Alpha-Win Company Research Report

PCA
(9629 TSE First Section)

Issued: 2/21/2019

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

● Flash Report on Performance

◆ A major specialized player in enterprise system software; evident growth trend for sales and profits

・PCA CORPORATION (hereinafter referred to as the "Company") sells proprietary packaged business software (for accounting, sales management, purchasing and inventory management, payroll, human resources, etc.) mainly toward small- and medium-sized companies as well as providing maintenance services.

・In recent years, the Company has been focusing on expanding the sales of its cloud-based software and streamlining its business. Its business results have continued to improve after making a V-shaped recovery. The Company has recently significantly revised upward its forecast for this fiscal year's financial performance, with high expectations that sales and profits will rise for the fourth consecutive year and record-high sales will be achieved (note that all fiscal years or FY in this Report are March-ending; e.g. FY 2019 ends in March 2019).

◆ Q3 results: double-digit sales growth with the cloud and solutions & slower rate of decline in profit despite a greater than 20% drop in operating profit from upfront investment costs, etc.

・Consolidated results for the third quarter (hereinafter "Q3") of FY 2019 disclosed on January 28 were as follows (hereinafter all descriptions are on a consolidated basis): Y7,836 million in sales (+12.6% YOY), Y521 million in operating profit (-23.7% YOY), Y547 million in recurring profit (-23.2% YOY), and Y371 million in net profit (+165.4% YOY) (Figure 1). In addition to the Company's efforts including the strengthening of its products, services, and marketing, the recovery of the general performance of Japanese companies, the recovery of investments in the information service industry, and the demand for PC replacements contributed to YOY sales growth in four out of the five sales categories (Maintenance Service, the exception, experienced a slight decline of -0.6%). In particular, the Cloud Service and the Other Operating Revenue (Solutions) categories grew significantly by 31.1% YOY (sales of Y1,763 million; +Y418 million contribution to sales growth) and 26.9% YOY (sales of Y1,638 million; +Y347 million contribution to sales growth), respectively. These two categories total 87% of the sales growth and serve as the growth driver of the Company as a whole.

・Meanwhile, despite an increase in sales, due to greater upfront investment costs leading to a lower gross margin (in the order of last Q3 ⇒ this Q3: 57.6% ⇒ 55.7%) and higher SG&A expenses ratio (47.7% ⇒ 49.1%), operating margin declined (9.8% ⇒ 6.6%). As a result, both operating profit and recurring profit declined by more than 20% YOY (net profit increased with the lack of the impairment loss recorded in the previous fiscal year). However, for the following reasons, we believe that strong fundamentals are being maintained:

1. The decrease in profit is due to forward-looking factors such as upfront investment costs including R&D expenses for the development of next-generation products and due to temporary factors such as the lump-sum recording of prior service costs as expense following the revision of retirement allowance rules.
2. The number of companies that have implemented PCA Cloud, the Company's growth driver, is steadily increasing, steadily expanding the Company's subscription-based business (Maintenance Service + Cloud Service). Sales for the Cloud Service for this Q3 (Oct-Dec 2018) were Y634 million (+28.3% YOY) and its sales growth rate is increasing. Also, quarterly sales for the Cloud Service (in million yen) were 424 for last FY's Q1 ⇒ 447 for Q2 ⇒ 475 for Q3 ⇒ 508 for Q4 ⇒ 544 for this FY's Q1 ⇒ 584 for Q2 ⇒ 634 for Q3; quarterly sales are not only increasing on a YOY basis but also increasing compared to the quarter before in a linear, rising trend. The growth in membership, rather than the rise in the price per contract, is contributing to this sales growth. In fact, the number of new members (inflow) seems to be increasing by about 200 companies per month. While the Company had achieved 10,000 companies as members of its cloud service in January 2018, about 2,000 more companies are estimated to have joined by the end of January 2019. In addition to the increase in sales, the Cloud Service is expected to contribute greatly to profit with its high profitability.
3. In addition, the labor management system of the Company's subsidiary (Xronos Inc.), which is a product related

to the Work-Style Reform, has maintained a YOY growth rate of about 20-30% (actual sales value is undisclosed). The Solutions business and related implementation services are also making a significant growth. The Company's overall sales growth rate has been mostly maintained at a double digit (cumulative YOY growth rate in %: 12.6 for this FY's Q1 → 9.9 for Q2 → 12.6 for Q3) and sales have been exceeding the values forecasted by the Company at the beginning of the fiscal year.

4. On a quarterly basis, operating profit has been growing (in million yen: 57 for this FY's Q1 → 187 for Q2 → 277 for Q3), such that the decline rate in profit has also been slowing down on a cumulative basis (cumulative YOY decline rate in %: -67.1 for this FY's Q1 → -44.1 for Q2 → -23.7 for Q3).

