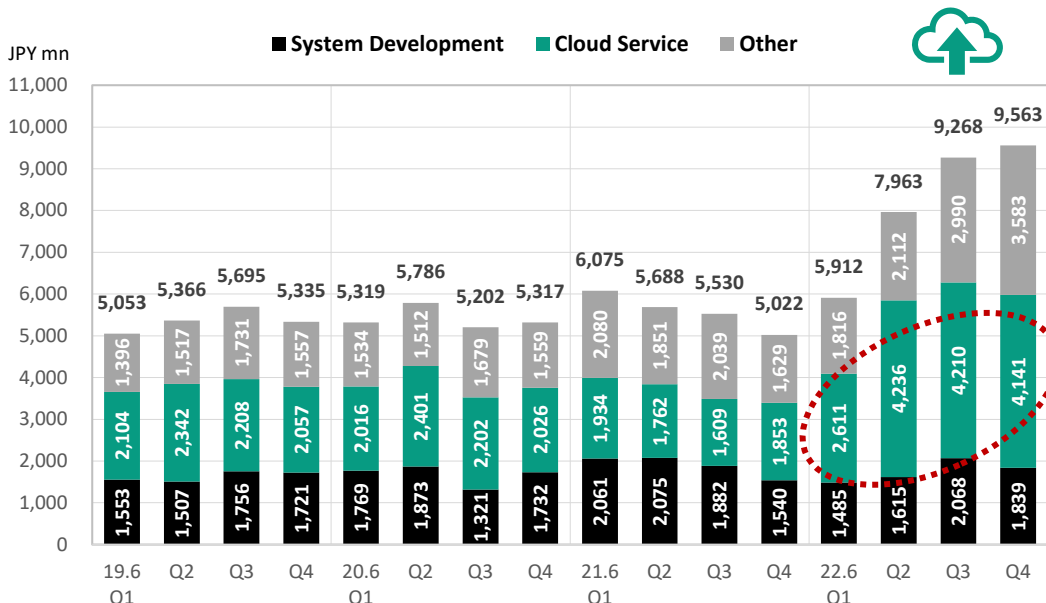


Cloud service business turns profitable FY23/6 1Q and 1H set to post double-digit sales growth

SUMMARY

- At the 4Q FY6/22 results briefing held on 8/5, as usual, CEO Kunimitsu Sato conducted the explanation of results for the period. Having been inaugurated to his current position in Sep-2020, this month marks the completion of his first two years in office. SIR's clear impression of his briefing this time was one of growing confidence, as focus initiative cloud service business turned profitable in year six. 1H orders for cloud service of ¥2,876mn (up 14x YoY) accounted for nearly 40% of total 1H orders, and the graph below shows cloud service as the main driver of the unprecedented increase in backlogs. Initial guidance for FY23/6 is for cloud service sales to increase 70.5% YoY, and gross profit to increase 2.5x.
- Another important implication for FY23/6 from the record level of backlogs is that 1Q results in November and 1H results next February are set to post double-digit growth in net sales, providing a pipeline of positive catalysts going forward. In addition to the startup of cloud service for new users, IWI is securing demand from existing customers to develop new functions based on stronger-than-expected growth in members, etc.
- On fundamentals, the P/E and EV/EBITDA are trading on 15% and 10% discounts to historical averages, respectively, and the DY of 2.38% is 13% above the historical average, in part reflecting the new 40% payout policy adopted last term. Provided there is not an unforeseen deterioration in security business, OPM is set to top 15% in FY24/6, drawing further attention to present undervaluation levels.

4Q total backlogs rose +3.2% QoQ and +90.4% YoY, posting a record high



Source: compiled by Sessa Partners from company IR results briefing materials.

4Q Follow-up



Focus Points:

Systems integrator boasting an overwhelming share with credit card companies in FEP systems development for nonstop secure datacenter connection packages.

Key Indicators

Share price (8/31)	924
YH (22/8/31)	924
YL (22/1/27)	490
10YH (18/10/24)	1,180
10YL (13/1/4)	173.0
Shrs out. (mn shrs)	26.34
Mkt cap (¥ bn)	22.178
EV (¥ bn)	18.246
Equity ratio (6/30)	63.1%
23.6 P/E (CE)	17.3x
23.6 EV/EBITDA (CE)	6.5x
22.6 P/B (act)	2.75x
22.6 ROE (act)	13.5%
23.6 DY (CE)	2.38%

6M price chart (weekly)



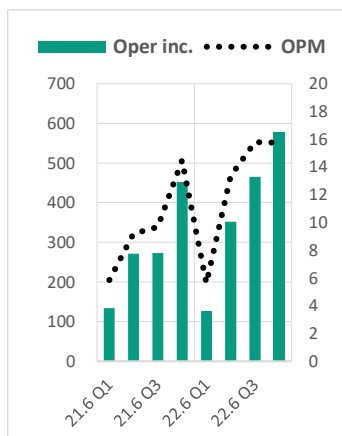
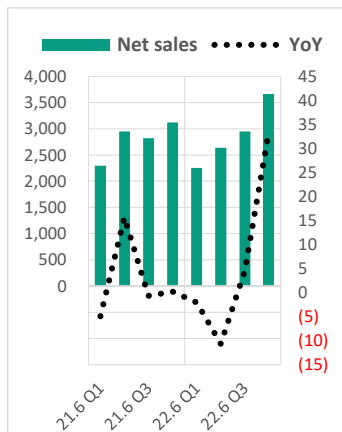
Source: SPEEDA price data

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This report was prepared by Sessa Partners on behalf of INTELLIGENT WAVE INC. Please refer to the legal disclaimer at the end for details.



Note: in the past, IWI has provided initial guidance for sales by category. From this year, initial guidance for sales shown at the bottom of P3 is broken down by payment & finance, cloud service and security, in line with MTP focus business strategies.

Review of “15 ALL” MTP on PP 6-7, new sustainable growth initiatives, business strategies and 2025 targets summarized on PP 7-8.

Sharp dividend hike on 15% profit overshoot Revised rolling MTP reflects growing confidence

SUMMARY

- IWI announced FY22/6 4Q financial results at 15:30 on Wednesday 8/03, and it plans to hold a briefing at 10:00 on Friday 8/5. As previewed in our 3Q Follow-up Report, full-term OP posted a 15.1% overshoot to guidance, up +34.4% YOY, and IWI hiked DPS by 21.4% (see below). One of the key drivers to strong profits was cloud service business turning profitable (cloud service net sales ¥1,173mn (+24.5%), orders ¥3,461mn (+350.7%) and backlogs ¥4,141mn (+123.5%).
- Along with 4Q results, IWI also published its revised rolling 3-year MTP (bottom table). Initial guidance for FY23/6 is net sales ¥13,500mn (+17.5%) and OP ¥1,800mn (+18.4%), with OPM of 13.3%, on track to reach its mid-term target of 15.0%. Based on the 8/19 closing price of 842, the share price is trading on a P/E of 17.3x and DY of 2.38%.

