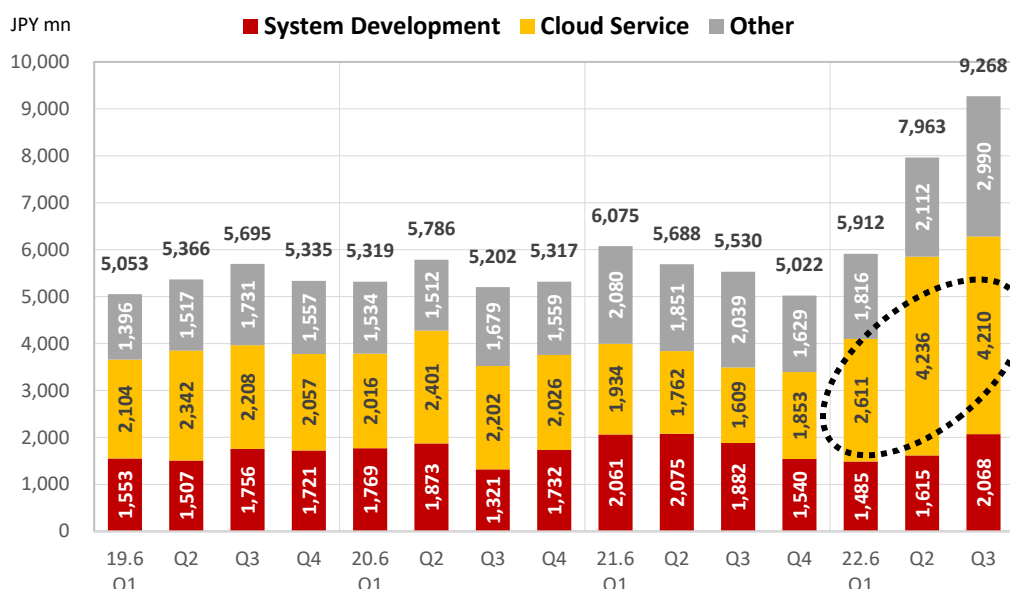
#### Chris Schreiber CFA

Company Specialist  
[research@sessapartners.co.jp](mailto:research@sessapartners.co.jp)



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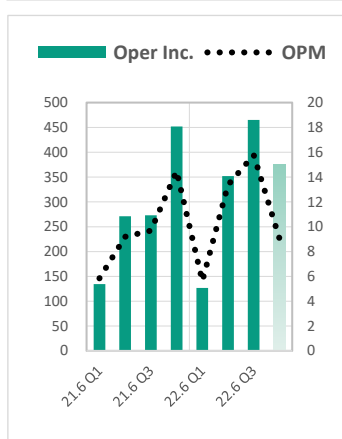
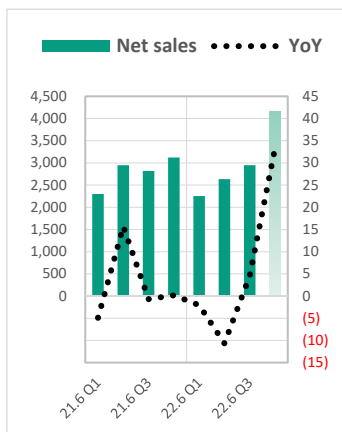
### 3Q total backlogs rose +16.4% QoQ and +67.6% YoY, posting a record high



Source: compiled by Sessa Partners from company IR results briefing materials.

# Cloud service drives brisk 3Q results

3Q-only sales +4.6% YoY, OP +70.3%, OPM 9.7% → 15.8%



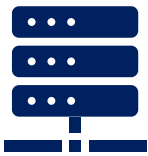
## RESULTS SUMMARY

- IWI announced FY6/22 3Q financial results at 15:30 on Friday 5/06, and it held a briefing at 09:00 on Tuesday 5/10. Headline numbers for the nine months ended March 31, 2022 were: net sales -2.9% YoY and OP +39.1%, with OPM rising from 8.4% → 12.0%. Based on the sales categories, the main factor for the overall ¥233mn (-2.9%) decline in nine months net sales was the decline in hardware of ¥510mn (-38.1%), due to a reactionary fall from the high base last year, attributed to replacement of non-stop servers due to FEP system server support expirations.
- The main factors for the profit increase and sharp improvement in OPM included steady growth in mainstay system development and software maintenance, as well as double-digit growth in cloud service, up ¥91mn (+13.0%) which has turned profitable, and in-house package software, up ¥52mn (+19.5%).
- At the same time, 3Q-only results were net sales +4.6% YoY and OP +70.3%, with OPM rising from 9.7% → 15.8%. 3Q-only hardware sales increased ¥90mn (+19.3%), so the base effect from large replacement orders has finished. In addition to the rebound in hardware sales, the main factors for the sharp improvement in profits and OPM include the following sales increases: cloud service ¥68mn (+29.3%), system development ¥67mn (+5.3%), and software maintenance ¥38mn (+11.0%).
- Based on 3Q progress ratios and implied 4Q profit declines in unchanged guidance, Sessa Partners believes there is significant potential for an overshoot on 4Q profits, even if there is a slight shortfall in net sales. The Company maintains it can achieve its full-term sales target, in part based on visibility of 4Q hardware demand.

