

Digital Hearts Holdings (TYO: 3676)

Enterprise Business continues to drive growth Record high Q1 sales and operating profit

◆ Good earnings results and sustained growth investment

Enterprise Business continues to drive high sales growth (+77% yoy) backed by the growing existing businesses and the benefits of M&A. Entertainment Business also achieved double-digit sales growth (+18%) against the backdrop of a strong games market. All in all, the company achieved its highest ever Q1 sales and operating profit. EBITDA grew by 20%. Meanwhile, it continues to invest in the growth of Enterprise Business, with three M&As and other deals being executed from the end of FY2022/3 onwards. With the company further bolstering its new management structure, various measures for growth are underway, including a resolution for equity finance.

◆ Share price: recovering and further scope for upside

The company's share price rose sharply on the back of strong results in the previous year and the management's forecast for a large dividend increase in FY2023/3. There was a swing back for some time afterwards, but the share price has returned to an uptrend. Considering the current good business performance and future growth expectations, the share price looks undervalued in terms of PER and PBR.

◆ Financial results for Q1 FY2023/3: Record high sales and operating profit for Q1

DIGITAL HEARTS HOLDINGS achieved a significant increase in sales and operating profit in Q1 FY2023/3, thanks to the growth in existing businesses and the effect of M&A. The company's sales and operating profit recorded a historic high 8,372 million yen (up 37.3% yoy) and 639 million yen (up 0.5% yoy), respectively, despite the amortisation of goodwill on M&As and the growth investment in Enterprise Business. EBITDA grew significantly to 893 million yen, up 21.9%.

Enterprise Business saw sales increase by 77% yoy due to the effects of M&As in the previous year, in addition to continued double-digit top-line sales growth in existing businesses. EBITDA grew by 25.8%, despite the continued investment in growth. Meanwhile, in Entertainment Business, Domestic debugging for console games performed well. Also, Global and others registered a 30% increase in sales. Consequently, the quarterly segment profit exceeded 1 billion yen for the first time.

◆ Full-year progress in FY2023/3: on target to achieve record high sales and operating profit

As of Q1, progress ratios vis-a-vis the company's full-year forecasts are 24% for sales, 19% for operating profit and 21% for EBITDA. These targets look achievable, with the earnings of the acquired companies into the group through M&As expected to kick in from Q2.

◆ Steady implementation of various measures for growth

The company clarified the roles of Enterprise and Entertainment operating companies with the launch of AGEST, Inc. in April 2022. The structure of the holding company overseeing the operating companies has been strengthened and DIGITAL HEARTS HOLDINGS is now ready to drive medium-term growth from an organisational perspective. In June, the company announced a resolution for equity financing (stock subscription rights) for an expected 4.2 billion yen to secure funds for M&As.

JPY, mn, %	Net sales	YoY %	Oper. profit	YoY %	Ord. profit	YoY %	Profit ATOP	YoY %	EPS (¥)	DPS (¥)
2019/3	19,254	11.0	1,605	-7.5	1,651	-7.4	1,575	31.3	72.13	13.00
2020/3	21,138	9.8	1,394	-13.2	1,372	-16.9	792	-49.7	36.31	14.00
2021/3	22,669	7.2	1,908	36.9	1,975	43.9	974	23.0	45.15	14.00
2022/3	29,178	28.7	2,701	41.5	2,778	40.7	1,780	82.7	82.35	15.00
2023/3 (CE)	35,500	21.7	3,290	21.8	3,290	18.4	2,250	26.4	104.04	21.00
2022/3 Q1	6,098	19.7	636	301.3	670	244.9	487	391.3	22.57	—
2023/3 Q1	8,372	37.3	639	0.5	637	-4.8	416	-14.7	19.24	—