IWI FY22/6 Q4 Non-consolidated Financial Results Summary

JPY mn, %	FY21/6 act	FY22/6 init CE	FY22/6 act	CHG AMT	PCT YoY	FY23/6 init CE	CHG AMT	PCT YoY
Net sales	11,188	12,000	11,493	306	2.7	13,500	2,007	17.5
YoY (pct)	2.4	7.3	2.7			17.5		
• System software develop	5,272	5,850	5,357	85	1.6	NA		
• Software maintenance	1,357	1,440	1,502	145	10.7	NA		
• In-house pkg software	335	400	354	19	5.7	NA		
• Cloud service	942	1,130	1,173	231	24.5	NA		
• Hardware	1,638	1,730	1,755	117	7.1	NA		
• Third party pkg software	509	250	350	(159)	(31.2)	NA		
• Security products	1,131	1,200	998	(133)	(11.8)	NA		
Gross income	3,157	NA	3,699	542	17.2	NA		
GPM (%)	28.2%	NA	32.2%			NA		
Operating income	1,131	1,320	1,520	389	34.4	1,800	280	18.4
OPM (%)	10.1%	11.0%	13.2%			13.3%		
Ordinary income	1,171	1,360	1,556	385	32.9	1,840	284	18.2
Net income	841	940	1,056	215	25.5	1,280	224	21.2
ROE (%)	11.6%	NA	13.5%			NA		
Total dividend payment	341	NA	446	105	30.8	NA		
Payout ratio (%)	40.6%	39.8%	42.3%			41.1%		
DOE (%)	4.7%	NA	5.7%			NA		
Net assets	7,568	NA	8,039	472	6.2	NA		
Equity ratio (%)	67.9%	NA	63.1%			NA		
EPS (¥)	31.98	35.76	40.16			48.70		
DPS (¥)	13.00	14.00	17.00			20.00		
BPS (¥)	287.85	NA	305.87			NA		

Source: compiled by SIR from TANSBIN financial statements. Note: figures reported in thou. yen rounded to nearest mn.

IWI Rolling Medium-Term Business Plan 2025

JPY mn, %	Previous Plan				Revised Plan			
	FY21/6 act	FY22/6 init CE	FY23/6 MTP	FY24/6 MTP	FY22/6 act	FY23/6 init CE	FY24/6 MTP	FY25/6 MTP
Net sales	11,188	12,000	13,500	15,000	11,493	13,500	15,000	16,500
YoY (pct)	2.4	7.3	12.5	11.1	2.7	17.5	11.1	10.0
OP	1,131	1,320	1,750	2,250	1,520	1,800	2,250	2,500
OPM (%)	10.1%	11.0%	13.0%	15.0%	13.2%	13.3%	15.0%	15.2%

Source: compiled by SIR from company press release.

Despite the slight shortfall in sales to initial guidance, FY22/6 sales were driven by recurring stock business categories software maintenance and cloud service, as well as a recovery in high-margin hardware sales for FEP renewal projects and new cloud service customers.

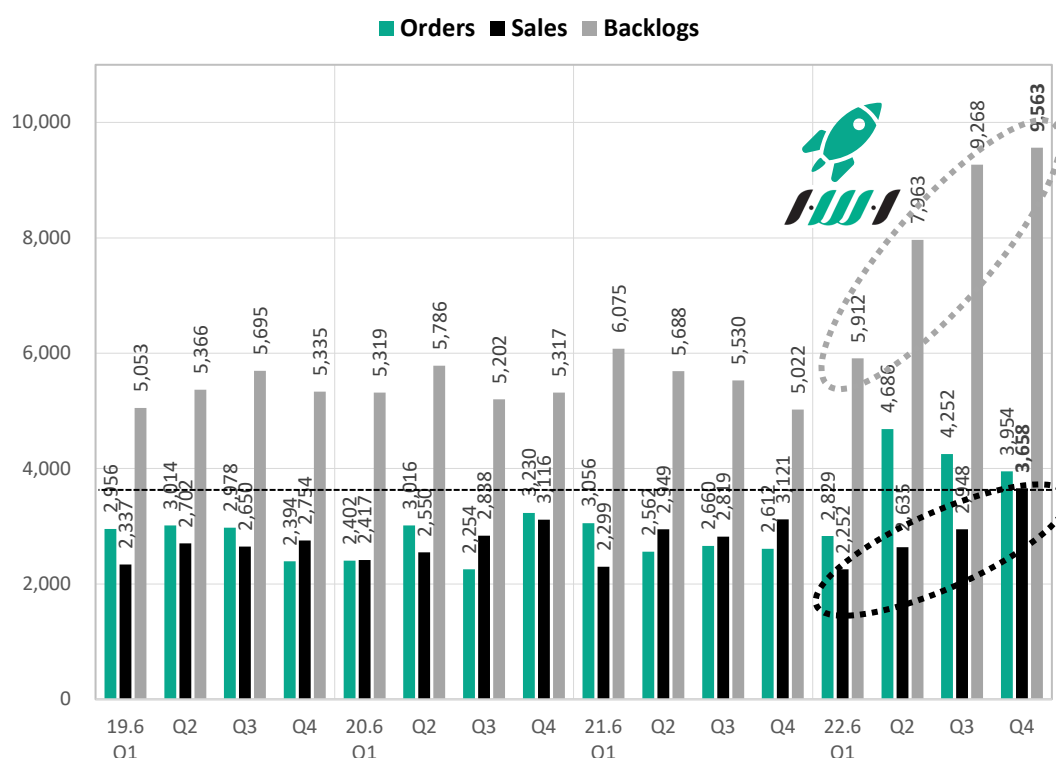
Combined with cloud service business turning profitable, OP posted a 15.1% overshoot to guidance, up +34.4% YoY.

IWI FY22/6 and 4Q-only Trend of Sales by Categories

JPY mn, %	FY6/21		FY6/22		CHG	PCT	FY6/21		FY6/22		CHG	PCT
	12M	12M	AMT	YoY			4Q-only	4Q-only	AMT	YoY		
Net sales	11,188	11,493	306	2.7			3,121	3,659	538	17.2		
• System software develop	5,272	5,357	85	1.6			1,562	1,498	(64)	(4.1)		
• Software maintenance	1,357	1,502	145	10.7			365	391	26	7.1		
• In-house pkg software	335	354	19	5.7			68	35	(33)	(48.5)		
• Cloud service	942	1,173	231	24.5			240	380	140	58.3		
• Hardware	1,638	1,755	117	7.1			299	926	627	209.7		
• Third party pkg software	509	350	(159)	(31.2)			78	113	35	44.9		
• Security products	1,131	998	(133)	(11.8)			509	314	(195)	(38.3)		

Source: compiled by SIR from TANSIN financial statements and company IR results briefing materials.

Brisk growth in orders boosted 4Q sales and backlogs to new levels (JPY million)



Source: compiled by SIR from TANSIN financial statements and company IR results briefing materials.

★FY23/6 1Q and 1H results set to post double-digit sales growth

Another important implication from the record level of backlogs is that 1Q results in November and 1H results next February are set to post double-digit growth in net sales, providing a pipeline of positive catalysts going forward.

IWI FY23/6 Non-Consolidated Initial Financial Forecasts

JPY mn, %	FY2022/6			FY2023/6			PCT
	1H act	2H act	FY act	1H CE	2H CE	FY CE	
Net sales	4,887	6,606	11,493	6,800	6,700	13,500	17.5
YoY	(6.9)	11.2	2.7	39.1	1.4	17.5	
• Payment & Finance	3,956	5,366	9,322	5,320	4,830	10,150	8.9
• Cloud Service	493	680	1,173	880	1,120	2,000	70.5
• Security	438	560	998	600	750	1,350	35.3
Operating income	478	1,041	1,519	900	900	1,800	18.5
ratio to sales	9.8%	15.8%	13.2%	13.2%	13.4%	13.3%	
Ordinary income	499	1,057	1,556	920	920	1,840	18.3
ratio to sales	10.2%	16.0%	13.5%	13.5%	13.7%	13.6%	
Net income	337	718	1,055	640	640	1,280	21.3
ratio to sales	6.9%	10.9%	9.2%	9.4%	9.6%	9.5%	

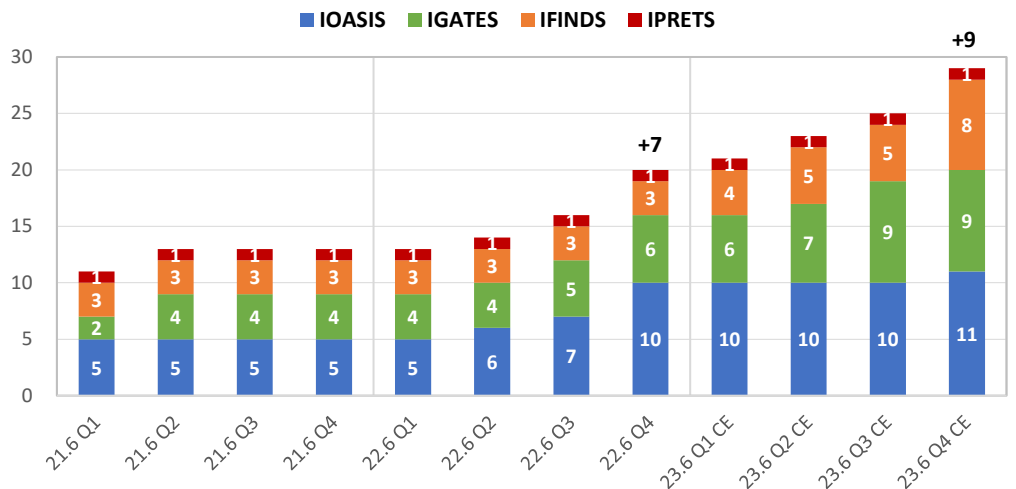
Source: compiled by SIR from company IR results briefing materials.



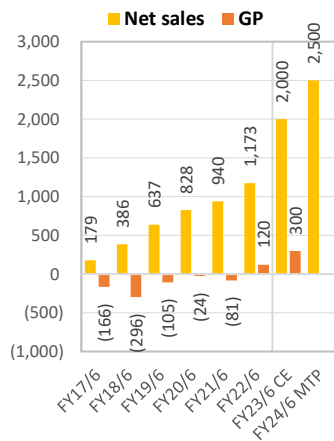
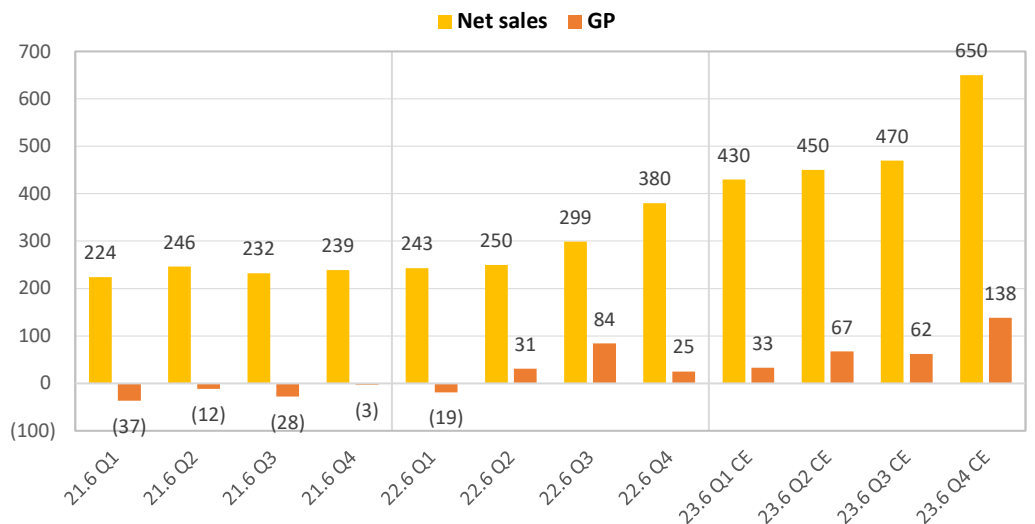
Cloud Functionality Service

- IPRETS:** Point rebate system
- IFINDS:** Card fraud detection
- IGATES:** Switching, gateway
- IOASIS:** Merchant acquiring

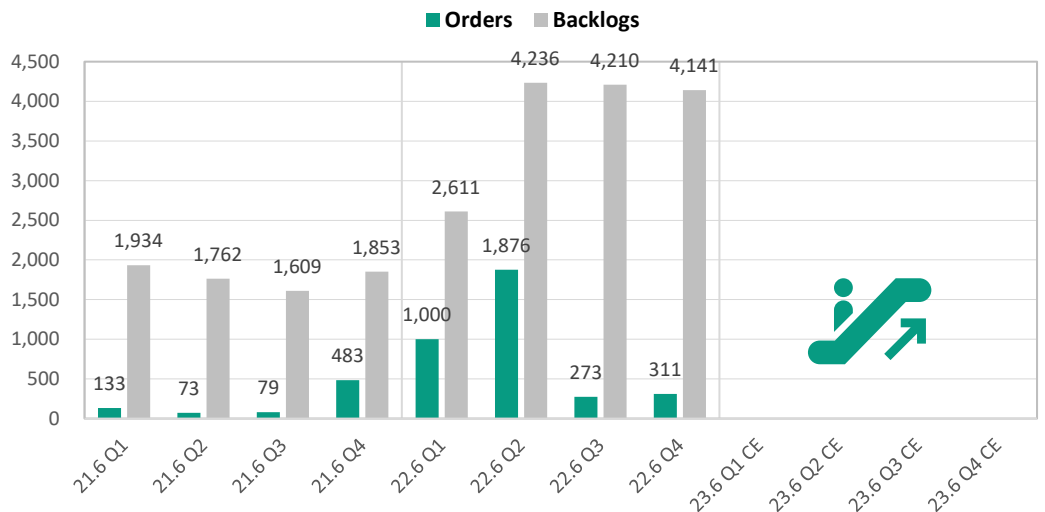
Cloud services: number of customers by service lines: targeting 29 by 4Q FY23/6



Cloud GP turned profitable on declining fixed costs, higher operating efficiency

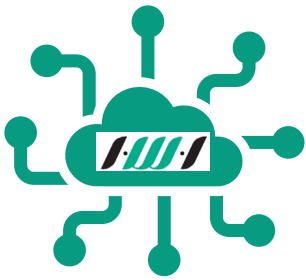


Brisk FY22/6 orders steadily extending visibility out to FY24/6 MTP target sales



In cloud service, orders for IOASIS one-of-a-kind merchant acquiring startup core systems in the 1H came from a telecom carrier, major global manufacturer, major credit card company and a retailer (enterprise customers).

Source: compiled by Sessa Partners from IR briefing materials.



IGATES: Gateway/Switching

ASP cloud service that inherits payment network connectivity/switching function of flagship NET+1 (for online authorization, clearing, switching to destination networks). 24/7 operation that facilitates central management of secure connection support to multiple payment networks such as Visa (EAS), Mastercard (MIP), CAFIS, JCN, as well as ATM network, direct connection with issuers and internet connection for smartphone payment. Benefits of introduction relative to a separate on-premise FEP system include:

- Reduction of initial costs
- Reduction of client systems operation load for monitoring
- Peace of mind for maintaining operations w/o holding assets

IFINDS: Card Fraud Detection

ASP cloud service that inherits fraud detection function for unauthorized card use of flagship ACE Plus. Real-time checking of domestic and overseas credit requests based on pre-set rules and scoring functions (please refer to the diagram on P14 for features overview). Same benefits of introduction as IGATES.

IOASIS: Merchant Acquiring

ASP cloud service that provides core systems for rapid startup of acquiring operations such as external connection with international brands and cashless payment companies, authorization, and management of payment at affiliate merchant stores. Compatible with both Visa and Mastercard, it is PCI-DSS compliant, built in a robust datacenter and supports 24/7 operation. Benefits of introduction relative to a separate on-premise FEP system include:

- Reduction of initial costs
- Shorter time period until launching service
- Peace of mind for maintaining operations w/o holding assets

Priority initiative on porting flagship FEP applications to ASP cloud services

One of the unavoidable characteristics of system integrator business is a certain amount of order volatility due to macroeconomic impacts on client capex. A focus initiative is switching to a recurring (stock) revenue model for cloud services. As startup costs disappear and revenue gains critical mass, this business is set to turn profitable. Descriptions of the three main cloud service applications are shown on the left, with **IOASIS for merchant acquiring being the only one of its kind available**. The exhibits on the previous page highlight that this business is now moving to a new stage after achieving critical mass, turning profitable on declining fixed costs and higher efficiency.

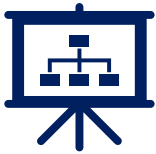
Flagship on-premise FEP infrastructure solutions for credit card authorization



Recurring fee-based ASP cloud solutions for credit card-related business



Source: IWI website – SERVICE/PRODUCTS. Photos licensed from Adobe Stock.



Review of MTP “15 ALL”



Yleisradio Oy, Finnish Broadcasting Company



★ While revenue for this solution is still small, it likely has good potential as terrestrial broadcasters move to offer new simultaneous livestream distribution service in response to viewers increasingly shifting away from the family room TV to mobile device platforms connected to the internet.

Previous Rolling MTP “15 ALL” Key Initiatives

The rolling MTP announced together with 21.6 Q4 financial results is targeting 3-year net sales CAGR of +10.3%, and 3-year OP CAGR of +25.8%. “15 ALL” refers to FY24/6 target net sales ¥15.0bn and OPM 15.0%.

① Hybrid IT infrastructure in mainstay payment business market

The benefit to prospective cloud service clients is an affordable scheme to lease the service, fixing the running costs including maintenance, with much shorter installation times and without the burden of adding to fixed assets. (please see P5: hybrid = on-premise flagship FEP + ASP cloud services).

② Expansion of business domain

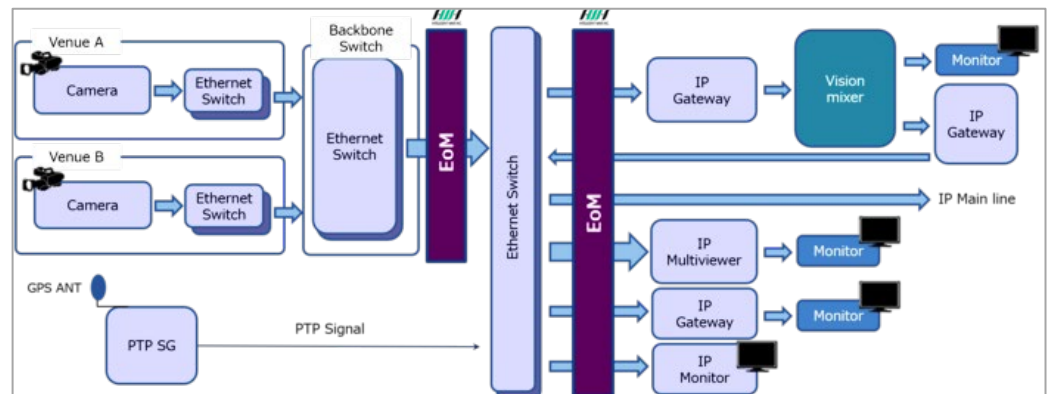
Promotion of DX (digital transformation) leads many industries worldwide to requiring real-time and high-speed bulk data processing. IWI is expanding domestic EoM users (see explanation below) such as TV Asahi, JDS, QVC Japan, and the company won an order from Finland’s public broadcaster Yle, confirming business viability overseas. New business R&D is also examining potential solutions for connected cars and medical IoT devices, etc.

③ DNP Group Synergies

Operational Technology (OT) is hardware and software that detects or causes a change through the direct monitoring and/or control of physical devices, processes and events in the enterprise. Promote business synergy for DNP’s assets and IWI’s technology, starting with OT security for “smart factories” (DNP’s own plants, then client facilities).

EoM IP Flow Monitoring Solution for Broadcasting

In addition to cloud services, another promising new business area for the company is leveraging its experience and know-how in FPGA’s (Field Programmable Gate Arrays) to develop an EoM hardware/software solution for **broadcasting**. A big shift towards IP transmission is taking place as transferred data gets bigger with the spread of 4K/8K broadcasting. EoM monitors latency, jitter and packet drop rate to preserve broadcast data quality. This uses a low latency L1 switch with FPGA made by Arista Networks. **EoM visualizes and monitors the communication status of IP flows between bases in real time.** It achieves high-speed processing of large amounts of data by utilizing hardware with FPGAs, drawing on IWI’s strengths in network communications technology.



Source: excerpt from IR results briefing materials



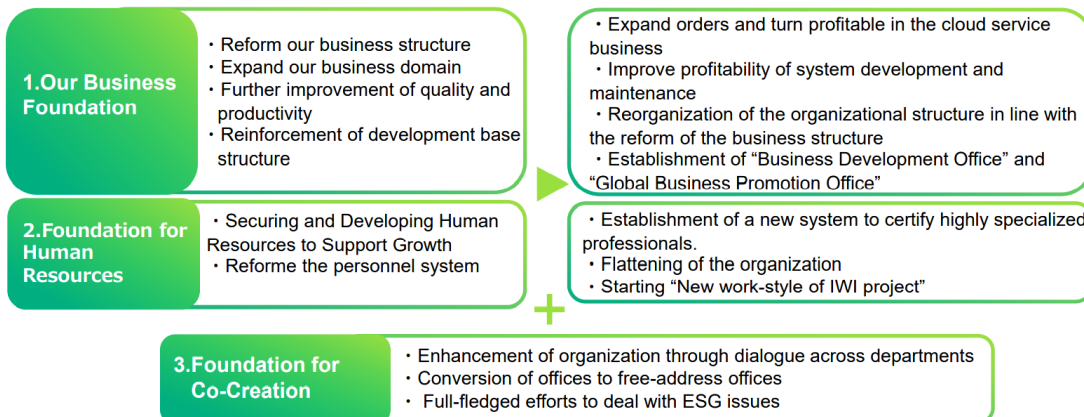
Progress of MTP “15 ALL” and new targets for Rolling MTP 2025

Initiatives for sustainable growth included in the new Rolling MTP 2025

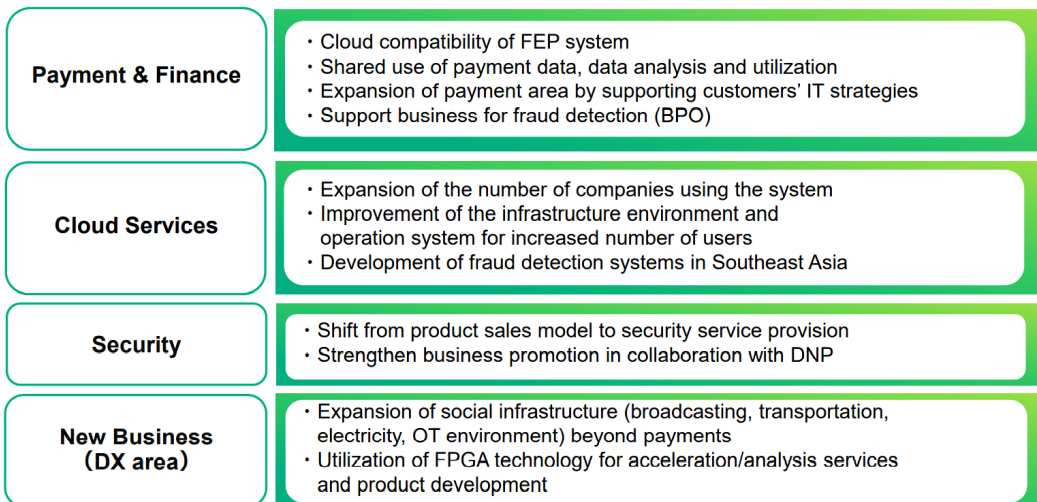
- ① Reinforcement and expansion of our business foundation
- ② Establishment of a foundation for human resources
- ③ Establishment of a foundation for co-creation

Progress of MTP “15 ALL” by sustainable growth initiatives

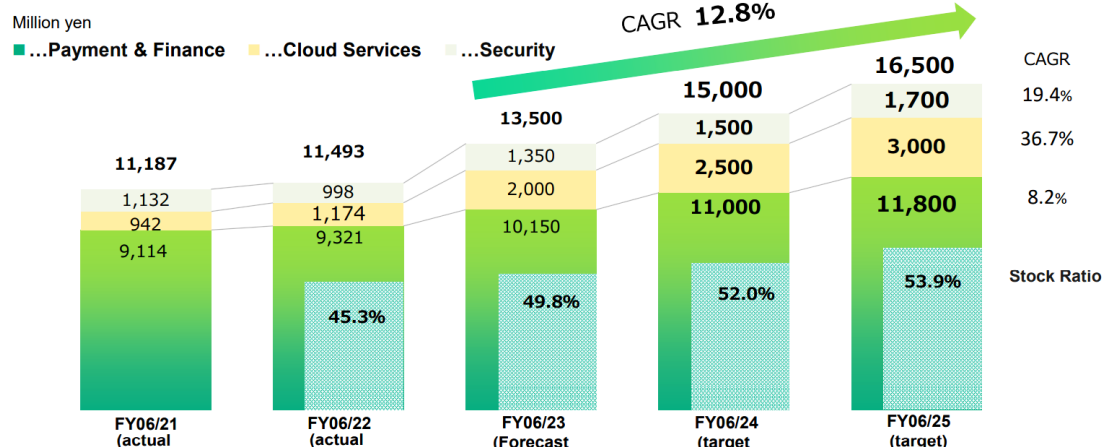
FY22/6 results



Strategies by Business Domain (see also business structure reforms on P8)



Roadmap to achieve Rolling MTP 2025 sales targets

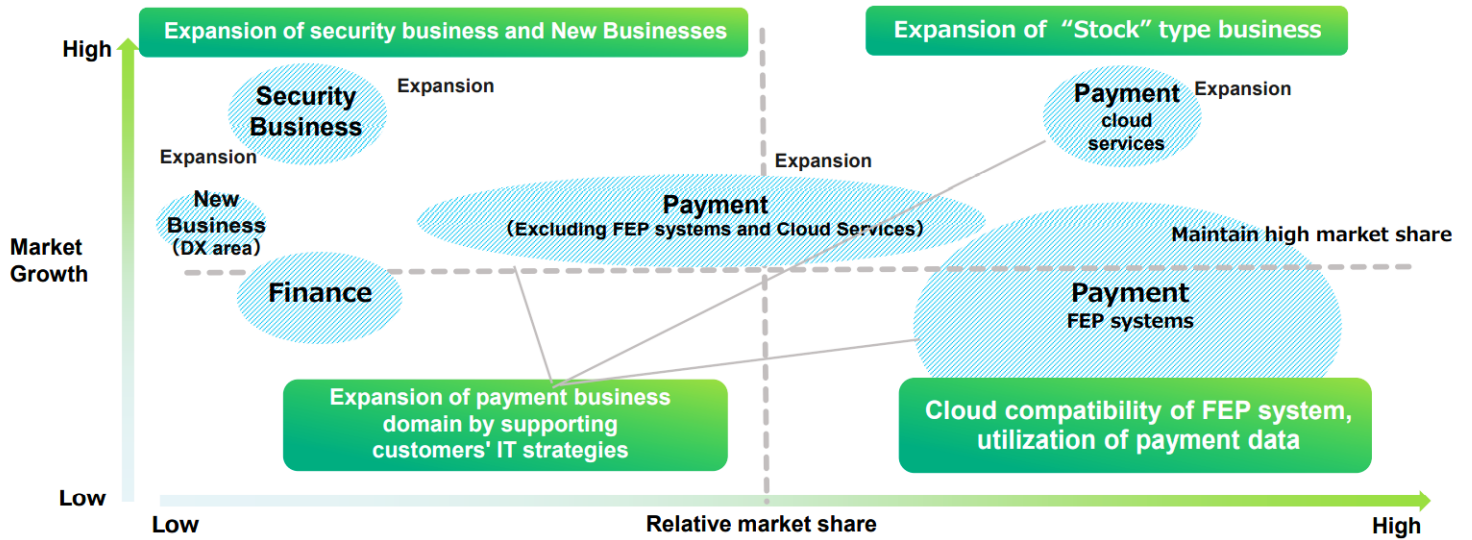


For FY23/6, the reason that the operating profit margin is only forecast to improve from 13.2% → 13.3% despite net sales expected to increase +17.5% YoY is due to: ① Cloud Service profits will not grow as fast as sales growth due to increased expenses for infrastructure and other system development, and ② an increase in SG&A expenses.