## INTELLIGENT WAVE Summary of Non-Consolidated Financial Results

| JPY mn, %              | Net sales | YoY    | Oper inc. | YoY    | Ord. inc. | YoY    | Net inc. | YoY    |
|------------------------|-----------|--------|-----------|--------|-----------|--------|----------|--------|
| 21.6 Q3 9M             | 8,067     | 3.4    | 679       | 15.9   | 696       | 15.9   | 471      | 18.1   |
| 22.6 Q3 9M             | 7,835     | (2.9)  | 944       | 39.1   | 965       | 38.5   | 659      | 40.0   |
| <i>progress ratios</i> |           |        |           |        |           |        |          |        |
| 9M 5Y AVG              | 72.5%     |        | 65.2%     |        | 64.4%     |        | 61.7%    |        |
| 22.6 9M                | 65.3%     |        | 71.5%     |        | 70.9%     |        | 70.1%    |        |
| <i>profit margins</i>  |           |        |           |        |           |        |          |        |
| 9M 5Y AVG              | —         |        | 7.6%      |        | 7.8%      |        | 5.3%     |        |
| 22.6 9M                | —         |        | 12.0%     |        | 12.3%     |        | 8.4%     |        |
| 21.6 Q4 12M            | 11,188    | 2.4    | 1,131     | 9.1    | 1,171     | 9.0    | 841      | 10.4   |
| 22.6 Q4 12M CE         | 12,000    | 7.3    | 1,320     | 16.8   | 1,360     | 16.1   | 940      | 11.8   |
| 21.6 Q1                | 2,299     | (4.9)  | 134       | (4.8)  | 129       | (8.8)  | 84       | (8.3)  |
| 21.6 Q2                | 2,949     | 15.7   | 271       | 19.2   | 293       | 33.5   | 202      | 38.4   |
| 21.6 Q3                | 2,819     | (0.7)  | 273       | 25.9   | 275       | 14.3   | 185      | 14.7   |
| 21.6 Q4                | 3,121     | 0.2    | 452       | 0.3    | 475       | 0.2    | 370      | 1.8    |
| 22.6 Q1                | 2,252     | (2.0)  | 127       | (5.7)  | 125       | (2.8)  | 83       | (0.9)  |
| 22.6 Q2                | 2,635     | (10.6) | 352       | 29.8   | 375       | 28.1   | 255      | 26.3   |
| 22.6 Q3                | 2,947     | 4.6    | 465       | 70.3   | 465       | 68.9   | 321      | 73.4   |
| 22.6 Q4 ce             | 4,165     | 33.5   | 376       | (16.7) | 395       | (16.8) | 281      | (24.0) |

Source: compiled by Sessa Partners from TANSWIN final statements. "CE" = company estimates.



**3Q-only net sales turned positive as the base effect for hardware finished;**

**The Company expects to achieve 4Q sales target in part due to visibility on hardware**

The table below gives a breakdown of sales by categories, for the cumulative 9 months on the left, and for 3Q-only on the right. As mentioned in the summary on the previous page, while cumulative net sales were still down YoY, 3Q-only net sales increased +4.5%, driven by the 4 categories highlighted in yellow. In addition to the boost from growth in focus initiative cloud service, it is notable that the base effect from large replacement orders for hardware from the previous year finished as of the 2Q, and hardware resumed YoY growth from the 3Q. According to the Company, it has visibility on significant hardware sales from the 4Q.

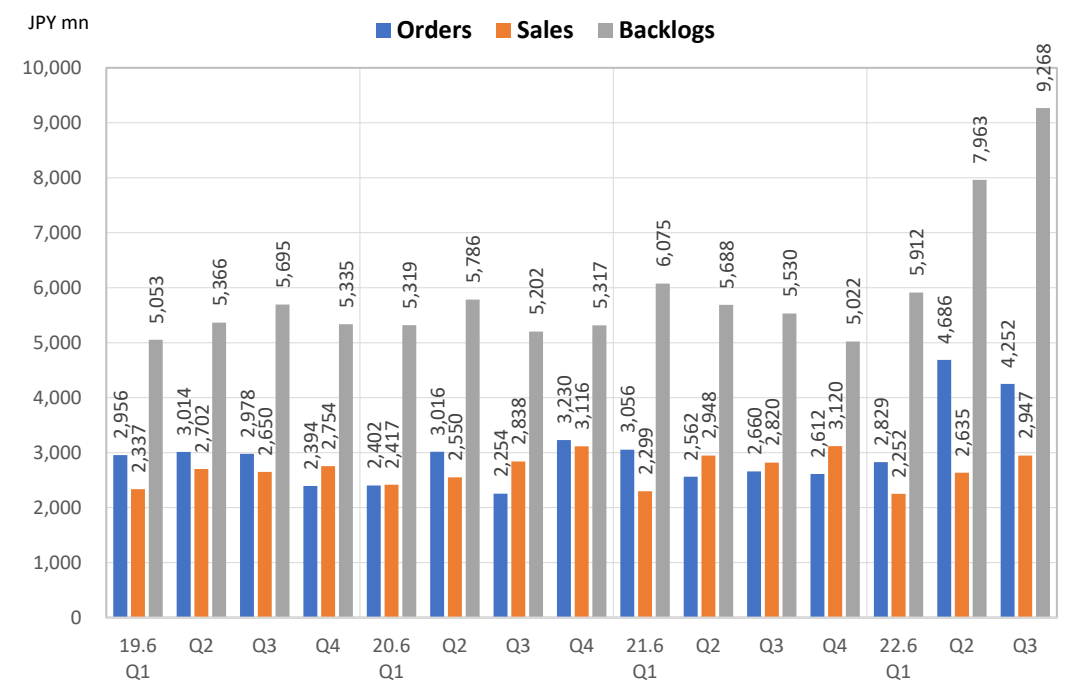
The graph on the bottom of the next page highlights the sharp growth in cloud service orders, driven mainly by enterprise customers. The Company noted that as inbound demand is set to stage a comeback going forward, discussions with potential regional bank customers have picked up again.

