Alpha-Win Company Research Report

PCA

(9629 TSE First Section)

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http://www.awincap.com/

● Flash Report on Financial Performance

◆ A major specialized player in enterprise system software; taking a lead in the cloud business as No. 1 in the industry

・PCA CORPORATION (hereinafter referred to as the "Company") sells proprietary packaged business software (for accounting, sales management, purchasing and inventory management, payroll, human resources, labor management, etc.) mainly to small- and medium-sized companies as on-premises or via the cloud. It also provides related maintenance services. The Company's mission is to contribute to society as a "management-supporting company" that supports the smooth management and operation of other companies. It is taking a lead in the cloud-based business software industry as No. 1 in the industry (PCA Cloud).

・In recent years, thanks to the transition to a subscription-based business model and the event-driven, high market demand, the Company's financial performance has been excellent. This fiscal year, it plans to increase sales and profits for the fifth consecutive year, as well as achieving record-high profit (net profit).

◆ This fiscal year's Q1 results came as a positive surprise: excellent results with greater-than-expected, significant rise in sales and profits, both hitting their Q1 record highs

・The Company's financial results for the first quarter (Q1: April-June 2019) of FY 2020 (note that all fiscal years or FY in this Report are March-ending; e.g. FY 2020 ends in March 2020) were excellent: sales were Y3,073 million (+31.0% YoY), operating profit was Y587 million (+917.5% YoY), recurring profit was Y598 million (+754.6% YoY), and net profit was Y364 million (+945.3% YoY) (see Figure 1).

・Sales and each of the profits substantially exceeded their past Q1 record highs. In the previous year's Q1, the profits fell by a large amount despite increased sales due to the upfront investment cost for developing next-generation products. Partly in reaction to this drop, this Q1's sales growth rate was much greater than before (+11.3% YoY in the previous Q1 → +31.0% YoY in the current Q1) and the growth in financial results was remarkable with an operating profit and a net profit that were about 10 times greater than in the previous Q1.

・The significant rise in sales seems to have been mainly caused by the following factors: 1) the Company's efforts in strengthening its products and services as well as marketing (shifting to the cloud business, expanding the lineup of products such as its consolidated subsidiary Xronos Inc.'s labor management system related to the work-style reform, increasing direct sales, continuing to hold the PCA Festa, strengthening cooperation with sales partners, etc.), 2) solid performance of Japanese companies and recovery of investment activities in the information service industry, and 3) high market demand related to the replacement of software to deal with the rise in consumption tax and the PC replacements in response to the termination of Windows 7 support in January 2020.

[Figure 1] First Quarter's Financial Results and Full-Year Plan

Q1 Results		FY 2019 Q1	FY 2020 Q1	% Change	Difference	Contribution to inc. in sales	Share of sales	FY 2020 full-year company plan	% Change
Unit: Y million		Apr-Jun 2018	Apr-Jun 2019	YoY: %	YoY: Y mil	%	%	Apr 2019 - Mar 2020	YoY: %
Consolidated Sales		2,346	3,073	31.0	727	100.0	100.0	12,783	11.8
Sales Category	Products	394	652	65.3	258	35.5	21.2	2,673	6.2
	Goods	107	102	-4.6	-5	-0.7	3.4	1,036	1.6
	Maintenance Service	788	865	9.8	77	10.6	28.1	3,407	9.0
	Cloud Service	544	764	40.3	220	30.3	24.9	2,804	14.4
	Other Operating Revenue	511	688	34.7	177	24.4	22.4	2,857	23
Gross Profit		1,287	1,868	45.1	581	-	-	7,331	12.4
	Gross Margin (%)	54.9	60.8		5.9	-	-	57.3	
SG&A Exp.		1,229	1,281	4.2	52	-	-	5,852	11.0
	SG&A Exp. Ratio (%)	52.4	41.7		-10.7	-	-	45.8	
Operating Profit		57	587	917.5	530	-	-	1,478	18.5
	O.P. Margin (%)	2.4	19.1		16.7	-	-	11.6	
Net Profit		34	364	945.3	330	-	-	976	7.7
	N.P. Margin (%)	1.4	11.8		10.4	-	-	7.6	

