1. Business Highlights for the Six Months of 34th Business Period (Fiscal Year Ending March 31, 2018)

(1) Qualitative Information on Consolidated Results of Operations

During the six months ended September 30, 2017, the global economy continued to face unstable conditions, as geopolitical tensions lingered regarding North Korea and the Middle East, while modest growth continued overall. The U.S. economy, despite the effects of hurricanes and other factors, remains relatively robust. Meanwhile, uncertainties towards President Trump’s economic and diplomatic policies are rising. In addition, the sense of caution remains strong regarding the Federal Reserve Board’s plan to raise interest rates in stages, with unstable foreign exchange rates due to uncertainty over the outlook for the future. Moreover, anxiety of an economic slowdown in emerging countries including China has intensified. In particular, excessive production and overcapacity of equipment in the Chinese material industry as well as cash outflow from China have brought further instability to the global economy. As Britain’s Brexit negotiations will soon enter the full-fledged phase, there are concerns over the emergence of political protectionism in other European countries, particularly in terms of the refugee issue.

Meanwhile, the Japanese economy is supported by the government-led monetary and fiscal policies, as well as the postponement of the increase in the consumption tax rate. The framework for the economic policies of the Abe administration and the Bank of Japan is expected to continue, following the outcome of the general election of members of the House of Representatives, which was held on October 22. Results in the manufacturing industry are showing signs of recovery owing to a continuing trend towards the depreciation of the Japanese yen after the U.S. presidential election held last November, despite the difficult outlook of foreign exchange rates and increased cautiousness in capital investment. Furthermore, various quality issues have emerged for major manufacturers, leading once again to questions concerning the quality of the Japanese manufacturing industry, which faces international competition. In Japan, which has been unable to break away from a deflationary economy, harsh business conditions have become obvious in the domestic distribution and retail industries. In addition, the business environment for financial institutions is increasingly severe due to side effects of the negative interest rate policy and the emergence of FinTech.

Regarding capital investment during the six months ended September 30, 2017, although corporations have been keeping a relatively positive attitude in capital spending, such spending lacks vigor on the whole. Furthermore, while investments in the research and development of new technologies such as AI and IoT have been active, the priority of capital investment in other fields has started to lower. Capital investment has been observed to be prioritized depending on the field. Internet-centered disruptive innovations have been changing the structure of the existing markets, and competitions among different industries have been intensifying. Although a growth strategy to stimulate investment in the private sector, which is referred to as the third arrow of the three-point economic policy, is important to set the Japanese economy on track for an autonomous and sustainable recovery, the course of such a plan is still unclear, and overcoming deflation economy has not been achieved.

Information security-related demand is vigorous, driven by enhancement of the defense against cyber-attacks for the public and private sectors owing to the damage reports caused by worldwide ransomware attacks. Furthermore, the prolonged economic slowdown triggered by the bankruptcy of Lehman Brothers that has added pressure on companies to reduce costs, and the recognition of risk in corporate ownership of equipment caused by the Great East Japan Earthquake have accelerated a widespread shift in IT system investments from “ownership of equipment” to “usage of services.” As companies continue to take IT assets off the balance sheet, the usage of cloud services is expanding in their place.

The fiscal year under review was the last year of our Medium-term Management Plan “TMX 3.0” announced on May 22, 2015, with the aim of “establishing the Company’s foundation and defining the future strategic direction for the next 30 years (establishment of the growth gene).” “TMX 3.0” advocates a breakaway from the labor-intensive contract business, which is typical of the IT industry, and therefore continues with our key principle of transforming ourselves into a “Next-Generation IT Service Creator” and a “Next-Generation IT Service Provider” through which the Company itself creates and provides IT services.

The core business strategies of "TMX 3.0"

- Strategic and accelerated promotion of cloud-related businesses
  - Profit contribution by the cloud business (Realize profitability of the healthcare cloud business)
  - Turn our cloud service into a platform (Diversification)
  - Establish the cloud business in overseas (Asian) markets (First by realizing success of the joint venture in China)
  - Quality improvement for cloud operation (Exponential improvement of operational skills)
  - Strategic application of various virtualization technologies ("Cloud first")
  - Analysis of Big data gathered by the cloud (Secondary use of the data)

- Pursuit of security and safety
  - Enhancement of defenses against cyber-attacks and provision of one-stop services
  - Realize a value chain of system design, construction, maintenance, operation and monitoring services, and automatization
  - Realize functional safety of embedded software for IoT (Internet of Things)
  - Contribute to safety and security within Internet-based society
    (Accumulation of knowledge as a professional group in the Technology for Information Security and Software Quality Assurance fields)

Our Group implemented the following initiatives in accordance with the business strategies of "TMX 3.0."

1) We carried out initiatives to preempt changes in demand for IT by proactively launching new businesses.

◇ Information Infrastructure Business

First quarter ended June 30, 2017

- Launched "Votiro Auto Mail Link with matriXgate," an automatic data sanitization solution for e-mail
- CROSS HEAD launched sales and system construction service for a virtualization product, U.S.-based Palo Alto Networks, Inc.'s "VM-Series," which runs on Amazon Web Services (AWS)
- CROSS HEAD launched "CROSS HEAD Vulnerability Assessment Service," utilizing security vulnerability assessment software "RADAR" of Finland-based F-Secure Corporation
- