

1Q FY25/5 results in-line with internal plan

Strategic increase in salaries and reinforcing new Consulting Business

SUMMARY

- CNS announced 1Q FY25/5 (Jun-Aug) results at 15:00 on October 11. Topline numbers were net sales -0.1% YoY, operating profit -43.6%, ordinary profit -44.2% and profit attributable to owners of parent -38.4%. According to the financial results supplementary explanation materials, the full-term initial forecast is weighted toward the 2H of the year, and 1Q profit margins were depressed as a result of implementation of the strategic salary increase of roughly 11% from the beginning of the fiscal year, as well as significant downsizing of the structure of the new Consulting Business with a view toward reconfiguration (net sales -81.6% YoY, see table on P2).
- As a recap from the results for FY24/5, in addition to poor performance of CNS Hokkaido, delayed startup of Consulting Business resulted in a 14.5% shortfall of profits from the initial full-term forecast. Newly launched Consulting Business started off with a shortage of consultants, and the business was commenced with existing engineers. Efforts were also focused on building a track record in business transformation design projects, but the inability to hire consultants as planned had a negative impact due to a lack of securing new consulting projects. Consulting Business net sales and gross profit recorded 20% and 30% shortfalls, respectively. The initial forecast for FY25/5 Consulting Business is net sales -61.0% YoY and GP -56.6% (see detailed initial forecasts on P3).

1Q FY25/5 CNS Consolidated Financial Results Summary

JPY mn, %	FY24/5	FY24/5	FY24/5	FY24/5	FY25/5	1Q act	FY25/5	1Q act
[J-GAAP]	1Q act	2Q act	3Q act	4Q act	1Q act	YoY	init CE	ACH ratio
Net sales	1,646	1,651	1,683	1,677	1,645		7,562	21.7%
YoY	17.5	14.3	10.5	3.5	(0.1)		13.6	
<i>by Business</i>								
● Digital Innovation Promotion Business	443	442	457	478	519	17.1	2,367	21.9%
● Big Data Analysis Business	265	293	296	286	321	21.4	1,295	24.8%
● System Infrastructure Business*	449	437	447	447	436	(2.8)	2,219	19.7%
● Business System Integration Business	395	383	383	357	351	(11.2)	1,524	23.0%
● Consulting Business	95	96	100	108	17	(81.6)	156	11.2%
Gross Profit	404	415	421	399	378	(6.4)	1,834	20.6%
GPM (%)	24.5%	25.1%	25.0%	23.8%	23.0%		24.3%	
SG&A expenses	263	233	232	292	298	13.6	1,174	25.4%
Ratio to sales (%)	16.0%	14.1%	13.8%	17.4%	18.1%		15.5%	
Operating profit	141	182	189	108	80		660	12.1%
YoY	33.7	11.5	8.2	(6.8)	(43.6)		6.5	
OPM (%)	8.6%	11.0%	11.2%	6.4%	4.8%		8.7%	
Ordinary profit	145	193	190	123	81	(44.2)	676	11.9%
Profit attributable to owners of parent	89	131	130	111	55	(38.4)	489	11.2%

Source: compiled by Omega Investment from TANSBIN Quarterly Financial Results Summaries.

*System Infrastructure Business includes cloud + on-premise.

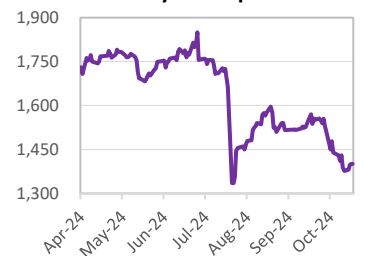
ACH ratio = progress relative to full-term CE.