・In addition, the progress in Q3 in terms of the Company's new full-year forecast for this fiscal year (forecast revision explained later) was 68% for sales and 44% for operating profit (at the end of Q3). In comparison, the progress rates for the previous fiscal year's Q3 were 71% for sales and 85% for operating profit; this fiscal year's plan has a higher dependence on Q4 results.

【 Figure 1 】 Q3 Results (Unit: Y mil, %)

		FY 2018 Q3	FY 2019 Q3	% Change	Difference	% of Sales Growth	% of Sales	FY 2018 Q3	FY 2019 Q3	% Change	Difference
Unit: Y mil, %		Apr-Dec 2017	Apr-Dec 2018	YOY: %	YOY: Y mil	%	%	Oct-Dec 2017	Oct-Dec 2018	YOY: %	YOY: Y mil
Consolidated Sales		6,959	7,836	12.6	877	100.0	100.0	2,486	2,919	17.4	433
Sales Category	Products (convetional software)	1,242	1,333	7.3	91	10.4	17.0	419	521	24.3	102
	Goods	747	782	4.7	35	4.0	10.0	374	392	4.8	18
	Maintenance Service	2,333	2,318	-0.6	-15	-1.7	29.6	783	765	-2.3	-18
	Cloud Service	1,345	1,763	31.1	418	47.7	22.5	474	634	33.8	160
	Other Operating Revenue	1,291	1,638	26.9	347	39.6	20.9	437	607	38.9	170
Gross Profit		4,006	4,367	9.0	361	-	-	1,422	1,653	16.2	231
	Gross Margin	57.6	55.7		-1.8	-	-	57.2	56.6		-0.6
SG&A Expenses		3,321	3,845	15.8	524	-	-	1,174	1,375	17.1	201
	SG&A Expenses Ratio	47.7	49.1		1.3	-	-	47.2	47.1		-0.1
Operating Profit		684	521	-23.8	-163	-	-	248	277	11.7	29
	O.P. Margin	9.8	6.6		-3.2	-	-	10.0	9.5		-0.5
Net Profit		139	371	166.9	232	-	-	32	175	446.9	143
	N.P. Margin	2.0	4.7		2.7	-	-	1.3	6.0		4.7

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

◆ Significant upward revision to this fiscal year's financial results forecast; re-entering a growth stage over the medium term

・Since the Company has been able to expand its business more than expected, on February 18, the Company largely revised up its financial results forecast for FY 2019 as follows (Figure 2; in the order of old forecast ⇒ new forecast; in million yen): 10,486 ⇒ 11,518 for sales, 825 ⇒ 1,195 for operating profit, 842 ⇒ 1,224 for recurring profit, and 588 ⇒ 870 for net profit attributable to owners of the parent (hereinafter "net profit").

・Overall sales were revised up by approximately 1 billion yen and sales for each of the five sales categories seem to have been revised up by more than 100 million yen each (details have not been disclosed). Particularly, in addition to the rapidly growing Cloud Service, sales of the Other Operating Revenue (Solutions) category including system implementation coaching fee and other companies' products and the Products (on-premises: conventional software) category helped by customers' PC replacements have been stronger than expected.

・Profits are expected to be raised most significantly by the increase in sales, with additional contribution from the cost control. As a result, operating margin for this fiscal year is expected to rise from last fiscal year's 8.2% to 10.4%, leading to a large growth in operating profit by a little less than 50%. Additionally, in Q4, the Company plans to completely sell the consolidated subsidiary MACS System Corporation (a medical system consulting company) which it owns 80% of the shares. Consequently, loss on sale of stock will be posted as an extraordinary loss of Y81 million, but since the forecast for net profit has been revised up by more than 40%, the net profit is expected to increase by about two-fold YOY. Due to this change, the dividend payout ratio will be reduced to about 24%, but the Company plans to keep the dividend for the current fiscal year the same as its initial plan. Also, in Q3, retirement benefit obligations (approx. Y114 million) were posted as expense in a lump sum under cost of sales and SG&A expenses; considering this expense and the extraordinary loss, the Company's performance seems to be buffered against negative impact in terms of its true profitability for the next fiscal year and onward.