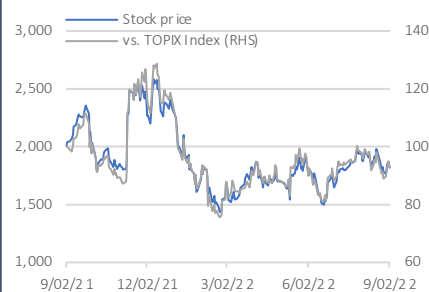
Q1 results update

Information Technology

As of Sep. 2, 2022

Share price (9/2)	1,818 Yen
52weeks high/low	¥2,700/1,405
Avg Vol (3 month)	91.8 thou shrs
Market Cap	¥43.4 bn
Enterprise Value	¥41.1 bn
PER (23/3 CE)	17.5 X
PBR (22/3 act)	5.23 X
Dividend Yield (22/3 CE)	1.15 %
ROE (TTM)	26.38 %
Operating margin (TTM)	8.60 %
Beta (5Y Monthly)	1.14
Shares Outstanding	23.890 mn shrs
Listed market	TSE Prime section

Share price performance



% of	1mo.	3mo.	12mo.
Share prices	-3.3%	21.5%	-9.5%
Relative share price	-3.6%	4.3%	-6.3%

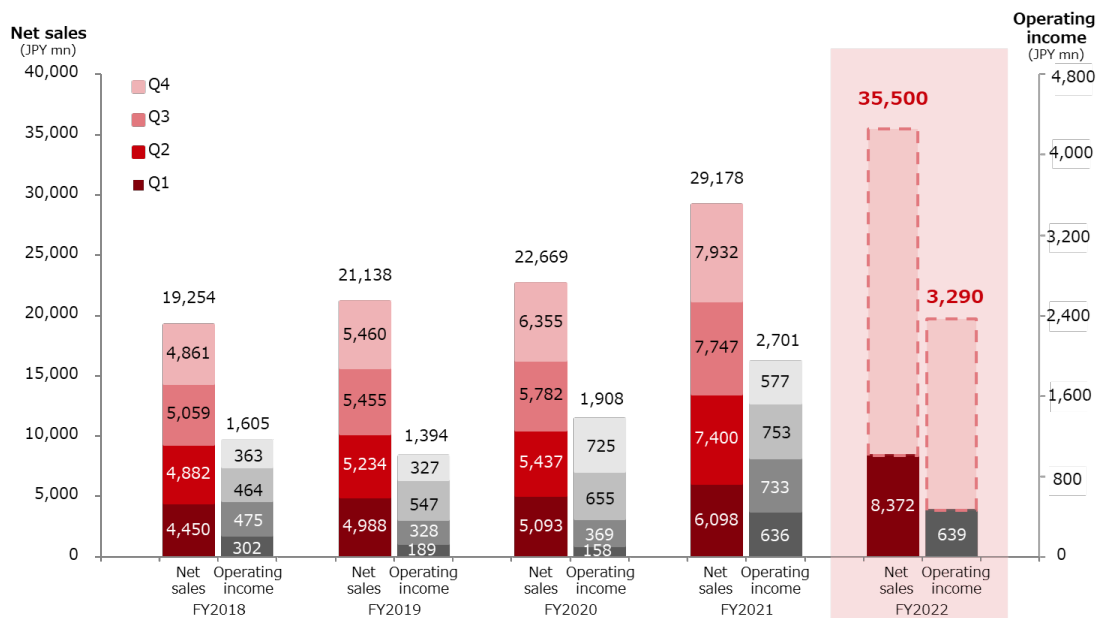
Points of interest

Expanding from game debugging to enterprise software testing. Enterprise Business is growing rapidly, driven by DX. Focus on global expansion in entertainment. The new management aims to generate sales of 50 billion yen in FY2024/3.

This report (financial update) has been prepared at the request of Digital Hearts Holdings. For details, please refer to the Disclaimer on the last page.