1Q Follow-up

Financial Indicators

Share price (10/31)	1,401
YH (24/4/18)	2,111
YL (24/8/5)	1,330
10YH (21/8/20)	3,035
10YL (23/1/17)	1,270
Shrs out. (mn shrs)	2.906
Mkt cap (¥ bn)	4.071
EV (¥ bn)	0.709
Equity ratio (8/31)	75.8%
25.5 P/E (CE)	8.3x
25.5 EV/EBITDA (CE)	1.0x
24.5 ROE (act)	13.2%
24.5 ROIC (act)	12.6%
24.8 P/B (act)	1.14x
25.5 DY (CE)	3.50%

6M daily share price



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1Q EARNINGS REVIEW AND FY25/5 FORECAST

- According to the 1Q TANSWIN financial results summary filing, the business environment for the CNS Group continued to show strong client demand for investing in DX toward transformation of business processes / business models, remaining brisk. Net sales of the Digital Innovation Promotion Business increased +17.1% YoY, with GPM increasing from 21.5% → 23.9%, driven by existing projects, new client projects related to ServiceNow, which were acquired in the previous fiscal year, expanded structure of cashless payment service projects, and new development projects from existing clients. Big Data Analysis Business net sales increased +21.4% YoY, relative to the low base of the same period the previous year, which was affected by a decrease in personnel due to organizational restructuring, the number of personnel available to handle projects increased due to an increase in career hires and business partner personnel, with an increase in personnel for existing projects, and several new clients were acquired.
- System Infrastructure Business net sales decreased slightly by -2.8% YoY, despite acquiring new end users leveraging the “U-Way Oracle Cloud VMware Solution Migration and Implementation Support Service,” due to the impact of the completion of projects at existing customers, the freezing of some projects due to customer circumstances, and delayed project starts. Business System Integration Business net sales decreased -11.2% YoY due to a significant reduction in the structure for operation and maintenance projects for some existing customers, and delayed startup of newly acquired projects relative to plan.

1Q FY25/3 CNS Consolidated Financial Results Summary

JPY mn, % [J-GAAP]	FY23/5 1Q act	FY23/5 2Q act	FY23/5 3Q act	FY23/5 4Q act	FY24/5 1Q act	FY24/5 2Q act	FY24/5 3Q act	FY24/5 4Q act	FY25/5 1Q act
Net sales	1,401	1,444	1,523	1,621	1,646	1,651	1,683	1,677	1,645
YoY	3.1	7.2	12.8	18.9	17.5	14.3	10.5	3.5	(0.1)
<i>by Business</i>									
● Digital Innovation Promotion Business	359	352	372	427	443	442	457	478	519
● Big Data Analysis Business	281	287	283	272	265	293	296	286	321
● System Infrastructure Business*	443	473	503	567	449	437	447	447	436
● Business System Integration Business	318	332	366	354	395	383	383	357	351
● Consulting Business	—	—	—	—	95	96	100	108	17
YoY									
● Digital Innovation Promotion Business	29.5	29.1	27.3	24.8	23.4	25.7	22.8	12.0	17.1
● Big Data Analysis Business	29.4	25.9	17.9	4.7	(5.9)	1.9	4.6	5.4	21.4
● System Infrastructure Business*	(16.6)	8.0	4.7	30.2	1.4	(7.7)	(11.1)	(21.3)	(2.8)
● Business System Integration Business	(4.6)	(18.5)	8.1	8.9	24.0	15.3	4.7	0.8	(11.2)
● Consulting Business	—	—	—	—	—	—	—	—	(81.6)
Gross Profit	334	372	398	402	404	415	421	399	378
● Digital Innovation Promotion Business	—	—	—	—	95	109	120	122	124
● Big Data Analysis Business	—	—	—	—	70	79	68	62	68
● System Infrastructure Business*	—	—	—	—	107	108	114	105	104
● Business System Integration Business	—	—	—	—	103	90	91	78	84
● Consulting Business	—	—	—	—	29	30	28	32	(2)
GPM (%)	23.9%	25.7%	26.1%	24.8%	24.5%	25.1%	25.0%	23.8%	23.0%
● Digital Innovation Promotion Business	—	—	—	—	21.5%	24.6%	26.3%	25.5%	23.9%
● Big Data Analysis Business	—	—	—	—	26.4%	26.8%	23.0%	21.8%	21.1%
● System Infrastructure Business*	—	—	—	—	23.9%	24.7%	25.6%	23.4%	23.8%
● Business System Integration Business	—	—	—	—	26.0%	23.5%	23.6%	21.8%	23.9%
● Consulting Business	—	—	—	—	30.8%	31.0%	27.5%	29.7%	—
SG&A expenses	229	208	223	287	263	233	232	292	298
Ratio to sales (%)	16.3%	14.4%	14.7%	17.7%	16.0%	14.1%	13.8%	17.4%	18.1%
Operating profit	106	163	175	116	141	182	189	108	80
YoY	(17.4)	(2.9)	7.4	54.8	33.7	11.5	8.2	(6.8)	(43.6)
OPM (%)	7.5%	11.3%	11.5%	7.1%	8.6%	11.0%	11.2%	6.4%	4.8%
Ordinary profit	112	172	185	119	145	193	190	123	81
Profit attributable to owners of parent (ATOP)	76	114	126	117	89	131	130	111	55