・Alpha-Win Research Department had previously predicted that this fiscal year's full-year performance will exceed the Company's (old) forecast made at the beginning of the fiscal year. However, the Company's new, revised forecast is even higher, expecting to achieve our forecasted values for FY 2020 one year in advance. Indeed, business momentum continues to be strong in Q4, especially for the Cloud Service, Products (on-premises), and Other Operating Revenue. Cost control is also being conducted along the Company's plan. Therefore, we judged that the Company will be able to achieve its new profit targets by the end of the fiscal year and revised up our forecast for this fiscal year to the same level as the Company's forecast. Based on the current situation, we also made upward revisions to the forecasts we had previously made for the next fiscal year and onward. Next fiscal year, we expect that the profits will increase by about 30% compared to this fiscal year's forecasted values because of the nearly 6% sales growth owing to event-driven high demand (Windows 7 support termination, change in the name of the era, and consumption tax revision) and the lack of temporary expenses recorded during this fiscal year as described above (lump-sum expense treatment of retirement benefit obligations and loss on sale of subsidiary's stock). Furthermore, since these changes will decrease the forecasted dividend payout ratio for next fiscal year to about 20%, we believe that a dividend hike is also possible.

・Meanwhile, in the fiscal year following the next, or FY 2021, we expect declines in sales and profits in recoil from the event-driven high demand. However, as with the recoil from the previous occurrence of event-driven high demand, we believe that sales and profit declines are unlikely to be large (sales drop by a little more than 20% and recurring loss posted in FY 2015 as shown on Figure 3; please refer to the full report issued on 12/18/2018 for details). This expectation is based on our evaluation that the Company's reviewing of its business model and profit structure over the medium term has strengthened its resistance to downturns. Also, our forecast is based on the evaluation that 1) for the meantime, due to the expansion of the cloud and maintenance services, the subscription-based business will expand to become a greater portion of the Company's entire business and lead to the stability of revenue, 2) the Work-Style Reform will be a tailwind for the labor management system and other products of the Company's group and support those businesses over the medium term, and 3) the Company is buffered with regards to profit, leaving room for appropriate cost control in the future.

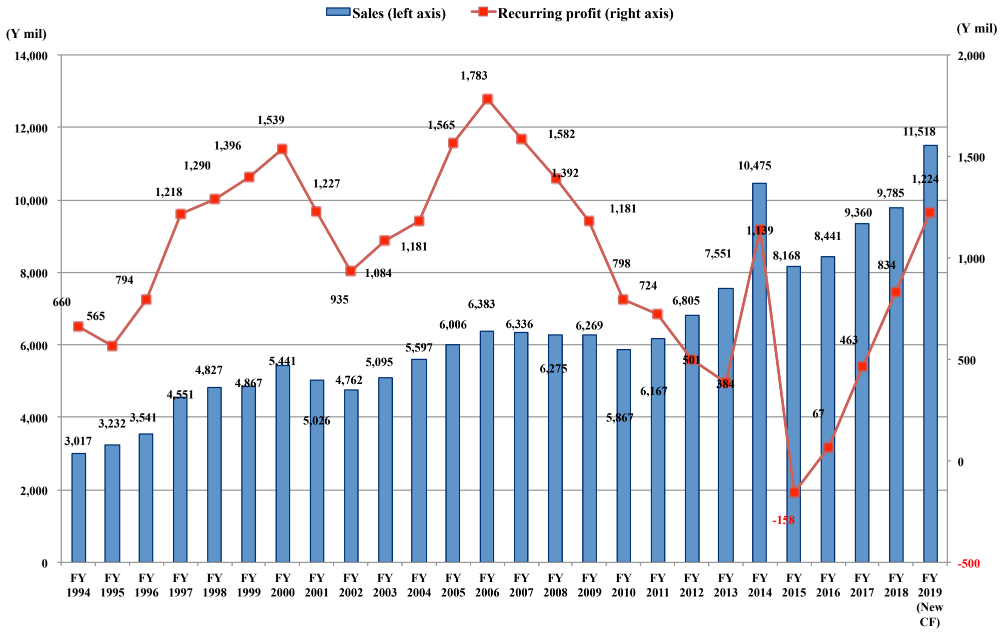
【 Figure 2 】 Financial Results Forecast for the Medium Term (Unit: Y mil, %)