Full year consolidated sales / operating profit trend



Source: The company handout for the 1st quarter results for FY2022/3 (published on August 9, 2022)

◇ Trends by segment: (See also table on p. 6)

1) Enterprise Business: 76.8% yoy increase in sales (3,589 million yen), 25.8% rise in EBITDA

Existing businesses continue to record double-digit revenue growth on the back of increased demand from DX developments and growing test outsourcing needs. The recent M&A effect has also contributed, and the sales of Enterprise Business grew by about 80% yoy. Consequently, gross profit has increased steadily with the margin remaining above 25%. Although SG&A expenses are rising reflecting pro-active investment to reinforce the business infrastructure and growth, EBITDA increased significantly to 185 million yen, or +25.8% yoy. Segment profit decreased (29 million yen, -66.2% yoy) due to continued investment for growth. As already announced, the sub-segments were reshuffled from this Q1. They are "QA solutions" and "IT Services and others" as shown below.

QA solution: sales: 2,102 million yen (+50.7%). Leveraging the company's unique characteristics, cross-selling has been strengthened in areas such as security testing and test automation, based on manual software testing. The company focused on increasing the number of new customers and the scale of transactions per client and achieved a 16.2% increase in revenue on an existing business basis. ERP-related sales also increased, with CEGB, which was acquired through M&A in March 2022, contributing from Q1. The gross profit margin of QA solution remained above 30%, despite continued investment for business expansion. In Q1, there were 627 customers with orders received and the average sales per client was 10 million yen (on a LTM basis, excluding subsidiaries that have been consolidated for less than 12 months).

IT services and others: sales: 1,486 million yen (+134.3%). Sales increased 2.4 times yoy due to the inclusion of identity Inc. (SES: temporary engineer staffing), which became a subsidiary in June 2021. Sales net of M&A impact rose 11.6%. Demand for security monitoring is steadily increasing against the backdrop of the expanding remote working and so on. The number of security monitoring units is held in excess of 550,000.

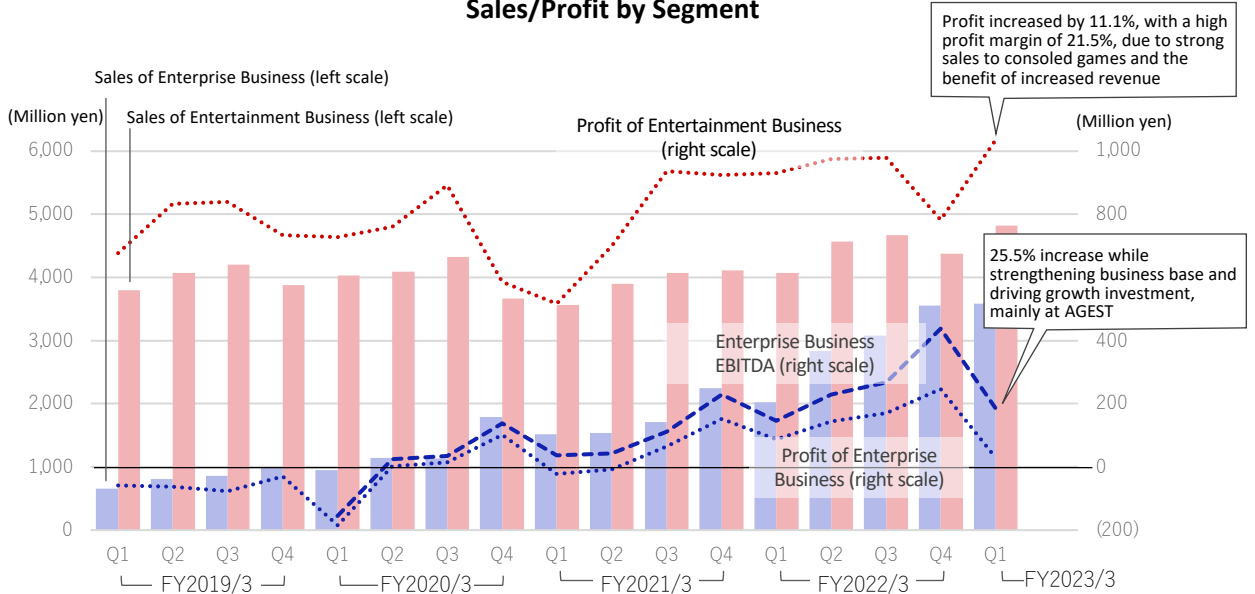
2) Entertainment Business: 18.4% increase in revenue (4,818 million yen), segment profit rose 11.4%

Increasing demand is steadily being captured against the backdrop of the buoyant domestic console games market and the accelerating overseas development of content. Both Domestic debugging, Global and others sales increased by double-digits. Segment profit increased by 11.4% due to higher Domestic debugging sales and improved gross margins, generating the highest segment profit ever in Q1. The segment profit margin remained high at 21.5%.