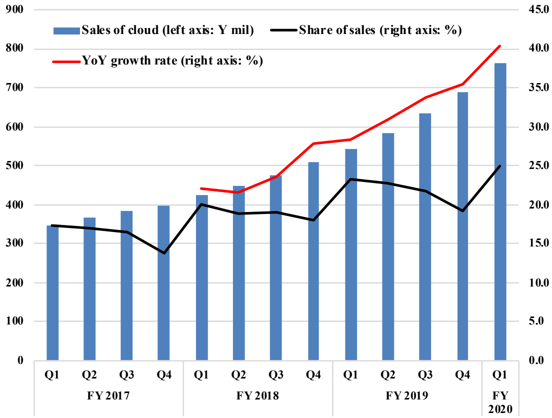
(Ref) Prepared by Alpha-Win Research Dept. based on the financial results summary. (Note) "Products" and "other operating revenue" were retroactively adjusted in response to the change in the sales accounting standard (also applies to the rest of this Report).

・Of the total increase in sales of Y727 million, Y258 million (about 36% of the total increase in sales) were from the products, Y220 million (about 30%) were from the cloud service, and Y177 million (24%) were other revenue.

・Actual sales for each sales category (as defined by the Company) were as follows:

1. For the products (conventional packaged software; on-premises), thanks to the high replacement demand from stand-alone software users, sales increased from Y394 million last Q1 → Y652 million this Q1 (+65.3% YoY; 21.2% of total sales) (the same order applies below). Of all the sales categories, the products had the highest sales growth rate as well as contributing the most to the sales increase. In response to the consumption tax revision, sales of the accounting software, the sales management software SHOKON and SHOKAN, and the labor management software grew. Presumably, the contribution to profit was also significant.
2. Meanwhile, sales of goods (business forms, etc.) decreased from Y107 million → Y102 million (-4.6% YoY; 3.4% of total sales) due to the trend toward paperless operation.
3. Maintenance service, which accounted for the largest percentage of the total sales (28.1%), has been a stable source of profit. Its sales grew by 9.8% YoY from Y788 million to Y865 million (last Q1, sales grew by 0.5% YoY), an especially high growth rate relative to recent years owing to the acquisition of maintenance contracts along with the strong sales of products.
4. Sales of the cloud service grew from Y544 million → Y764 million and its sales growth rate has increased (+28.3 YoY in the previous Q1 → +40.3% in the current Q1). Its share of total sales was 24.9%; adding the maintenance service, the share of sales of the subscription-based businesses has reached 53%. As shown on Figure 2, quarterly sales have been continuing to increase year-on-year as well as compared to the previous quarter regardless of seasonality. The number of cloud service users had reached 12,000 in March 2019 and new users have been joining at a pace of about 150 to 160 companies per month, contributing to the sales increase. Since this business is excellent in continuity and has a high marginal profit ratio, its contribution to profit must also have been significant.
5. Other operating revenue also increased significantly from Y511 million → Y688 million (+34.7% YoY). In addition to the implementation services for various systems (provided by the consolidated subsidiary KEC), sales of other companies' goods contributed to the steady growth of this category's sales.

[Figure 2] Quarterly Change in Sales of the Cloud Business



・Meanwhile, regarding profit, since the Company is based on a business model with a high marginal profit ratio, a large increase in sales is directly linked to an improvement in the profit margin and a large increase in profit. In addition, the cost of sales decreased due to the completion of most of the software amortization during the previous fiscal year, leading to an improvement in the gross margin by 5.9% from 54.9% in the previous year's Q1 to 60.8% in the current Q1. Also, the SG&A expenses increased by Y52 million or 4.2% YoY, a small increase compared to the sales growth rate (SG&A expenses ratio improved by 10.7% from 52.4% → 41.7%). This improvement may be explained by the fact that the R&D and other upfront investment activities, although still in progress, are starting to relax to normal levels, and the fact that the Company is properly carrying out cost control. As a result, the operating margin improved significantly from 2.4% to 19.1%. As a reference, the Company's predicted full-year operating margin for this fiscal year is 11.6%; the actual operating margin in Q1 exceeded this target. There were no major non-operating or extraordinary gains or losses. The significant increase in operating profit led to record-high Q1 net profit.