**Sales by Categories: hardware resumed growth from 3Q**

| JPY mn, %                      |       | FY6/21       | FY6/22       | CHG          | PCT          | FY6/21       | FY6/22       | CHG        | PCT        |
|--------------------------------|-------|--------------|--------------|--------------|--------------|--------------|--------------|------------|------------|
|                                |       | 9M           | 9M           | AMT          | YOY          | 3Q-only      | 3Q-only      | AMT        | YOY        |
| <b>Net sales</b>               |       | <b>8,067</b> | <b>7,834</b> | <b>(233)</b> | <b>(2.9)</b> | <b>2,820</b> | <b>2,947</b> | <b>127</b> | <b>4.5</b> |
| • System software develop.     | flow  | 3,710        | 3,859        | 149          | 4.0          | 1,273        | 1,340        | 67         | 5.3        |
| • Software maintenance         | stock | 992          | 1,111        | 119          | 12.0         | 345          | 383          | 38         | 11.0       |
| • In-house package software    | flow  | 267          | 319          | 52           | 19.5         | 58           | 51           | (7)        | (12.1)     |
| • Cloud service                | stock | 702          | 793          | 91           | 13.0         | 232          | 300          | 68         | 29.3       |
| • Hardware                     | flow  | 1,339        | 829          | (510)        | (38.1)       | 467          | 557          | 90         | 19.3       |
| • Third party package software | flow  | 431          | 237          | (194)        | (45.0)       | 191          | 69           | (122)      | (63.9)     |
| • Security products            | flow  | 622          | 684          | 62           | 10.0         | 253          | 246          | (7)        | (2.8)      |

Source: compiled by Sessa Partners from IR briefing materials.

**Orders maintained a high level, and backlogs posted a record high**



Source: compiled by Sessa Partners from IR briefing materials.



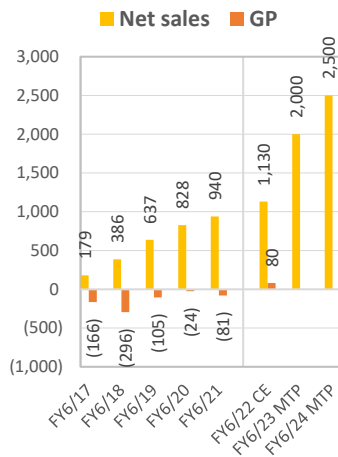


**Cloud Functionality Service**

- IPRETS:** Point rebate system
- IFINDS:** Card fraud detection
- IGATES:** Switching, gateway
- IOASIS:** Merchant acquiring

**Running well ahead of CE**

★ 2Q GP came in well above the forecast for ¥18mn → **¥31mn**, and 3Q GP came in well above the forecast for ¥46mn → **¥84mn**.

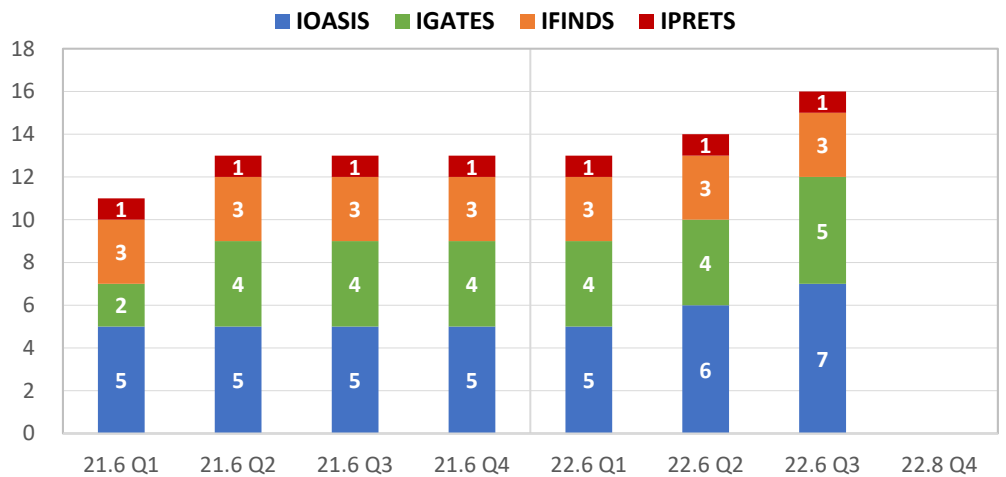


**Enterprise customers are driving high growth**

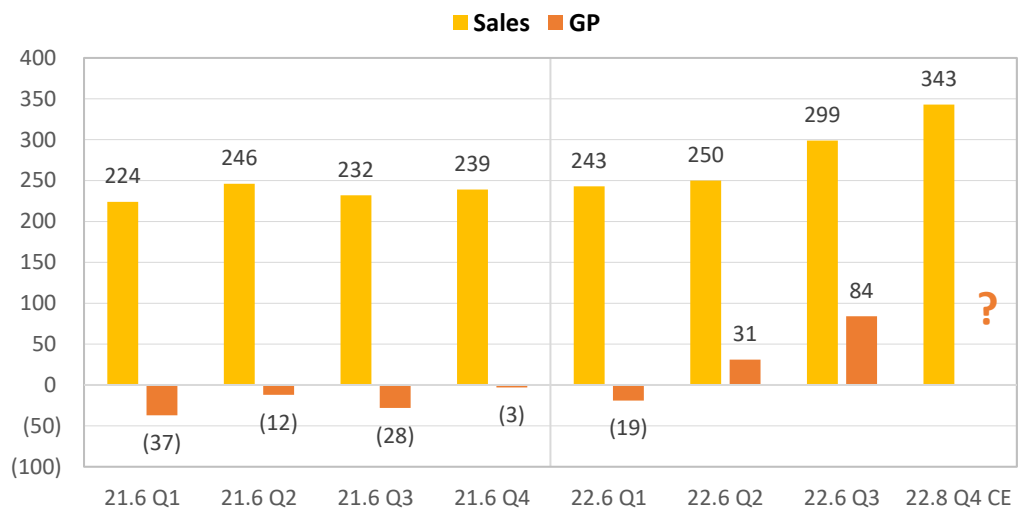
Two orders for IOASIS in Q1 were from a major telecom carrier and financing subsidiary of a major global manufacturer.

Three orders for IOASIS in Q2 included a major credit card company and a retailer. The company also won a large-scale project from an international credit card company for IGATES, as well as an order for IFINDS fraud detection from a credit card company.