Source: excerpts from IR 4Q FY22/6 results briefing materials (includes top exhibit on P8).

★ Overview of Business Structure Reforms spelled out in Rolling MTP 2025

- Expansion of “stock*” type business centered on cloud services
- Cloud compatibility of FEP system, utilization of payment data
- Expansion of payment business domain by supporting customers' IT strategies
- Expansion of security business and New Businesses



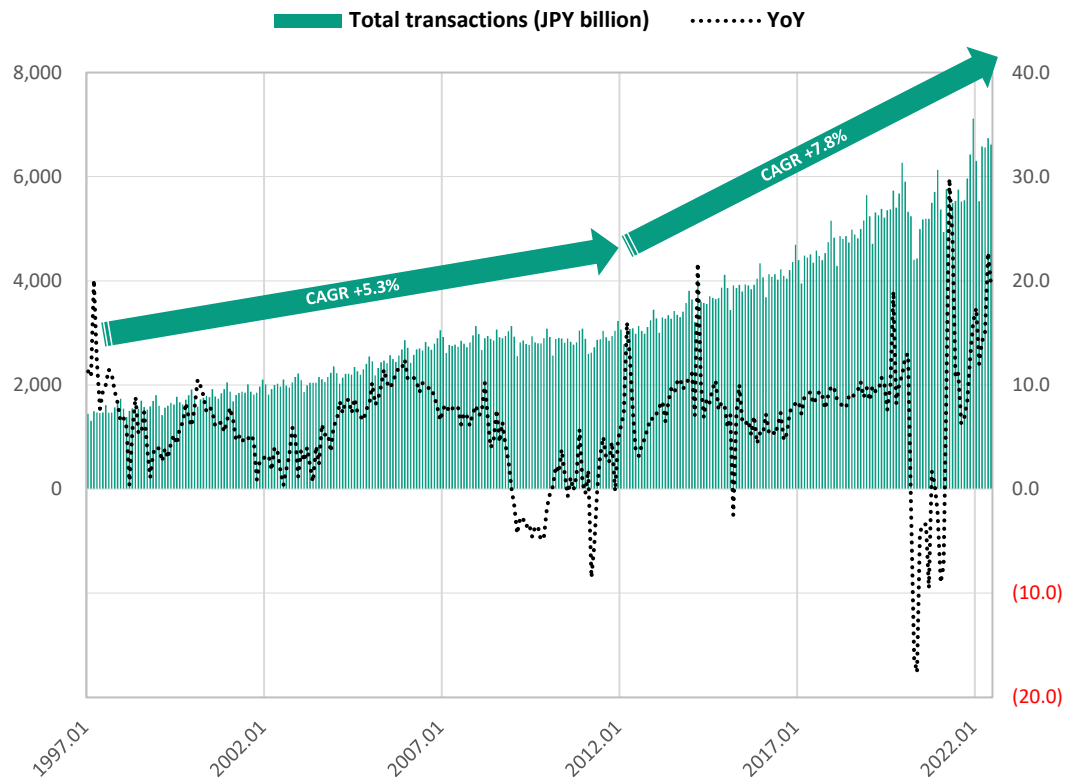
* “Stock” type: projects and contracts that can generate a certain amount of sales on a regular basis

Source: excerpt from IR results briefing materials



✦ *Credit card business is growth business*

METI Monthly Survey of Specified Service Industries: Credit Cards



Source: compiled by SIR from METI long-term data (monthly data from Jan-1997 through Jun-2022). https://www.meti.go.jp/statistics/tyo/tokusabido/result/result_1.html

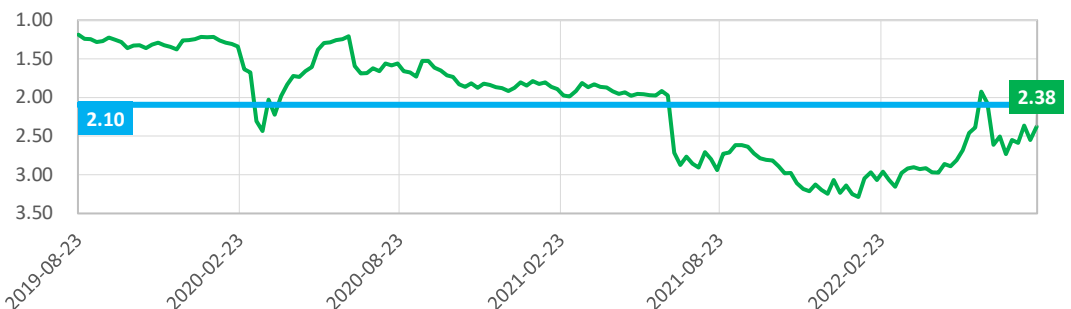
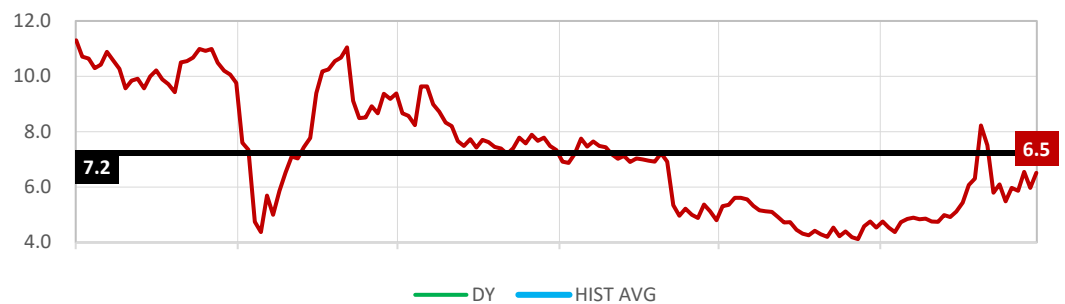
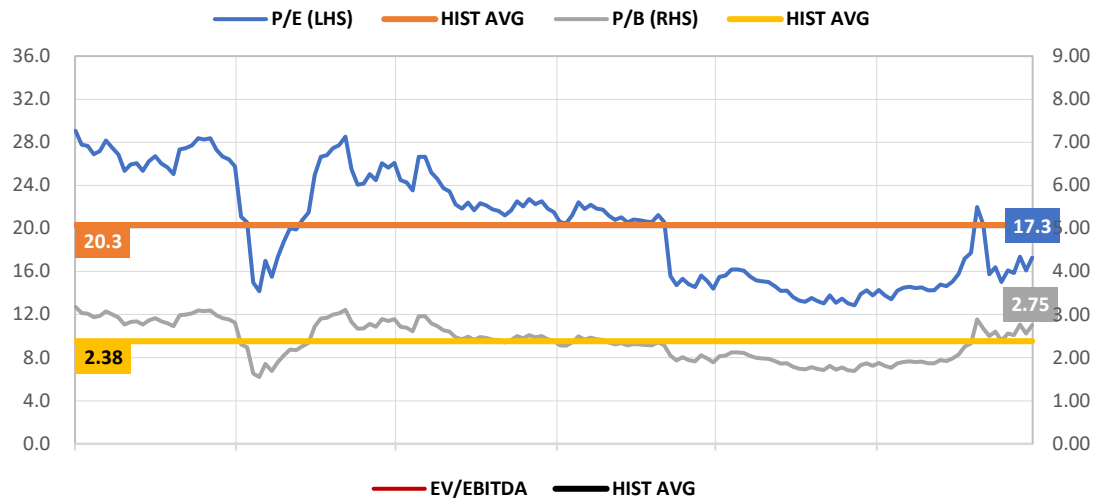
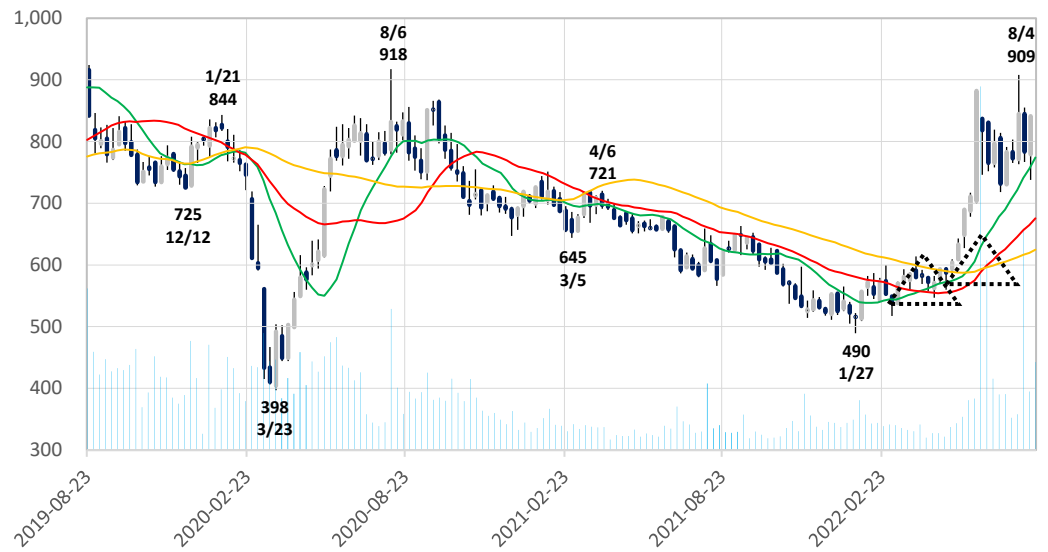