	FY 2018	FY 2019				FY 2019				FY 2020				FY 2021			
Unit: Y mil, %	Actual	Old CF	New CF	% Revised	Revised Amount	Old F	New F	% Revised	Revised Amount	Old F	New F	% Revised	Revised Amount	Old F	New F	% Revised	Revised Amount
Sales	9,785	10,486	11,518	9.8%	1,032	10,600	11,520	8.7%	920	11,300	12,200	8.0%	900	10,500	11,000	4.8%	500
Operating Profit	807	825	1,195	44.8%	370	875	1,200	37.1%	325	1,200	1,600	33.3%	400	830	1,100	32.5%	270
(O.P. margin)	*8.2%*	*7.9%*	*10.4%*			*8.3%*	*10.4%*			*10.6%*	*13.1%*			*7.9%*	*10.0%*		
Recurring Profit	834	842	1,224	45.4%	382	900	1,225	36.1%	325	1,220	1,620	32.8%	400	850	1,120	31.8%	270
(R.P. margin)	*8.5%*	*8.0%*	*10.6%*			*8.5%*	*10.6%*			*10.8%*	*13.3%*			*8.1%*	*10.2%*		
Net Profit	441	588	870	48.0%	282	620	870	40.3%	250	836	1,110	32.8%	274	582	767	31.8%	185
(N.P. margin)	*4.5%*	*5.6%*	*7.6%*			*5.8%*	*7.6%*			*7.4%*	*9.1%*			*5.5%*	*7.0%*		
EPS		85.95	130.94			90.51	130.94			122.04	162.01			84.96	111.95		
Sales (% growth)		7.2%	17.7%			8.3%	17.7%			6.6%	5.9%			-7.1%	-9.8%		
O.P. (% growth)	86.8%	2.2%	48.1%			8.4%	48.7%			37.1%	33.3%			-30.8%	-31.3%		
R.P. (% growth)	79.9%	0.9%	46.8%			7.9%	45.5%			35.6%	32.2%			-30.3%	-30.9%		
N.P. (% growth)	174.1%	33.5%	97.3%			35.9%	97.3%			5.8%	27.6%			-30.3%	-30.9%		

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

【 Figure 3 】 Long-term Transition in Performance (Unit: Y mil)

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



◆ Stock Price

・After the disclosure of the upward revision to this fiscal year's full-year financial results forecast, the stock price soared and has been staying in a high price zone. Reflecting the expectations for strong performance, the stock price has been considerably outperforming the TOPIX since the fall of 2018. The valuation is somewhat high compared to the average of the First Section of the TSE (based on the closing price of February 20, 2019: P/E of approx. 13.9, P/B of 1.2, and simple-average dividend yield of 1.95%). However, since we expect that a substantial rise in profit will also occur during the next fiscal year, the Company's P/E is 14.5 based on the predicted EPS for the next fiscal year and the stock price does not seem expensive. Furthermore, when comparing major valuation indicators with the Company's competitors, Obic Business Consultants and Miroku Jyoho Service, the Company's stock continues to be relatively cheap (Figure 4).

・Going forward, we expect that the stock price will reflect the cloud business' growth rate and financial results forecast for the next fiscal year and onward, as well as the level of dividend (possible dividend hike). We should keep watching this stock as a defensive stock based on domestic demand with a clear prospect for strong performance during the next fiscal year.

【 Figure 4 】 Comparison of Valuation Indicators with Competitors

(Ref) Prepared by Alpha-Win Research Dept. based on each company's financial results summary and stock price

Company Name	PCA (consolidated)	Obic Business Consultants (OBC: non-consolidated)	Miroku Jyoho Service (MJS: consolidated)
Code	9629	4733	9928
Stock Price (at 2/20 closing)	2,347	4,385	2,818
Market Cap (Y mil)	18,072	353,887	98,084
P/E (price-to-earnings ratio)	17.9	35.7	26.7
P/B (price-to-book ratio)	1.4	3.0	5.1
Dividend Yield (%)	1.3	1.0	1.1
EV/EBITDA	7.0	26.5	18.7
P/S (price-to-sales ratio)	1.7	12.9	3.2

Market cap = shares outstanding x market stock price
EV/EBITDA = (market cap + interest-bearing debt - cash & deposits) / (O.P. + depreciation + intangible fixed asset amortization, etc.)
: based on FY 2018; recent value for market cap only
P/S = market cap / sales [the Company's forecast for FY 2019]
The companies' predicted EPS for FY 2019 used in all P/E calculations. Actual BPS as of the end of Dec 2018 used for P/B calculations.