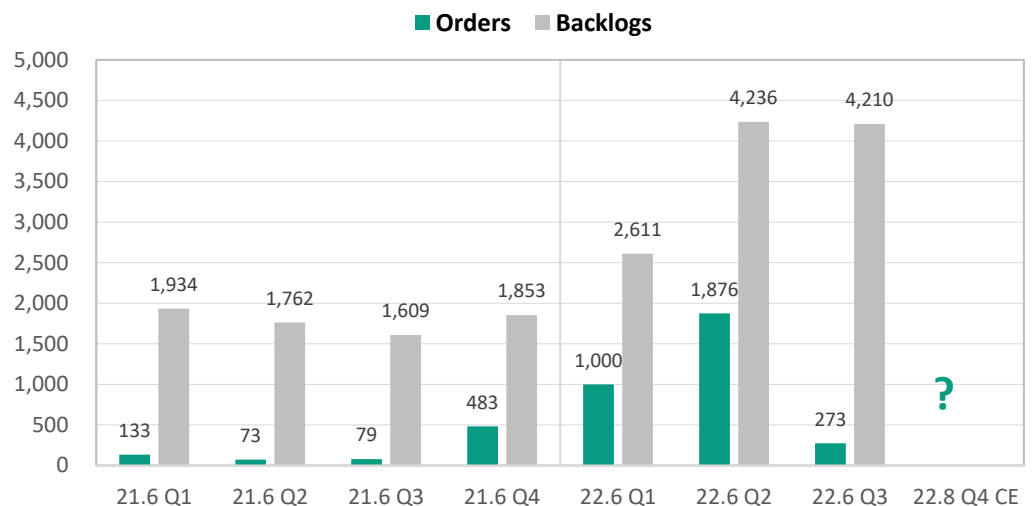
**Cloud service: number of customers by service lines (actual)**



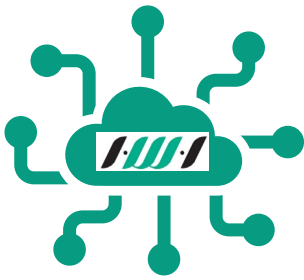
**Cloud service GP overshooting on declining fixed costs, higher operating efficiency**



**Depending on 4Q cloud orders, visibility extending out to FY6/24 MTP target sales**



Source: compiled by Sessa Partners from IR briefing materials.



**IGATES: Gateway/Switching**

ASP cloud service that inherits payment network connectivity/switching function of flagship NET+1 (for online authorization, clearing, switching to destination networks). 24/7 operation that facilitates central management of secure connection support to multiple payment networks such as Visa (EAS), Mastercard (MIP), CAFIS, JCN, as well as ATM network, direct connection with issuers and internet connection for smartphone payment. Benefits of introduction relative to a separate on-premise FEP system include:

- Reduction of initial costs
- Reduction of client systems operation load for monitoring
- Peace of mind for maintaining operations w/o holding assets

**IFINDS: Card Fraud Detection**

ASP cloud service that inherits fraud detection function for unauthorized card use of flagship ACE Plus. Real-time checking of domestic and overseas credit requests based on pre-set rules and scoring functions (please refer to the diagram on P14 for features overview). Same benefits of introduction as IGATES.

**IOASIS: Merchant Acquiring**

ASP cloud service that provides core systems for rapid startup of acquiring operations such as external connection with international brands and cashless payment companies, authorization, and management of payment at affiliate merchant stores. Compatible with both Visa and Mastercard, it is PCI-DSS compliant, built in a robust datacenter and supports 24/7 operation. Benefits of introduction relative to a separate on-premise FEP system include:

- Reduction of initial costs
- Shorter time period until launching service
- Peace of mind for maintaining operations w/o holding assets

**Priority initiative on porting flagship FEP applications to ASP cloud services**

One of the unavoidable characteristics of system integrator business is a certain amount of order volatility due to macroeconomic impacts on client capex. A focus initiative is switching to a recurring (stock) revenue model for cloud services. As startup costs disappear and revenue gains critical mass, this business is set to turn profitable. Descriptions of the three main cloud service applications are shown on the left, with **IOASIS for merchant acquiring being the only one of its kind available**. The exhibits on the previous page highlight that this business is now moving to a new stage after achieving critical mass, with Q3 gross profit coming in ahead of forecast, and leaving room for an overshoot on 2H profits on declining fixed costs and higher efficiency.

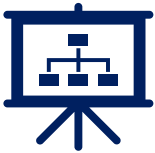
**Flagship on-premise FEP infrastructure solutions for credit card authorization**



**Recurring fee-based ASP cloud solutions for credit card-related business**



Source: IWI website – SERVICE/PRODUCTS. Photos licensed from Adobe Stock.



New MTP “15 ALL”



Yleisradio Oy, Finnish Broadcasting Company



★ Developing a solution to monitor and control a network in a whole broadcasting master system, “SmartOrchestrator (tentative name).”

Unveiled at a trade show in November.

**New 3-year Rolling MTP “15 ALL” Key Initiatives**

The new rolling MTP announced together with 21.6 Q4 financial results is targeting 3-year net sales CAGR of +10.3%, and 3-year OP CAGR of +25.8%. “15 ALL” refers to FY6/24 target net sales ¥15.0bn and OPM 15.0%.

**① Hybrid IT infrastructure in mainstay payment business market**

The benefit to prospective cloud service clients is an affordable scheme to lease the service, fixing the running costs including maintenance, with much shorter installation times and without the burden of adding to fixed assets. (please see P5 and P7: hybrid = on-premise flagship FEP + ASP cloud services).

**② Expansion of business domain**

Promotion of DX (digital transformation) leads many industries worldwide to requiring real-time and high-speed bulk data processing. IWI is expanding domestic EoM users (see explanation below) such as TV Asahi, JDS, QVC Japan, and the company won an order from Finland’s public broadcaster Yle, confirming business viability overseas. New business R&D is also examining potential solutions for connected cars and medical IoT devices, etc.