・The balance sheet at the end of this Q1 is not largely different from the previous year's Q1. The increase in profit caused an increase in the cash and deposits (last Q1 → this Q1: Y7,280 million → Y8,134 million) and the net assets (last Q1 → this Q1: Y11,995 million → Y12,375 million). As a result, the ratio of cash and deposits over the forecasted sales for this fiscal year or total assets was 63.6% (equivalent to 7.6 months' worth of average monthly sales) and 40.9%, respectively; the Company has ample liquidity at hand. In addition, its financial standing is strong with an equity ratio of 61.9% and a current ratio of 249.0%.

◆ Progress Rate in Terms of the Financial Forecast

・The Company has not disclosed an interim financial forecast for this fiscal year. Q1's progress rate against the Company's full-year forecast for this fiscal year was 24.0% for sales (20.5% in last year's Q1 and 21.5% in the year before the previous) and 39.1% for operating profit (4.6% in last year's Q1 and 21.7% in the year before the previous). This progress is excellent even in comparison to the past 14 years during which the Company's Q1 results have been disclosed. Also, both the sales and profits seem to be growing steadily in line with the Company's plan to increase full-year sales by 11.8% YoY and operating profit by 18.5% YoY (see Figure 1 shown above).

・The Company has not changed its forecast on full-year sales, profits, and dividend since the Q1 results were mostly in line with its plan and because the second half, which will be largely influenced by the event-driven, high market demand, is hard to predict.

・Since the event-driven high demand is causing an extremely high growth especially for the products, the cloud, and other revenue, making a full-year prediction simply based on the extension of the Q1 results is risky. We must evaluate how long the event-driven high demand will continue into Q3 and onward. The improvement in Q1 sales growth rates and margins of the four sales categories excluding the goods, though, was above our forecast. Since there currently seems to be no slowdown in the orders received and the growth of sales, we believe that the Company's sales will also grow steadily in Q2 (June-August 2019), especially for the products and the cloud. In fact, we have already made a forecast that the results will exceed the Company's full-year targets. Furthermore, we believe that the full-year forecast may be revised even higher, since the strong results during the first half will leave room for adjustments, the demand related to PC replacements will continue in Q3, the subscription-based businesses will continue to support the overall financial performance in Q3, and cost control is expected to be conducted.

・Regarding next fiscal year, we expect that the profits will temporarily decline in a fallback from the event-driven high demand. However, we believe that the cloud business will serve as a stable driver of high growth, such that the EPS will grow annually by 8-10%, based on leveled-out figures, over the medium term after the event-driven high demand ends. Furthermore, with a strong financial performance over the medium to long term, we believe that the Company may improve its shareholder return through increased dividend and a flexible buyback of shares, as well as stock splits and the enhancement of the shareholder benefit program.

◆ Stock Price

・The Company's stock is seen as a defensive, domestic-demand-related, and small-cap growth stock with strong financial performance that is positively affected by the rise in consumption tax. After the announcement of Q1 results, in anticipation of excellent financial performance during this fiscal year, the stock price soared and, in July, reached the highest price since becoming listed on the TSE First Section. Over the past 12 months, the Company's stock price has grown by about 2.5 times, significantly outperforming the TOPIX.

・Regarding valuation, the Company's valuation is high compared to the average of the First Section of the TSE (based on the closing price on 7/31/2019: P/E of 13.6, P/B of 1.2, and simple average of the dividend yield of 2.1%). On the other hand, compared to its competitors Obic Business Consultants and Miroku Jyoho Service, except for dividend yield and this fiscal year's forecasted P/E (note: our forecast for this fiscal year is 25.7), all the indicators (P/B, EV/EBITDA, and P/S) have an undervalued impression (Figure 3).

[Figure 3] Comparison of Valuation Indicators with Competitors

(Ref) Prepared by Alpha-Win Research Dept. based on each company's securities report and stock data

Company Name	PCA (consolidated)	Obic Business Consultants (OBC: non-consolidated)	Miroku Jyoho Service (MJS: consolidated)
Code	9629	4733	9928
Stock Price (at 7/31 closing)	4,065	4,705	3,435
Market Cap (Y mil)	31,301	379,712	119,560
P/E (price-to-earnings ratio)	27.7	35.1	26.2
P/B (price-to-book ratio)	2.3	3.1	5.9
Dividend Yield (%)	0.8	1.1	1.1
EV/EBITDA	14.0	20.9	19.1
P/S (price-to-sales ratio)	2.4	12.7	3.5