Source: compiled by Omega Investment from TANSWIN Quarterly Financial Results Summaries.

*System Infrastructure Business includes cloud + on-premise.

- As mentioned on P1, Consulting Business net sales decreased -81.6% YOY due to significant downsizing of the structure of the new Consulting Business with a view toward reconfiguration, however, the progress ratio was in-line with internal plan as a result of acquisition of new consulting projects and the early hiring of additional staff for existing projects.
- Following efforts to curtail external PR activities during the previous fiscal year, the ratio of SG&A expenses to sales during the 1Q increased from 16.0% → 18.1% due to an increase in the cost of hiring consultants who can be deployed immediately and the payment of increased fees for outsourcing back-office operations, and as a result, OP decreased -43.6% YoY. The impact of the salary increase of approximately 11% including the base up implemented at the beginning of the current fiscal year, including labor costs included in manufacturing cost of sales, is a 3pp increase in the personnel cost ratio compared to the previous period.
- The CNS Group will celebrate its 40th Anniversary since founding during FY25/5. Initial forecasts are summarized below. The main reason for the slowdown in profit growth relative to accelerating top line growth is factoring in implementation of a uniform 8% base increase and regular salary increases of approximately 11%, which are aimed at improving work ethic and attracting and retaining talented employees, as well as the anticipation of a certain level of expenses due to planned leading investments in innovation creation. The initial dividend indication is for a +1yen hike to ¥49 per share under the new progressive dividend policy (see details on the bottom of P5).

FY25/5 Consolidated Financial Forecast Summary

JPY mn, %	FY23/5 act	FY24/5 act	Pct YoY	FY25/5 init CE	Pct YoY
Net sales	5,989	6,657	11.1	7,562	13.6
Cost of sales	4,483	5,017	11.9	—	
ratio to sales	74.9%	75.4%			
Gross profit	1,506	1,639	8.9	1,834	11.9
GPM (%)	25.1%	24.6%		24.3%	
SG&A expenses	946	1,019	7.7	—	
ratio to sales	15.8%	15.3%			
Operating profit	559	619	10.9	660	6.6
OPM (%)	9.3%	9.3%		8.7%	
Ordinary profit	587	650	10.6	676	4.0
ratio to sales	9.8%	9.8%		9.0%	
Profit ATOP	433	461	6.5	489	6.2
ratio to sales	7.2%	6.9%		6.5%	

Source: compiled by Omega Investment from FY24/5 Results and MTP IR briefing materials.