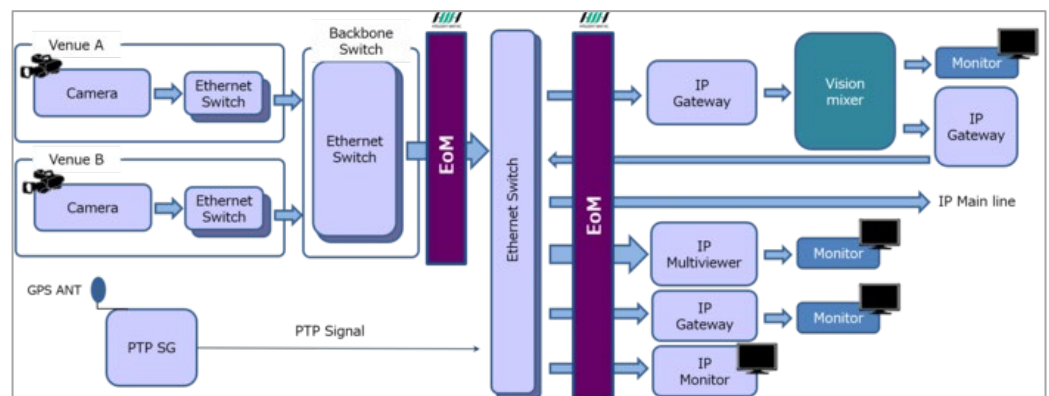
**③ DNP Group Synergies**

Operational Technology (OT) is hardware and software that detects or causes a change through the direct monitoring and/or control of physical devices, processes and events in the enterprise. Promote business synergy for DNP’s assets and IWI’s technology, starting with OT security for “smart factories” (DNP’s own plants, then client facilities).

**EoM IP Flow Monitoring Solution for Broadcasting**

In addition to cloud services, another promising new business area for the company is leveraging its experience and know-how in FPGA’s (Field Programmable Gate Arrays) to develop an EoM hardware/software solution for **broadcasting**. A big shift towards IP transmission is taking place as transferred data gets bigger with the spread of 4K/8K broadcasting. EoM monitors latency, jitter and packet drop rate to preserve broadcast data quality. This uses a low latency L1 switch with FPGA made by Arista Networks.

**EoM visualizes and monitors the communication status of IP flows between bases in real time.** It achieves high-speed processing of large amounts of data by utilizing hardware with FPGAs, drawing on IWI’s strengths in network communications technology.



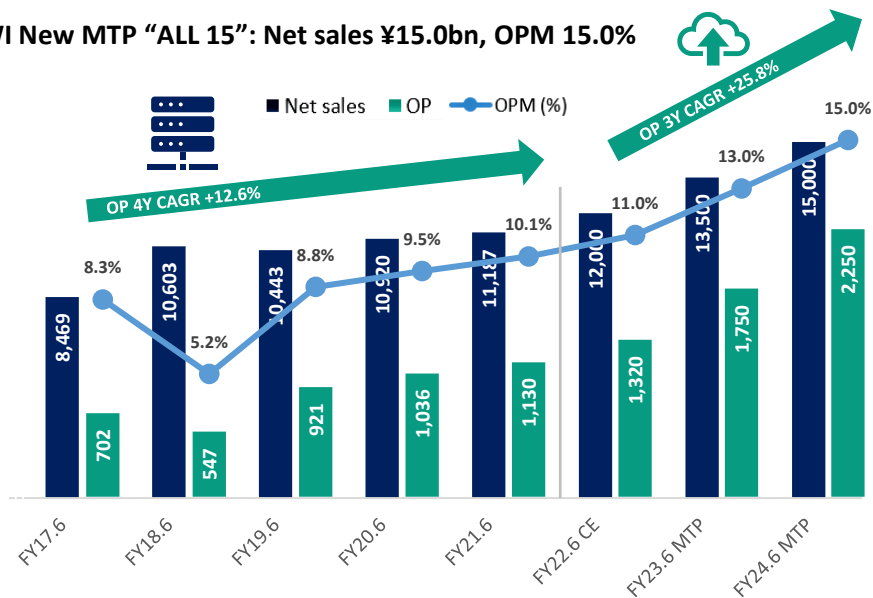
Source: IR results briefing materials



**Taking off**

OP 3Y CAGR +25.8%  
OPM 10.1% → 15.0%

**IWI New MTP "ALL 15": Net sales ¥15.0bn, OPM 15.0%**

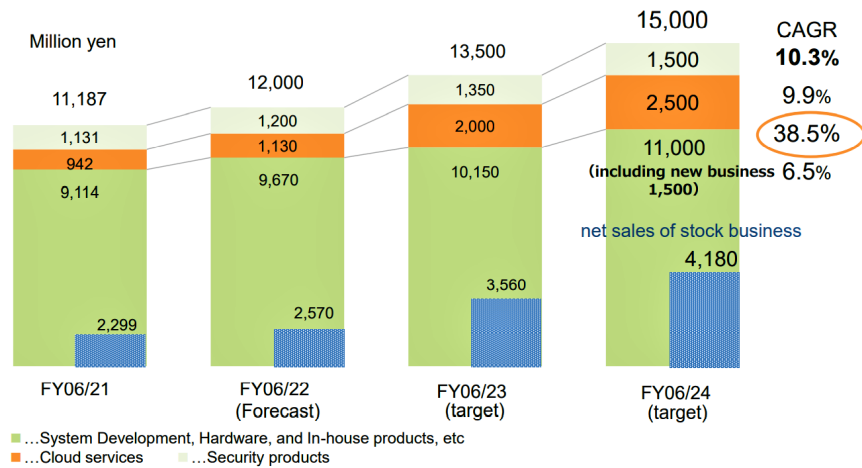


Source: compiled by Sessa Partners from TANSBIN financial statements and company IR results briefing materials.