Performance and Valuations: SESSA Smart Charts

- ✓ Volume contracted sharply over FY21/6, which we believe was likely due to lack of participation by foreigners on concerns about not meeting TSE1 listing criteria for tradable market cap (free float) over ¥10bn.
- ✓ However, IWI listed on the Prime Market in Apr-2022 as planned, and the TSE has phased weighting reduction measures for TOPIX constituents.
- ✓ The P/E is now on a 15% discount to its historical average, and EV/EBITDA is on a 10% discount to its historical average.
- ✓ **The dividend yield of 2.38% is now 13% above its historical average.**

+3.56%	▲	120.34
+12.3%	▲	543.23
+5.34%	▲	254.23
-3.89%	▼	321.58
+5.97%	▲	100.08
+2.13%	▲	564.23
+6.43%	▲	765.96
-11.6%	▼	120.34
+23.1%	▲	893.23
+5.56%	▲	128.96
-3.67%	▼	432.1
-11.3%	▲	765.2
2.54%	▲	432.1

SESSA Smart Charts: 3-Year Weekly Share Price and Valuations Trend



Source: compiled by Sessa Partners from SPEEDA historical earnings and price data. Valuations calculated based on CE.



Analyst's view

Structural profitability improvement is the driver

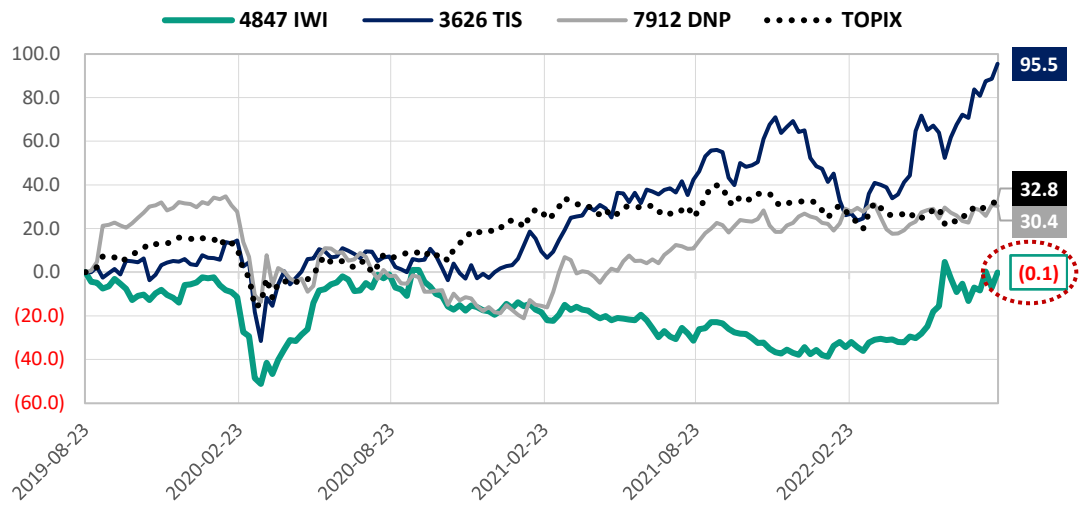
- ✓ A focus initiative is switching to a recurring (stock) revenue model for cloud services. As startup costs disappear and revenue gains critical mass, cloud services business has turned profitable.
- ✓ As can be seen in the right-hand monthly stock price chart, the share price appears to have put in a triple bottom just below 500 in Mar-2018, Mar-2020 (COVID) and in Jan-2022, and risk appears balanced on the upside considering high profit growth expected going forward...
- ✓ The ratio of foreign shareholders dropped 55% from 4.84% at the end of June 2020 to 2.19% at the end of June 2021. The subsequent collapse of volume has put valuations at extremely compelling levels **just as profits are taking off.**



CEO Kunimitsu Sato (62)