Domestic debugging: sales: 3,334 million yen (+13.7%). The development of new titles in the console game market has become more active. Sales in this field were strong, driving growth in the Domestic debugging business. Meanwhile, the gross margin remained high at 32.8%, up 1.5 percentage points yoy, thanks to the ongoing efforts to improve operational efficiency and the sales rise.

Global and others: sales: 1,484 million yen (+30.4%). Cross-border/global projects were steadily won against the backdrop of a buoyant market environment. All Global, Creative, Media and others services achieved double-digit revenue growth. Going forward, in addition to pursuing synergies with the DIGITAL HEARTS CROSS Group, the company plans to expand its business in Asia and create new value by strengthening initiatives

Sales/Profit by Segment



Source: Omega Investment, based on company data

with alliance partners, including GameWith, with which it has newly formed a capital and business alliance.

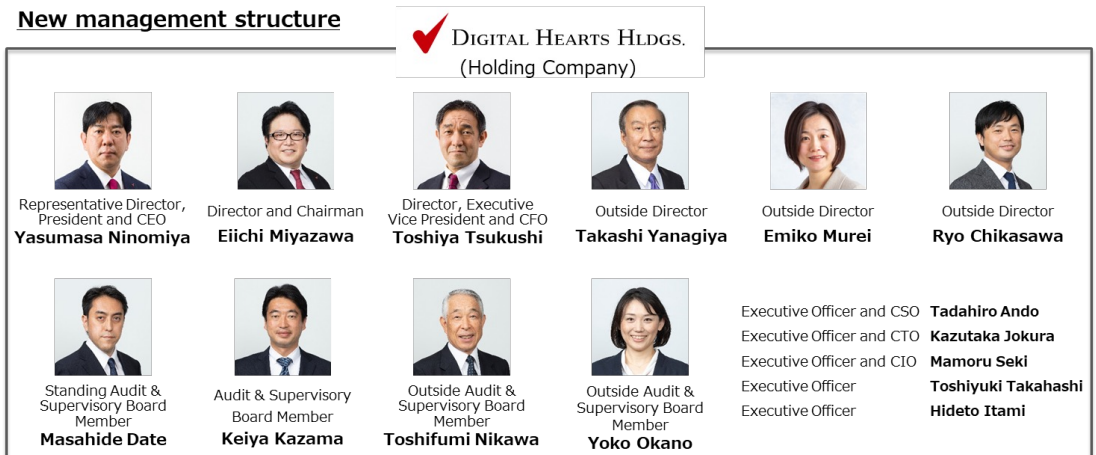
◇ Result progress vs FY2023/3 targets: Running on target. The company aims at record high sales and operating profit

As of Q1, progress ratios against the full-year forecast were 23.6% of net sales, 19.5% of operating profit, 21.1% of EBITDA and 18.5% of net profit attributable to shareholders of the parent company. Sales are expected to be firm vis-a-vis the company forecast, considering the outlook of steady growth in Q2 and beyond, mainly in Enterprise Business, and the benefits of M&As during the current fiscal year. Profit-wise, the company should also meet its targets, as sales will increase while growth investment will be restrained HoH in the 2H.

◇ New management structure: Establishing a group structure to ensure growth from an organisational perspective as well

The establishment of AGESt in April 2022 clarified the group structure, with AGESt as the Enterprise Business company, DIGITAL HEARTS as the Entertainment Business and DIGITAL HEARTS HOLDINGS as the holding company that oversees these businesses. Furthermore, the number of outside directors and executive officers has been increased at the holding company. The company is now ready to drive medium-term growth from an organisational perspective, aiming to strengthen its governance structure and improve its business execution capabilities.

