



## Digital Hearts Holdings (3676)

TSE1

### Company revises down full-term guidance, and gets an early start on structural reforms in light of coronavirus

#### ➤ Revisions to FY3/20 Full-term Consolidated Guidance

[JPY, mn, %]	(Initial CE)	(Revised CE)	(Chg)	(Chg, %)
• Net Sales	23,000	→ 21,100	-1,900	-8.3
• Operating profit	1,800	→ 1,400	-400	-22.2
• Ordinary profit	1,830	→ 1,380	-450	-24.6
• Profit attributable to owners of parent	1,250	→ 800	-450	-36.0
• EPS(¥)	57.14	→ 36.67		

➤ Regarding the downward revisions to FY3/20 full-term guidance, they were within expectations (for sales, OP and ordinary profit) consistent with achievement rates through the 3Q against initial full-term guidance.

➤ At the same time, in light of the earnings impact from the spread of novel coronavirus infections, the company got off to an early start on structural reforms, booking an extraordinary loss of ¥70mn including related restructuring expenses. As a result, profit attributable to owners of parent will decline by nearly -50% YoY.

➤ While there are many unclear aspects about the positive and negative effects on the software testing industry from the coronavirus crisis, the company has initiated a swift response, looking beyond to the post-coronavirus world.

#### 1. Revised FY3/20 full-term guidance is for net sales +9.6% (initial CE +19.5%) and OP -12.8% (initial CE +12.1%)

**Net sales:** this is basically in line with 9-months cumulative 3Q net sales +8.9%. For mainstay Entertainment Business, due to postponements of game title developments by client firms coming into the 4Q in the wake of the spread of COVID-19, full-term net sales will post a shortfall.

#### Digital Hearts Holdings Consolidated Earnings Trend

JPY mn, %	Net Sales	YoY %	Oper. Profit	YoY %	Ord. Profit	YoY %	Profit ATOP	YoY %	EPS (¥)
FY2016/3 act	15,011	13.0	1,963	29.4	1,958	28.4	361	-33.0	15.72
FY2017/3 act	15,444	2.9	1,906	-2.9	1,997	2.0	795	120.2	35.58
FY2018/3 act	17,353	12.4	1,735	-9.0	1,782	-10.8	1,200	50.9	55.14
FY2019/3 act	19,254	11.0	1,605	-7.5	1,651	-7.4	1,575	31.3	72.13
FY2020/3 init CE	23,000	19.5	1,800	12.1	1,830	10.8	1,250	-20.7	57.14
FY2020/3 rev'd CE	21,100	9.6	1,400	-12.8	1,380	-16.4	800	-49.2	36.67
Change (rev'd CE – init CE)	-1,900		-400		-450		-450		
Change (%)	-8.3		-22.2		-24.6		-36.0		

Source: compiled by Sessa Partners from company IR materials

#### Focus Points

Pioneer specialist firm in software testing. Aiming to become Asia's no.1 comprehensive test solutions provider by expanding enterprise business.

#### Key Indicators

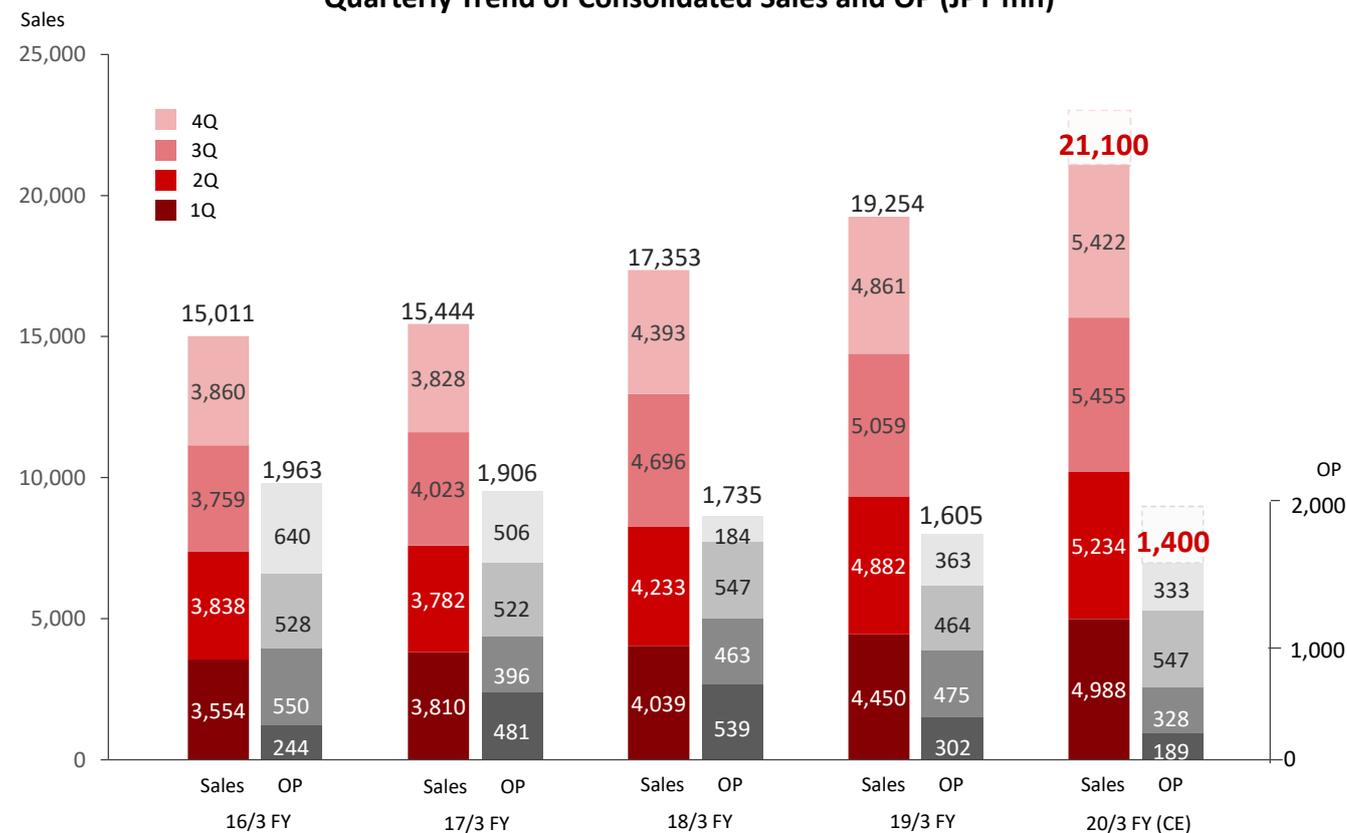
Share price (4/27)	752
YH (20/2/10)	1,118
YL (20/3/23)	552
10YH (16/9/29)	2,200
10YL (20/3/23)	552
Mkt cap (¥ bn)	17.9
Shrs out. (mn shrs)	23.89
Shr eqty ratio (Sep 30)	46.7%
FY3/20 P/E (rev'd CE)	20.5x
FY3/19 P/B (act)	3.4x
FY3/19 ROE (act)	38.6%
FY3/20 DY (CE)	1.86%