Net Sales and Gross Profit Forecasts by Division

JPY mn, %	FY24/5		FY25/5		Pct YoY		
	act	act	CE	CE			
Consolidated total	Net sales	% sales	6,657	100.0%	7,562	100.0%	13.6
	GP	GPM (%)	1,639	24.6%	1,834	24.3%	11.9
● Digital Innovation Promotion Business	Net sales	% sales	1,819	27.3%	2,367	31.3%	30.1
	GP	GPM (%)	445	24.5%	551	23.3%	23.8
● Big Data Analysis Business	Net sales	% sales	1,139	17.0%	1,295	17.1%	13.6
	GP	GPM (%)	278	24.5%	294	22.8%	5.6
● System Infrastructure Business	Net sales	% sales	1,779	26.7%	2,219	29.4%	24.7
	GP	GPM (%)	434	24.4%	576	26.0%	32.6
● Business System Integration Business	Net sales	% sales	1,517	22.8%	1,524	20.2%	0.4
	GP	GPM (%)	361	23.8%	360	23.7%	(0.2)
● Consulting Business	Net sales	% sales	399	6.0%	156	2.1%	(61.0)
	GP	GPM (%)	118	29.7%	51	33.0%	(56.6)

Source: compiled by Omega Investment from FY24/5 Results and MTP IR briefing materials.



SHARE PRICE AND VALUATIONS



Key takeaways:

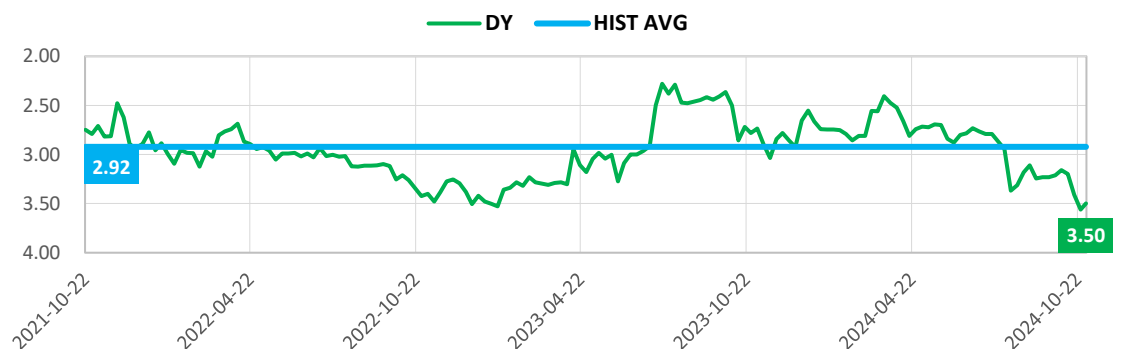
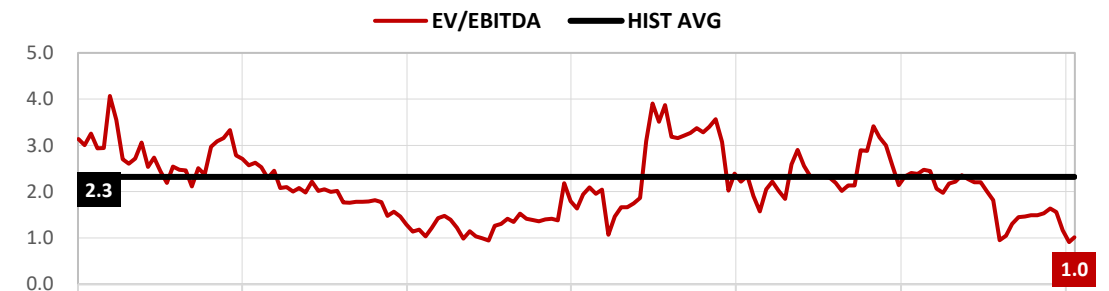
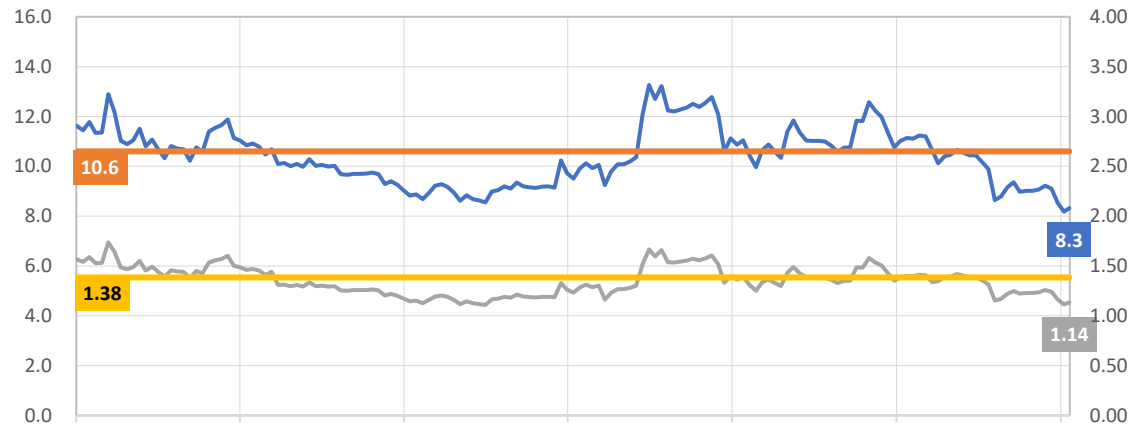
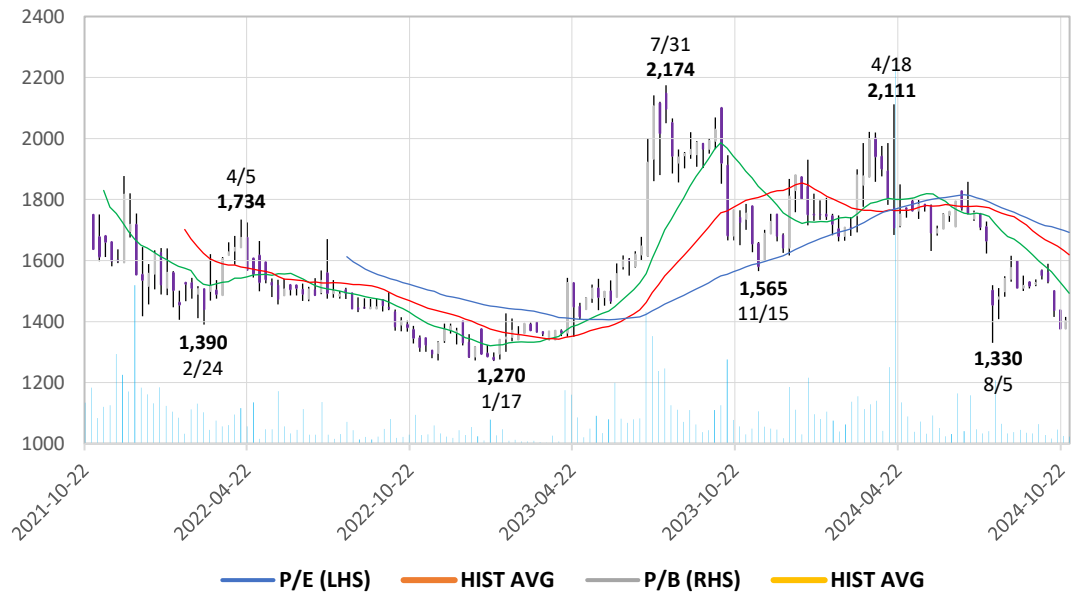
❶ The P/E and P/B ratios are trading 21% and 18% below their respective historical averages.