New management structure



- Points**
- Outside director : **Three outside directors out of six directors**, to strengthen our governance
 - Diversity : Appoint a new female director and **increase the number of female executives from one to two**
 - Executive officers : **Increase the number of members** to improve business execution capabilities

Source: The company handout for the 1st quarter results for FY2022/3 (published on August 9, 2022)



◇ Resolved on equity finance for M&A and other purposes

On 30 June, the company announced equity finance through the issue of stock subscription rights with a revised exercise price (allotment date: 19 July 2022). The estimated amount raised is 4.24 billion yen (approximate net proceeds assuming all subscription rights are exercised at the initial exercise price). The maximum dilution to existing shareholders would be 11.0% if all subscription rights were exercised, but the financing is intended to enable the company to make the investments necessary to realise its medium-term management vision. Therefore, investors should expect a return in the form of capital gains.

◇ Share price: On a recovery trend, but room for further upside

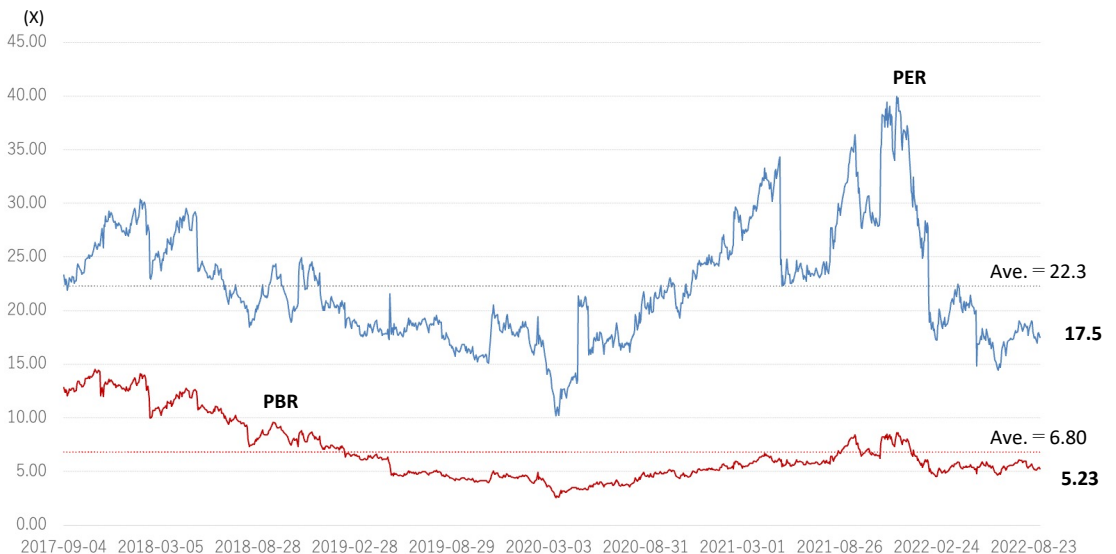
The company's share price rose sharply on the back of strong results in the previous year and the management's forecast for a large dividend increase in FY2023/3. There was a swing back for some time afterwards, but the share price has returned to an uptrend. As we have seen, the business environment surrounding the company is extremely favourable. In addition, the company has settled down the group reorganisation and the finance necessary for growth, so there is little to be concerned about in the immediate future.

On the other hand, the valuations of the company's shares are running below their historical averages. Considering the company's current strong business performance and future growth expectations, the shares look undervalued in terms of PER and PBR.

Digital Hearts Holdings (3676) Share Price Trend (3Year-to-date)



Historical PER/PBR (five years)



Note: PER is based on company forecasts; PBR is based on actual results; company forecasts for the period 19 May 2020 - 10 August 2020 were not announced due to the pandemic disease, so the guidance announced on 11 August 2020 were applied retrospectively.