Analyst, Takafumi Yamawaki  
research@sessapartners.co.jp

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### Quarterly Trend of Consolidated Sales and OP (JPY mn)



Source: compiled by Sessa Partners from company IR materials

At the same time, for growing Enterprise Business, while full-term net sales will post a sharp increase YoY on steady progress in winning new projects, they will still fall short of the high hurdle in initial guidance. As a result, full-term FY3/20 net sales guidance was revised down by ¥1,900mn from ¥23,000mn (+19.5%) → ¥21,100mn (+9.6%), which still renews a record high. As can be seen from the graph above, revised guidance implies 4Q-only net sales of ¥5,422mn (+12%).

**OP and ordinary profit:** OP was revised down by ¥400mn from ¥1,800mn (+12.1%) → ¥1,400mn (-12.8%), and in addition to the aforementioned shortfall in net sales, Entertainment Business saw a deterioration of profitability in overseas business as well as weakness in Creative Business. Ordinary profit was revised down by ¥450mn from ¥1,830mn (+10.8%) → ¥1,380mn (-16.4%), and while initial guidance called for both OP and ordinary profit to increase by double digits, revised guidance is for double-digit declines. As can be seen from the graph above, revised guidance implies 4Q-only OP of ¥333mn (-8%).

**Profit attributable to owners of parent:** the company booked an extraordinary loss, getting off to an early start on structural reforms in response to the coronavirus crisis. In weighing optimizing the balance of operating labs (test centers) nationwide, the company decided to close the Shinjuku Lab, one of 3 test centers in Tokyo, booking related expense of ¥40mn. In addition, the company is consolidating the Vietnam base of acquired group company US firm LogiGear (acquired in Aug-2019), with associated restructuring expense of ¥20mn, booking a total extraordinary loss of ¥70mn. As a result, profit attributable to owners of parent was revised down by ¥450mn from ¥1,250mn (-20.7%) → ¥800mn (-49.2%).

## 2. Impact of the coronavirus crisis and the company's response

**Pros and cons of the coronavirus crisis:** the positive effects of the coronavirus crisis on the company's earnings include: a) for Entertainment Business, increased demand for games-related business from stay-at-home consumption, and b) for Enterprise Business, a rapid increase in corporate IT investment in the wake of the widespread implementation of employees teleworking from home including security protocols.

At the same time, negative effects include: c) for Debugging within Entertainment Business, this business involves working with highly sensitive information regarding game software before launch, and in the past test personnel worked at test centers installed with advanced security, however the current crisis requires this system to be reconfigured, d) progress in Debugging business and System Testing business may be hindered due to delays in development projects at client firms, and e) uncertainties about the economy and social conditions post-coronavirus.

Negative factors d) and e) are out of the company's control, however regarding factor c), the company issued a press release on April 7, "DIGITAL HEARTS starts 'Remote Debugging,' in which testers conduct debugging operation of game software at home —A hybrid system of operations at test centers and at home that ensures stable services with quality—." This allows test personnel to perform debugging work for mobile software games at home, in line with government policy and directives, moving ahead with building a system which can flexibly respond to changes in the environment.

In addition, as mentioned above, the company started early restructuring of both Japan and overseas business as a measure to deal with the coronavirus crisis and the uncertainties of the economic and social situation. In the future, while the business outlook is expected to remain difficult, the company is gradually advancing measures to deal with the uncertainty.

Financial results for FY3/20 are scheduled to be announced on May 12.

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**Sessa Partners Inc.**

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