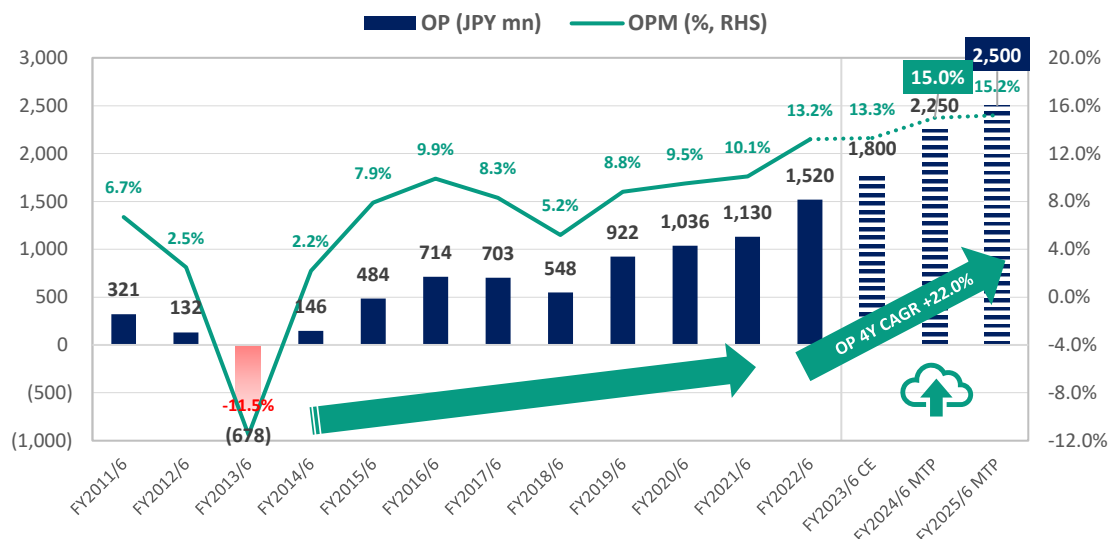
3-Year Weekly Relative Performance: only IWI is down slightly due to confusion in FY21/6 over the TSE Prime Market listing, just as profits are taking off



Long-Term Trend of IWI's Share Price (monthly)



15-Year Long-Term Trend of IWI OP/OPM with Rolling MTP Targets



Source: compiled by SIR from SPEEDA earnings database and IR results briefing materials.



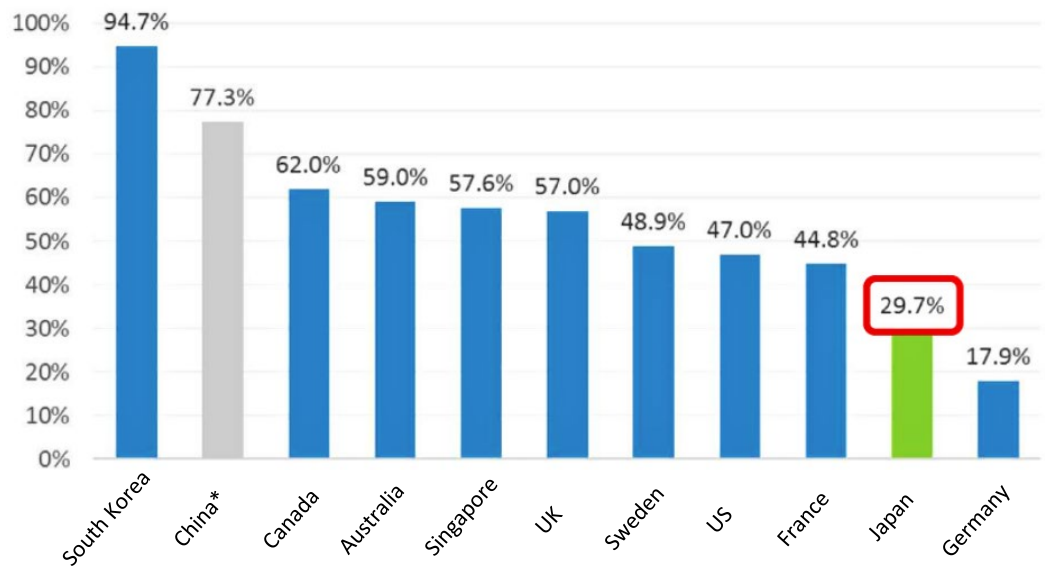
Japan is still a highly cash-based transaction society

Source: BOJ

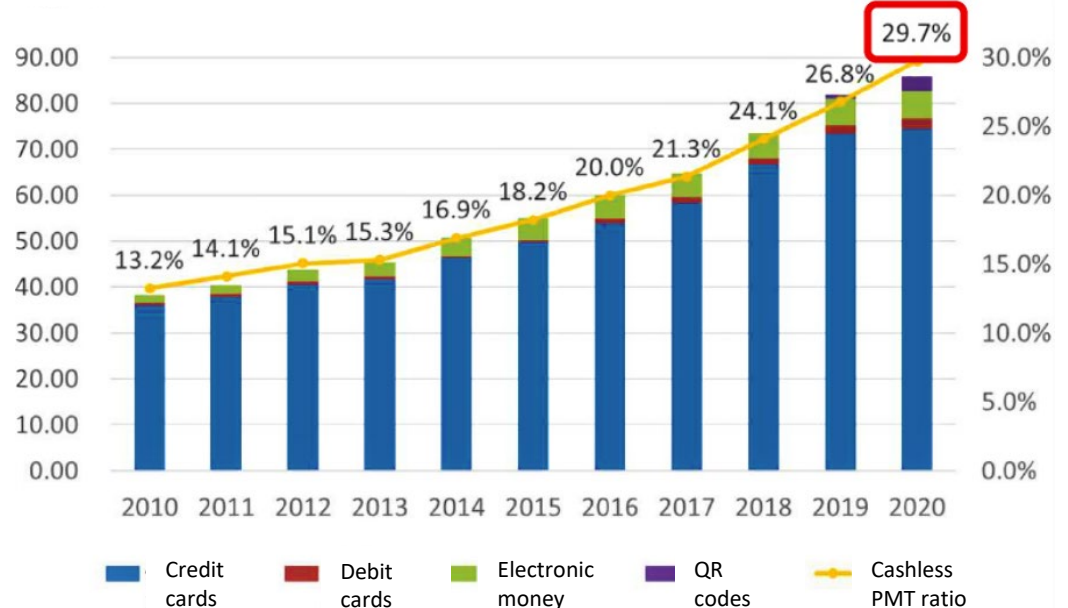
Current Status of Cashless Payments in Japan: Targeting 40% by 2025

The Cabinet Secretariat announced “Future Investment Strategy 2017” in June-2017, and the Ministry of Economy, Trade and Industry announced “Cashless Vision” in April-2018. Cashless Vision set a goal of raising the cashless payment ratio to 40% by 2025 when the Japan International Expo (Osaka – Kansai Expo) will be held, and in the future target 80%. **Promotion of cashless payment not only raises convenience for consumers, but it also addresses issues like the chronic labor shortage from the declining birthrate and aging society, improves productivity of SMEs, and helps to revitalize rural areas.** While Japan has a well-developed credit card industry which is enjoying structural growth drivers including government policy targeting a higher cashless ratio, South Korea and China are leading Asia in adopting cashless payments through aggressive adoption of new cashless technologies.

Cashless payments as a pct of household final consumption expenditure 2018



Trend of cashless payments and the cashless PMT ratio in Japan (JPY tril.)



Source: https://www.meti.go.jp/shingikai/mono_info_service/cashless_payment/pdf/2021_001_04_00.pdf

Note: *China is a reference value from Euromonitor International. Japan figure is for 2020.

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