❷ EV/EBITDA on 1.0x is one of the lowest in the industry by far, and it is trading 55% below its historical average.

❸ The DY at 3.50% is one of the highest among peers, and some have yet to pay a dividend, trading 20% above its historical average.

➔ Even adjusting for the lower liquidity of the TSE Growth Market shown on the following page using the TSE Mothers index, CNS valuations are all trading at the bottom of their listing ranges, presenting a contradiction with the underlying strong earnings, and prospects for double-digit growth to continue for the next 4-5 years. **Apparent weak 1Q results on the surface present an opportunity to buy on weakness.**

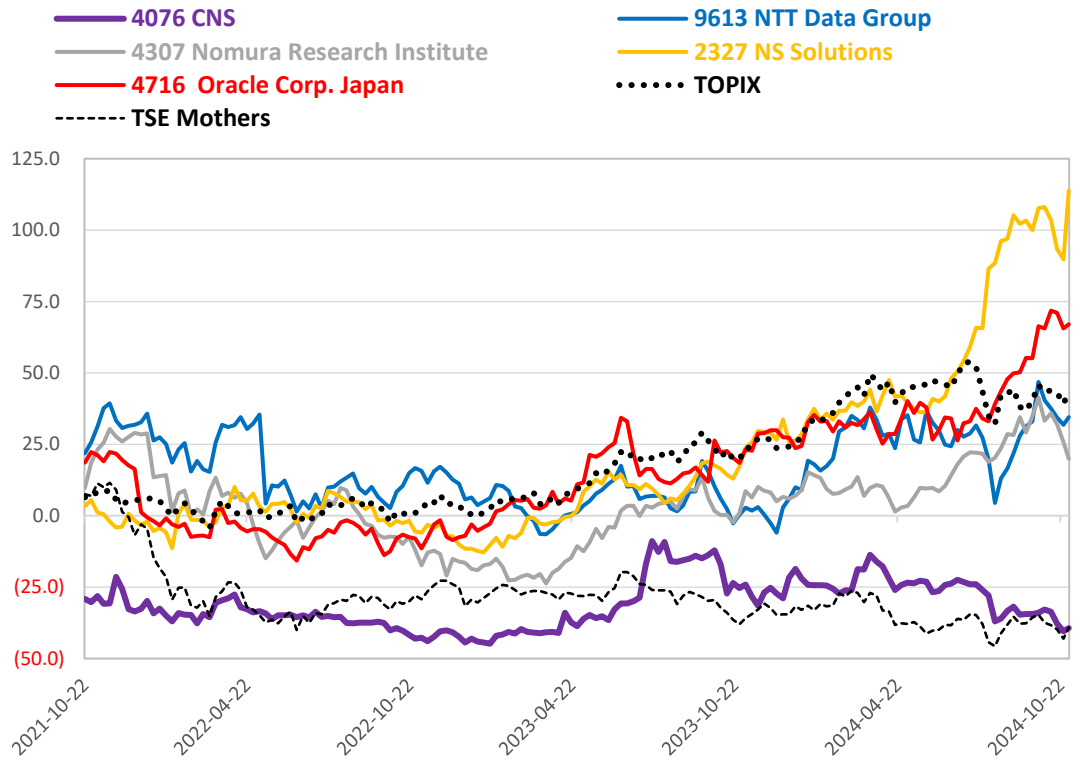
3-Year Weekly Share Price Chart, 13W/26W/52W MA, Volume and Valuation Trends



Source: compiled by Omega Investment from historical price data. Forecast values based on current Company estimates.