Shift to hybrid model of FEP + ASP cloud services stock recurring revenues

**Cloud services growth is driving the rapid improvement in IWI's profitability**



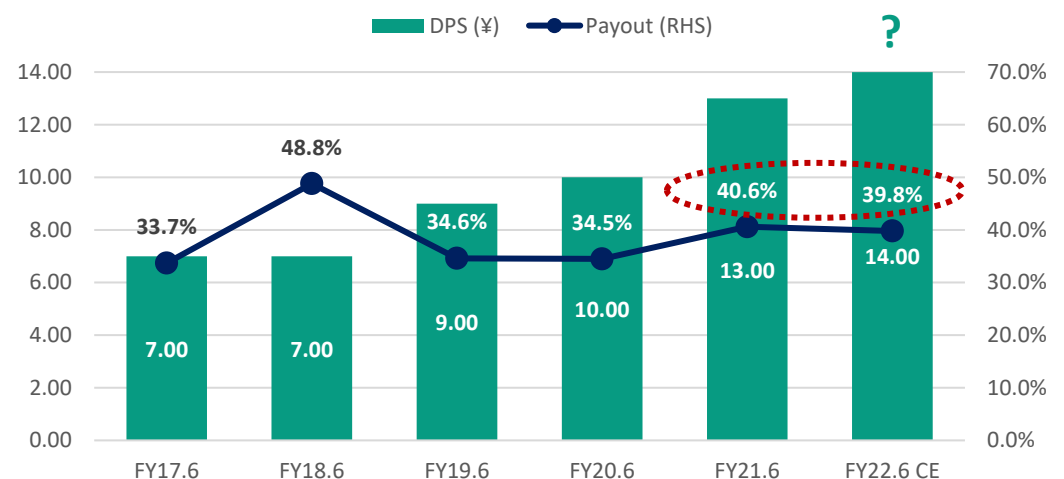
Source: excerpted from 1Q FY6/22 IR results briefing materials.



★ Hiking target dividend payout from 30% → 40%

★ Potential for a full-term dividend hike on likely profit full-term overshoot

**Trend of IWI Annual Dividends and Payout Ratio**



Source: compiled by Sessa Partners from TANSBIN financial statements.

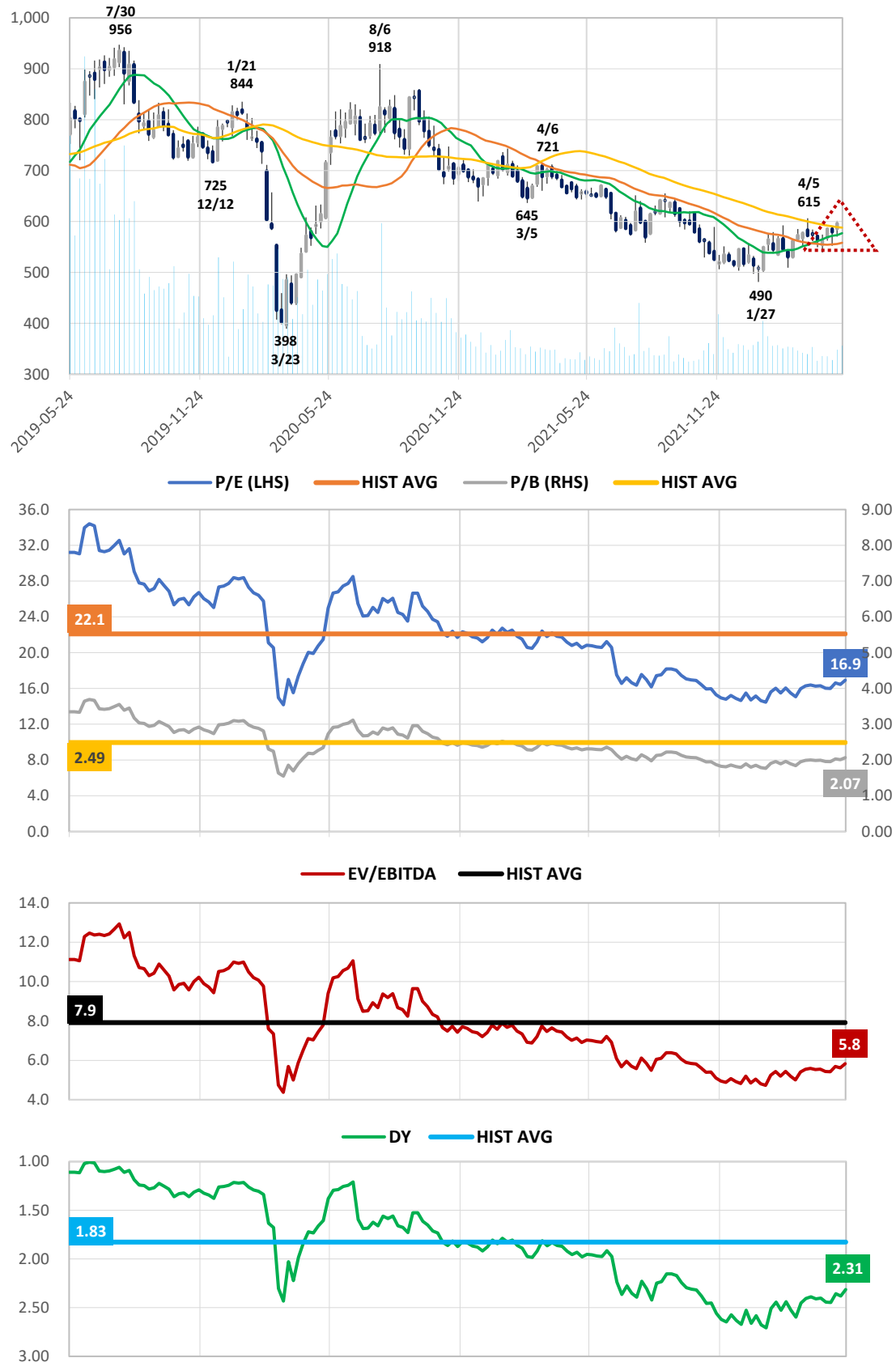


**Performance and Valuations:  
SESSA Smart Charts**

- ✓ Volume contracted sharply over last term, which we believe was likely due to lack of participation by foreigners on concerns about not meeting TSE1 listing criteria for tradable market cap (free float) over ¥10bn.
- ✓ However, IWI listed on the Prime Market in April as planned, and the TSE has phased weighting reduction measures for TOPIX constituents.
- ✓ The P/E is now on a 23% discount to its historical average, and P/B on a 17% discount. EV/EBITDA is 26% below its historical average.
- ✓ **The dividend yield of 2.31% is now 27% above its historical average, with potential for a dividend hike.**