Financial data I

	2020/3				2021/3				2022/3				2023/3
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
[Sales by segment]													
Net sales	4,988	5,234	5,455	5,460	5,093	5,437	5,782	6,355	6,098	7,400	7,747	7,932	8,372
YoY	12.1%	7.2%	7.8%	15.0%	2.1%	3.9%	6.0%	16.4%	19.7%	36.1%	34.0%	24.8%	37.3%
Enterprise business	954	1,140	1,133	1,794	1,523	1,540	1,710	2,246	2,029	2,833	3,074	3,553	3,589
YoY	46.3%	41.5%	32.0%	82.5%	59.6%	35.1%	50.9%	25.2%	33.2%	83.9%	79.7%	58.2%	76.8%
Composition of sales	19.1%	21.8%	20.8%	32.9%	29.9%	28.3%	29.6%	35.3%	33.3%	38.3%	39.7%	44.8%	42.9%
New sub-segments													
QA solutions									1,395	-	-	-	2,102
YoY									-	-	-	-	50.7%
Composition of sales									22.9%	-	-	-	25.1%
IT services and others									634	-	-	-	1,486
YoY									-	-	-	-	134.3%
Composition of sales									10.4%	-	-	-	17.7%
Old sub-segments													
System testing	430	570	488	924	788	777	937	1,078	1,018	1,144	1,233	1,558	-
YoY	65.8%	99.5%	33.5%	91.4%	83.1%	36.2%	92.0%	16.7%	29.2%	47.2%	31.5%	44.5%	-
Composition of sales	8.6%	10.9%	8.9%	16.9%	15.5%	14.3%	16.2%	17.0%	16.7%	15.5%	15.9%	19.6%	-
IT services / Security	523	569	645	869	735	763	772	1,167	1,011	1,688	1,841	1,995	-
YoY	33.4%	9.5%	30.9%	73.9%	40.4%	34.1%	19.8%	34.3%	37.5%	121.2%	138.2%	70.9%	-
Composition of sales	10.5%	10.9%	11.8%	15.9%	14.4%	14.0%	13.4%	18.4%	16.6%	22.8%	23.8%	25.2%	-
Entertainment business	4,033	4,093	4,321	3,666	3,566	3,900	4,072	4,109	4,069	4,566	4,672	4,378	4,818
YoY	6.2%	0.5%	2.9%	-5.4%	-11.6%	-4.7%	-5.8%	12.1%	14.0%	17.1%	14.7%	6.6%	18.4%
Composition of sales	80.9%	78.2%	79.2%	67.1%	70.0%	71.7%	70.4%	64.7%	66.7%	61.7%	60.3%	55.2%	57.5%
New sub-segments													
Domestic debugging					2,681	2,846	2,953	3,054	2,931	3,030	3,149	3,011	3,334
YoY					-	-	-	-	9.3%	6.4%	6.7%	-1.4%	13.7%
Composition of sales					52.7%	52.4%	51.1%	48.1%	48.1%	41.0%	40.7%	38.0%	39.8%
Global and others					887	1,049	1,118	1,054	1,137	1,536	1,522	1,366	1,484
YoY					-	-	-	-	28.2%	46.3%	36.1%	29.6%	30.4%