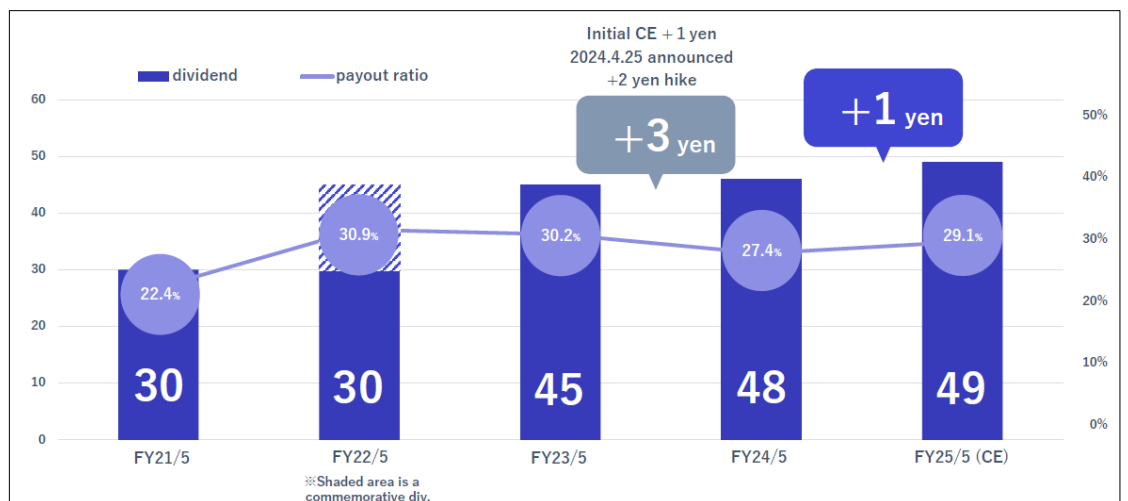
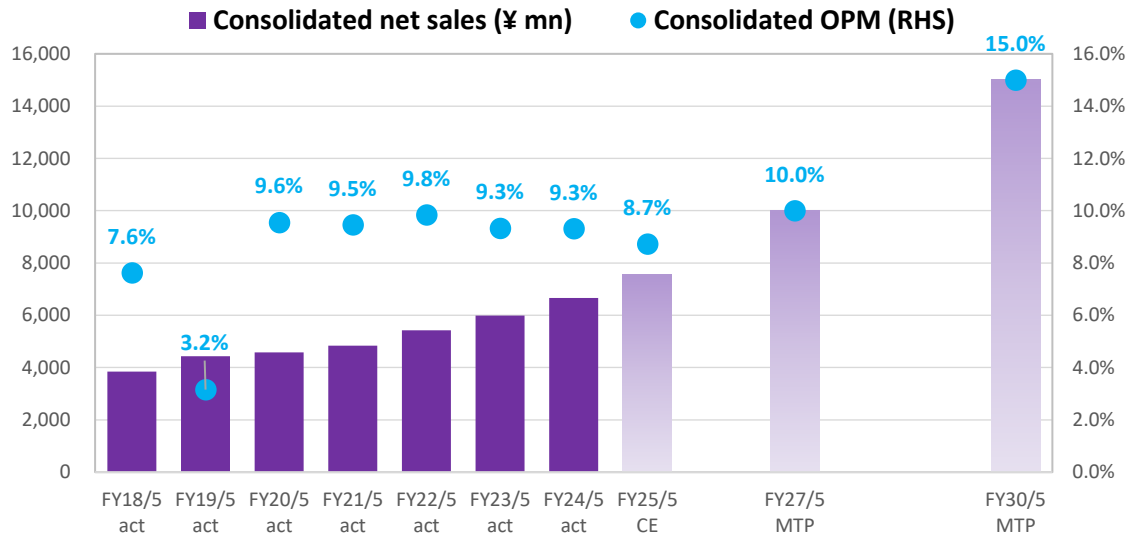


3-Year Relative Share Price Performance versus Major Customers and Partners




Shareholder return policy

Expanding business by quickly identifying changes in the ICT industry and being proactive in taking on challenges in new fields, based on the trust and track record with major system integrators and ongoing relationships with them → these business characteristics enable CNS to secure stable revenues. In order to achieve sustainable growth together with shareholders, continuation of the progressive dividend policy to increase dividends in line with profit growth, with a target payout ratio of 30% or more.



Omega Investment's case for CNS as an attractive opportunity

Omega Investment believes that CNS is one of those rare hidden gems among small cap growth companies waiting to be discovered. First, as an investor, it is reassuring that the Chairman and President are major shareholders, so their financial interests are directly aligned with shareholders. More importantly, management is taking steps to ensure a steady transition from the current DX-driven high market growth to sustainable growth regardless of underlying market conditions, including transforming the profit structure to higher margins not dependent on contract-based orders. 