|        |   |        |
|--------|---|--------|
| +3.56% | ▲ | 120.34 |
| +12.3% | ▲ | 543.23 |
| +5.34% | ▲ | 254.23 |
| -7.89% | ▼ | 321.58 |
| +5.97% | ▲ | 100.08 |
| +2.13% | ▲ | 564.23 |
| +6.43% | ▲ | 765.90 |
| -11.6% | ▼ | 120.34 |
| +23.1% | ▲ | 893.23 |
| +5.56% | ▲ | 128.90 |
| -3.67% | ▼ | 432.1  |
| -11.3% | ▲ | 765.2  |
| 2.54%  | ▲ | 432.1  |

**SESSA Smart Charts: 3-Year Weekly Share Price and Valuations Trend**



Source: compiled by Sessa Partners from SPEEDA historical earnings and price data. Valuations calculated based on CE.





Analyst's view

**Structural profitability improvement is the driver**

✓ A focus initiative is switching to a recurring (stock) revenue model for cloud services. As startup costs disappear and revenue gains critical mass, cloud services business has turned profitable.

✓ As can be seen in the right-hand monthly stock price chart, the share price appears to have put in a double bottom just below 500 in Mar-2018 and in Jan-2022, and risk appears balanced on the upside considering high profit growth expected going forward...

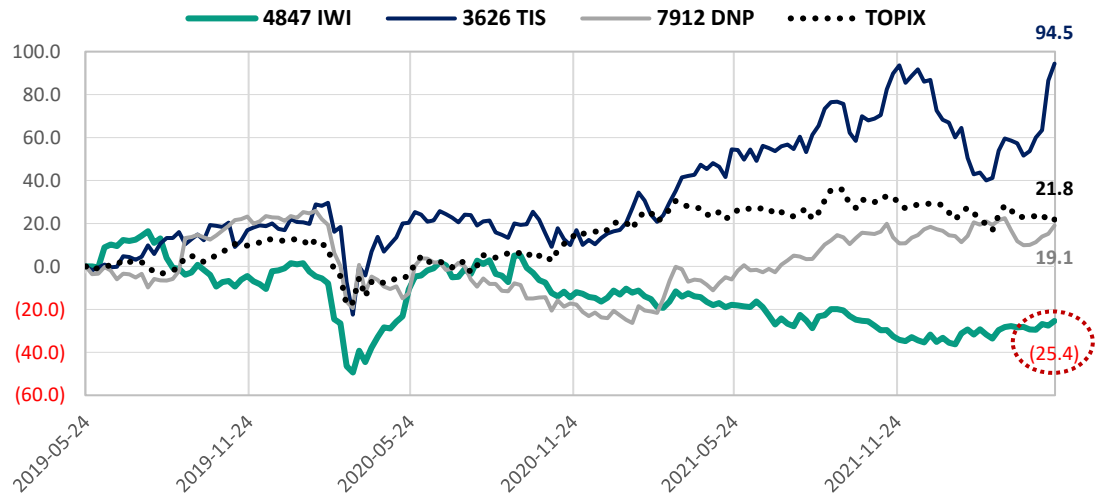
✓ The ratio of foreign shareholders dropped 55% from 4.84% at the end of June 2020 to 2.19% at the end of June 2021. The subsequent collapse of volume has put valuations at extremely compelling levels **just as profits are beginning to take off.**



CEO Kunimitsu Sato (61)



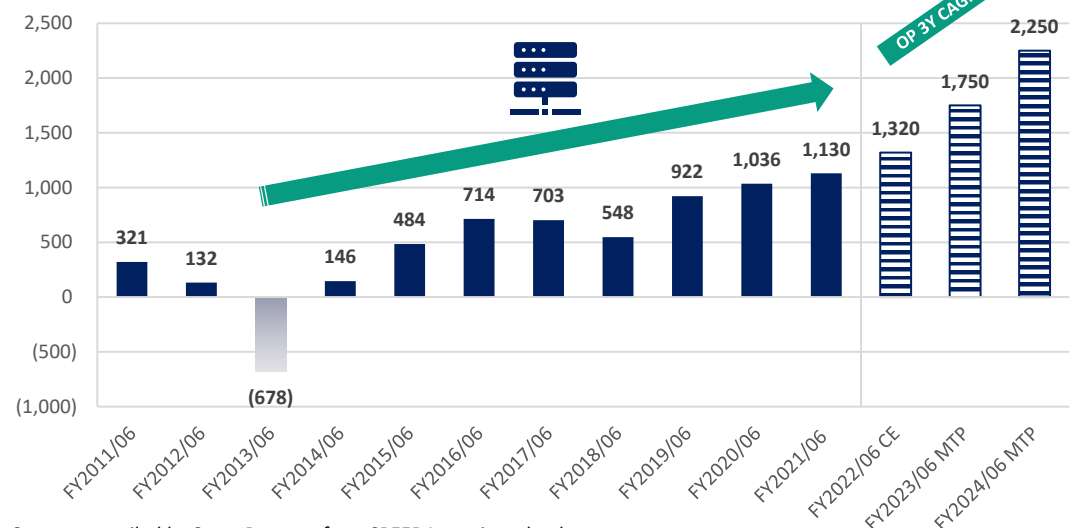
**3-Year Weekly Relative Performance: only IWI is underwater due to confusion over the TSE Prime Market listing, just as profits are taking off**



**Long-Term Trend of IWI's Share Price (monthly)**



**Long-Term Trend of IWI Operating Income (JPY mn)**



Source: compiled by Sessa Partners from SPEEDA earnings database.