Composition of sales					17.4%	19.3%	19.3%	16.6%	18.7%	20.8%	19.7%	17.2%	17.7%
Old sub-segments													
Debugging	3,444	3,480	3,730	3,167	3,023	3,235	3,375	3,424	-	-	-	-	-
YoY	10.8%	6.0%	6.8%	-1.5%	-12.2%	-7.0%	-9.5%	8.1%	-	-	-	-	-
Composition of sales	69.1%	66.5%	68.4%	58.0%	59.4%	59.5%	58.4%	53.9%	-	-	-	-	-
Game Consoles	1,186	1,056	1,341	1,126	1,023	1,147	1,258	1,402	-	-	-	-	-
YoY	21.1%	5.4%	15.9%	10.7%	-13.7%	8.6%	-6.2%	24.5%	-	-	-	-	-
Composition of sales	23.8%	20.2%	24.6%	20.6%	20.1%	21.1%	21.8%	22.1%	-	-	-	-	-
Mobile solutions	2,013	2,171	2,141	1,848	1,819	1,959	2,005	1,870	-	-	-	-	-
YoY	1.0%	1.7%	2.0%	-4.9%	-9.6%	-9.8%	-6.4%	1.2%	-	-	-	-	-
Composition of sales	40.4%	41.5%	39.2%	33.8%	35.7%	36.0%	34.7%	29.4%	-	-	-	-	-
Amusement	245	253	248	193	179	130	111	153	-	-	-	-	-
YoY	77.5%	75.7%	4.6%	-24.3%	-26.9%	-48.6%	-55.2%	-20.7%	-	-	-	-	-
Composition of sales	4.9%	4.8%	4.5%	3.5%	3.5%	2.4%	1.9%	2.4%	-	-	-	-	-
Creative	350	307	282	285	311	367	372	398	-	-	-	-	-
YoY	-31.4%	-45.2%	-33.1%	-27.6%	-11.2%	19.6%	32.0%	39.2%	-	-	-	-	-
Composition of sales	7.0%	5.9%	5.2%	5.2%	6.1%	6.8%	6.4%	6.3%	-	-	-	-	-
Media and others	238	306	308	212	234	294	324	286	-	-	-	-	-
YoY	35.5%	32.6%	8.7%	-19.4%	-1.5%	-3.9%	5.0%	34.5%	-	-	-	-	-
Composition of sales	4.8%	5.9%	5.7%	3.9%	4.6%	5.4%	5.6%	4.5%	-	-	-	-	-
Operating profit	189	328	547	327	158	369	655	725	636	733	753	577	639
YoY	-37.2%	-30.9%	18.0%	-9.9%	-16.4%	12.4%	19.7%	121.3%	301.3%	98.5%	14.9%	-20.4%	0.5%
Operating profit margin	3.8%	6.3%	10.0%	6.0%	3.1%	6.8%	11.3%	11.4%	10.4%	9.9%	9.7%	7.3%	7.6%
Enterprise business	-184	2	14	100	-21	-7	64	152	87	144	171	246	29
YoY	-	-	-	-	-	-	363.5%	52.4%	-	-	163.8%	61.9%	33.8%
Segment profit margin	-19.4%	0.3%	1.2%	5.6%	-1.4%	-0.5%	3.8%	6.8%	4.3%	5.1%	5.6%	6.9%	0.8%
Entertainment business	727	760	891	585	517	700	936	923	930	975	978	783	1,036
YoY	7.3%	-8.8%	6.1%	-20.3%	-28.9%	-8.0%	5.0%	57.9%	79.9%	39.3%	4.5%	-15.2%	11.4%
Segment profit margin	18.0%	18.6%	20.6%	16.0%	14.5%	18.0%	23.0%	22.5%	22.9%	21.4%	20.9%	17.9%	21.5%