CNS Consolidated Financial Highlights and Key Indicators

JPY mn, %	FY19/5	FY20/5	FY21/5	FY22/5	FY23/5	FY24/5	FY25/5	FY27/5	FY30/5
[J-GAAP]	act	act	act	act	act	act	init CE	MTP+	MTP+
Net sales	4,434	4,578	4,841	5,419	5,989	6,657	7,562	10,000	15,000
YoY	15.1	3.2	5.8	11.9	10.5	11.1	13.6	14.5	14.5
<i>by Business</i>									
• Digital Innovation Promotion Business			832	1,184	1,509	1,819	2,367		
• Big Data Analysis Business			772	945	1,123	1,139	1,295		
• System Infrastructure Business*			1,833	1,884	1,985	1,779	2,219		
• Business System Integration Business			1,403	1,405	1,370	1,517	1,524		
• Consulting Business			—	—	—	399	156		
<i>Sales breakdown</i>									
• Digital Innovation Promotion Business			17.2%	21.8%	25.2%	27.3%	31.3%		
• Big Data Analysis Business			15.9%	17.4%	18.7%	17.1%	17.1%		
• System Infrastructure Business*			37.9%	34.8%	33.1%	26.7%	29.3%		
• Business System Integration Business			29.0%	25.9%	22.9%	22.8%	20.2%		
• Consulting Business			—	—	—	6.0%	2.1%		
Gross Profit	711	973	1,148	1,322	1,506	1,639	1,834		
• Digital Innovation Promotion Business			249	313	382	445	551		
• Big Data Analysis Business			218	282	333	278	294		
• System Infrastructure Business*			373	425	459	434	576		
• Business System Integration Business			306	301	330	361	360		
• Consulting Business			—	—	—	118	51		
GPM (%)	16.0%	21.3%	23.7%	24.4%	25.1%	24.6%	24.3%		
• Digital Innovation Promotion Business			29.9%	26.4%	25.3%	24.5%	23.3%		
• Big Data Analysis Business			28.2%	29.8%	29.7%	24.4%	22.7%		
• System Infrastructure Business*			20.3%	22.6%	23.1%	24.4%	26.0%		
• Business System Integration Business			21.8%	21.4%	24.1%	23.8%	23.6%		
• Consulting Business			—	—	—	29.6%	32.7%		
SG&A expenses	571	536	690	789	947	1,019	1,174		
Ratio to sales (%)	12.9%	11.7%	14.3%	14.6%	15.8%	15.3%	15.5%		
Depreciation	14	16	20	25	30	34	40		
EBITDA	154	454	478	559	589	654	700		
Operating profit	140	437	458	533	559	620	660	1,000	1,800
YoY	(52.4)	212.3	4.8	16.4	4.8	10.9	6.5	17.3	21.6
OPM (%)	3.2%	9.6%	9.5%	9.8%	9.3%	9.3%	8.7%	10.0%	12.0%
Ordinary profit	276	486	490	594	588	650	676		
Total income taxes	66	156	147	185	156	175	—		
Profit attributable to owners of parent	143	325	337	409	433	461	489		
Total assets	2,423	2,803	3,139	4,152	4,547	4,934	—		
Total shareholders' equity	1,445	1,720	1,994	3,039	3,341	3,672	—		
Shareholders' equity ratio	59.6%	61.4%	63.5%	73.2%	73.5%	74.4%	—		
Total cash dividends	50	63	75	131	131	139	—		
DOE	—	4.0%	4.0%	5.2%	4.1%	4.0%	—		
Net profit	143	325	337	409	433	461	489		
Payout ratio	35.1%	19.3%	22.3%	31.9%	30.2%	30.2%	—		
ROE	—	20.6%	18.1%	16.3%	13.6%	13.2%	—		
NOPAT (OP - income taxes)	74	281	312	348	403	445	—		
Invested capital (IBD + net assets)	1,555	1,728	2,001	3,045	3,354	3,683	—		
• Interest-bearing debt	110	8	7	6	13	11	—		
• Net assets	1,445	1,720	1,994	3,039	3,341	3,672	—		
ROIC	—	17.1%	16.7%	13.8%	12.6%	12.6%	—		

Source: compiled by Omega Investment from IR results briefing materials and Annual Securities Reports (YUHO financial statements).

*Note: System Infrastructure Business includes cloud and on-premise (separately disclosed weight of cloud in FY22/5 was 61%).

+Note: MTP YoY figures for FY27/3 and FY30/3 are expressed as 3-year CAGR.



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