Market cap = shares outstanding x market stock price [at 7/31 closing] The companies' estimated EPS for FY 2020 used in all P/E calculations
EV/EBITDA = (market cap + interest-bearing debt - cash & deposits) / (O.P. + depreciation + intangible fixed asset amortization, etc.)
P/S = market cap / sales [the companies' estimate for FY 2020]

【 9629 PCA 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		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		11,439	16.9	1,248	54.7	1,277	53.0	906	105.5	133.25	1,789.76	31.00
2020	CE	12,783	11.8	1,478	18.5	1,499	17.4	976	7.7	146.77	-	31.00
2020	E	12,900	12.8	1,600	28.2	1,620	26.9	1,050	15.9	157.87	1,916.61	31.00
2021	E	11,000	-14.7	1,200	-25.0	1,220	-24.7	800	-23.8	120.28	2,005.89	31.00
2022	E	11,600	5.5	1,400	16.7	1,420	16.4	920	15.0	138.32	2,113.21	33.00
2018	Q1	2,108	5.6	175	626.2	185	435.0	98	—	14.37	1,579.92	—
2019	Q1	2,346	11.3	57	-67.1	69	-62.3	34	-64.6	5.09	1,624.69	—
2020	Q1	3,073	31.0	587	917.5	598	754.6	364	945.3	54.76	1,848.46	—

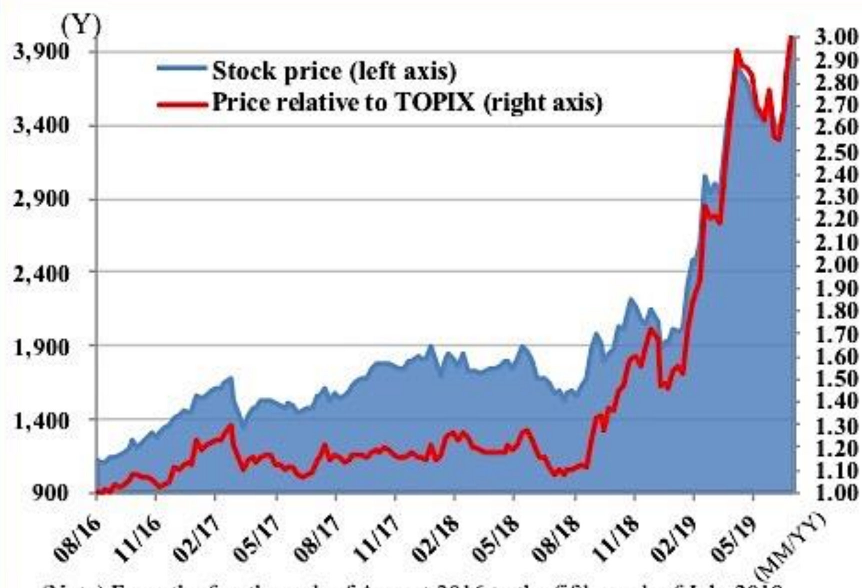
(Note) CE = Company's estimate/forecast. E = Alpha-Win Res. Dept.'s estimate/forecast. Q1 (first quarter) is from April to June.

【 Stock Price and Valuation Indicators: 9629 PCA 】 Figure B

Item	as of 7/31/2019	Item	P/E	P/B	Dividend Yield	Dividend Payout Ratio
Stock Price (Y)	4,065	Last FY (actual)	30.5	2.3	0.8%	23.3%
Shares Outstanding (thou.)	7,700	This FY (est.)	25.7	2.1	0.8%	19.6%
Market Capitalization (Y mil)	31,301	Next FY (est.)	33.8	1.9	0.8%	25.8%
Dilutive Shares (thou.)	0	Equity Ratio at This Q1-End	61.9%	Last FY's ROE		7.8%

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

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



(Note) From the fourth week of August 2016 to the fifth week of July 2019

【Performance】

Period	Return	vs. TOPIX
1 month	13.1%	12.1%
3 months	18.9%	22.9%
6 months	103.3%	103.6%
12 months	153.4%	183.9%

(Note) Reflects stock price and index values up through 7/31/2019

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