Note) Total segment sales and operating profit may not match the total because of adjustments in both sales and operating profit.

Source: Omega Investment, based on company data

Financial data II

	2020/3				2021/3				2022/3				2023/3
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
[Statements of income]													
Net sales	4,988	5,234	5,455	5,460	5,093	5,437	5,782	6,355	6,098	7,400	7,747	7,932	8,372
Cost of sales	3,772	3,830	3,949	3,953	3,819	4,002	4,001	4,700	4,271	5,290	5,579	5,645	5,899
Gross profit	1,216	1,403	1,506	1,507	1,273	1,437	1,781	1,655	1,827	2,109	2,167	2,287	2,472
SG&A expenses	1,026	1,074	958	959	1,115	1,067	1,126	1,150	1,191	1,375	1,414	1,709	1,832
Operating profit	189	328	547	327	158	369	655	725	636	733	753	577	639
Non-operating income	3	2	1	1	38	10	24	5	38	31	12	30	5
Non-operating expenses	3	7	7	7	2	3	4	10	4	4	5	21	7
Ordinary profit	189	323	542	542	194	376	675	720	670	760	759	587	637
Extraordinary income		0	0	0		19	32		13	66	1	1	-
Extraordinary expenses		0	0	75	82	13	16	415	2	42	32	35	-
Net profit before income taxes	189	323	542	240	113	381	691	318	681	785	730	552	637
Total income taxes	77	159	162	99	38	122	224	145	189	281	233	38	201
Net profit attributable to owners of the parent	112	165	375	139	99	256	438	180	487	429	445	417	416
[Balance Sheets]													
Current assets	6,717	7,574	7,710	7,453	6,648	7,291	8,017	9,744	9,604	9,848	10,658	10,392	10,874
Cash and deposits	3,650	3,849	3,882	3,739	3,027	3,482	4,085	5,076	4,911	5,435	5,746	5,208	5,573
Notes and accounts receivable	2,677	3,017	3,013	2,985	2,889	3,099	3,201	4,097					
Notes, accounts receivable and contract assets									4,161	3,872	4,372	4,411	4,614
Non-current assets	2,481	3,252	3,227	3,184	3,205	3,167	3,160	4,593	6,321	6,178	6,342	7,172	8,158
Tangible fixed assets	545	646	627	579	560	549	565	598	602	623	621	693	1,067
Intangible fixed assets	793	1,404	1,390	1,379	1,445	1,424	1,433	2,670	4,389	4,244	4,225	5,094	5,206
Goodwill	491	1,066	1,033	1,027	1,032	991	950	2,467	4,175	4,042	3,945	4,763	4,812
Investments and other assets	1,142	1,202	1,209	1,225	1,199	1,193	1,161	1,324	1,330	1,309	1,495	1,384	1,883
Total assets	9,199	10,827	10,938	10,637	9,854	10,459	11,177	14,338	15,925	16,026	17,001	17,565	19,033
Current liabilities	3,621	4,679	4,863	5,135	4,450	4,655	5,061	7,904	8,954	8,775	9,354	9,679	10,759
Short-term borrowings	1,704	2,504	2,506	2,546	2,546	2,551	2,552	4,728	5,534	5,406	5,406	5,421	6,806
Non-current liabilities	622	624	629	63	62	132	135	119	294	55	58	309	162
Long-term debt	48	46	48	-	-	66	65	63	236	-	-	169	-
Total liabilities	4,243	5,304	5,493	5,198	4,513	4,788	5,196	8,024	9,249	8,830	9,413	9,989	10,921
Total net assets	4,955	5,523	5,445	5,438	5,340	5,670	5,980	6,314	6,677	7,196	7,588	7,576	8,111
Shareholders' equity	4,734	5,039	4,919	4,898	4,841	5,172	5,460	5,642	5,983	6,436	6,719	6,776	7,030
Capital	300	300	300	300	300	300	300	300	300	300	300	300	300
Legal capital reserve	366	357	357	355	355	331	331	331	331	338	338	-	-
Retained earnings	6,378	6,543	6,765	6,904	6,848	7,105	7,393	7,575	7,916	8,342	8,626	9,021	9,275
Treasury shares	-2,311	-2,162	-2,503	-2,662	-2,662	-2,565	-2,565	-2,565	-2,565	-2,545	-2,546	-2,545	-2,545
Stock acquisition right	13	13	13	13	13	13	13	13	-	-	-	-	-
Total liabilities and net assets	9,199	10,827	10,938	10,637	9,854	10,459	11,177	14,338	15,925	16,026	17,001	17,565	19,033
[Statements of cash flows]													
Cash flow from operating activities		-5		1,086		101		1,416		1,703		3,077	
Net profit before tax and other adjustments		513		1,296		494		1,504		1,466		2,749	
Cash flow from investing activities		-963		1,018		-261		-1,813		-1,682		-2,537	
Cash flow from financing activities		637		-515		-90		1,730		316		-546	
Free cash flow		958		68		362		3,229		3,385		5,614	
Cash and cash equivalents at end of period		-347		-458		-252		1,341		359		132	
Cash and cash equivalents at beginning of period		4,162		4,162		3,704		3,704		5,041		5,041	
Cash and cash equivalents at end of period		3,814		3,704		3,447		5,041		5,400		5,173	

Source: Omega Investment, based on company data



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