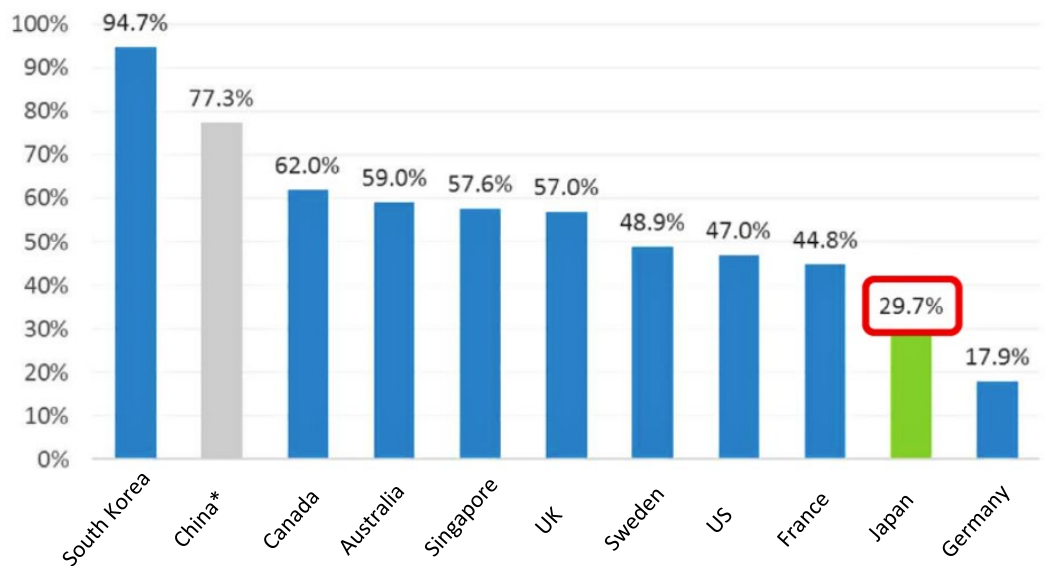


Source: BOJ

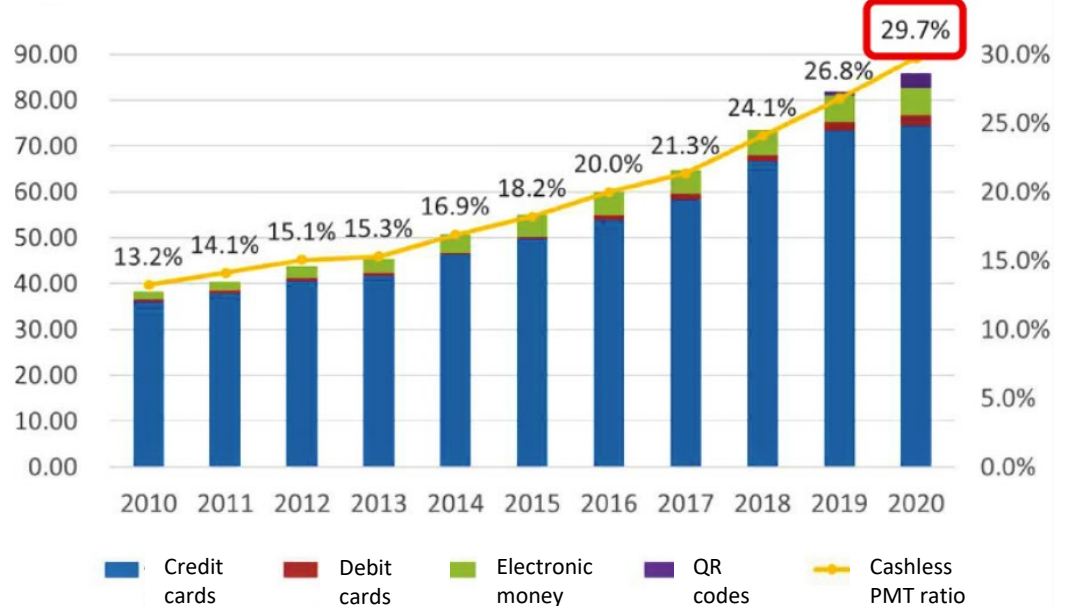
**Current Status of Cashless Payments in Japan: Targeting 40% by 2025**

The Cabinet Secretariat announced “Future Investment Strategy 2017” in June-2017, and the Ministry of Economy, Trade and Industry announced “Cashless Vision” in April-2018. Cashless Vision set a goal of raising the cashless payment ratio to 40% by 2025 when the Japan International Expo (Osaka – Kansai Expo) will be held, and in the future target 80%. **Promotion of cashless payment not only raises convenience for consumers, but it also addresses issues like the chronic labor shortage from the declining birthrate and aging society, improves productivity of SMEs, and helps to revitalize rural areas.** While Japan has a well-developed credit card industry which is enjoying structural growth drivers including government policy targeting a higher cashless ratio, South Korea and China are leading Asia in adopting cashless payments through aggressive adoption of new cashless technologies.

**Cashless payments as a pct of household final consumption expenditure 2018**



**Trend of cashless payments and the cashless PMT ratio in Japan (JPY tril.)**



Source: [https://www.meti.go.jp/shingikai/mono\\_info\\_service/cashless\\_payment/pdf/2021\\_001\\_04\\_00.pdf](https://www.meti.go.jp/shingikai/mono_info_service/cashless_payment/pdf/2021_001_04_00.pdf)  
 Note: \*China is a reference value from Euromonitor International. Japan figure is for 2020.

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**Sessa Partners Inc.**

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5-3-18 Hiroo, Shibuya-ku, Tokyo  
info@sessapartners.co.jp