【 9629 PCA Sector: Information & Communication 】

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)
2016		8,440	3.3	40	-	66	-	-93	-	-13.70	1,567.18	31.00
2017		9,360	10.9	432	957.9	463	593.6	160	-	23.49	1,568.59	31.00
2018		9,785	4.5	807	86.8	834	79.9	441	174.1	64.37	1,644.39	31.00
2019	CF	11,518	17.7	1,195	48.1	1,224	46.8	870	97.3	130.94	-	31.00
2019	F	11,520	17.7	1,200	48.7	1,225	46.9	870	97.3	130.94	1,740.36	31.00
2020	F	12,200	5.9	1,600	33.3	1,620	32.2	1,110	27.6	162.01	1,836.38	33.00
2021	F	11,000	-9.8	1,100	-31.3	1,110	-31.5	767	-30.9	111.95	1,882.33	33.00
2018	Q3	6,959	7.3	684	69.8	712	64.6	139	-51.4	20.40	1,644.39	-
2019	Q3	7,836	12.6	521	-23.7	547	-23.2	371	165.4	54.16	1,677.60	-

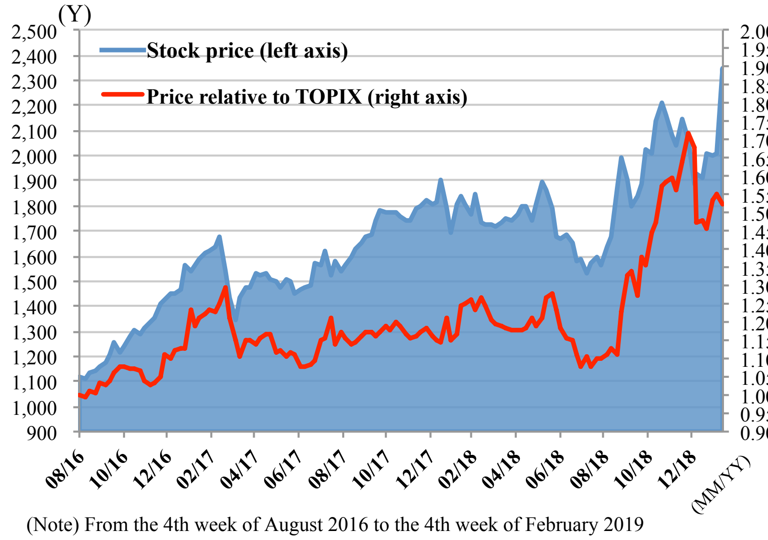
(Note) CF = the Company's forecast. F = Alpha-Win Research Dept.'s forecast. Q3 = cumulative up through the third quarter.

【 Stock Price and Valuation Indicators: 9629 PCA 】

Item	as of 2/20/2019	Item	P/E	P/B	Dividend Yield	Dividend Payout Ratio
Stock Price (Y)	2,347	Last FY (actual)	36.5	1.4	1.3%	48.2%
Shares Outstanding (thou.)	7,700	This FY (forecast)	17.9	1.3	1.3%	23.7%
Market Capitalization (Y mil)	18,072	Next FY (forecast)	14.5	1.3	1.4%	20.4%
Dilutive Shares (thou.)	0	Equity Ratio at Last FY-End		65.0%	Last FY's ROE	3.9%

(Note) Forecasts were made by Alpha-Win Research Dept.

【 Stock Chart (end-of-week prices): 9629 PCA 】



(Note) From the 4th week of August 2016 to the 4th week of February 2019

【Performance】		
Period	Return	vs. TOPIX
1 month	17.4%	14.0%
3 months	6.0%	9.6%
6 months	46.7%	57.8%
12 months	25.8%	37.8%

(Note) Stock price and index values up to 2/20/2019.

Each period compares the most recent value and the respective month's month-end value.

E.g. The 1-month period compares the value on 1/31 and the most recent market price reflected.

****

Disclaimers

This Alpha-Win Company Research Report (hereinafter "this Report") has been prepared by Alpha-Win-Capital Inc. (hereinafter "Alpha-Win") on the request of the company presented in this Report.

This Report is not to be construed as a recommendation or solicitation of investment. Alpha-Win shall not be liable for any consequences including direct or indirect loss, lost profit, or damage resulting from the use of or reliance on this Report. Investors who read this report must make their own decisions on all investment matters and take full responsibility regarding their investment.

This Report has been prepared with a focus on objectivity and neutrality based on the analysis of generally accessible public information and facts and supplemental information including interview(s) by the analyst. Furthermore, we have aimed to distinguish between forecast and decisions by the company and forecast and decisions by Alpha-Win and clearly state the difference in this Report.

Contents of this Report are based on information current as of the issue date and are subject to change without notice. We do not warrant or represent that the information in this Report is accurate, reliable, complete, appropriate, or fit for any purpose and do not accept any responsibility or liability.

Copyright of this Report belongs to Alpha-Win and no part of the publication may be copied, photocopied, cited, or translated without our consent.

Alpha-Win, the writer, and/or other persons involved in the publication of this Report may already hold, or buy and sell in the future, the stock of the company presented in this Report.

For inquiries regarding this Report, please send us an e-mail to info@awincap.com. However, Alpha-Win and the writer of this Report do not have any obligation to reply to inquiries. PSV20190221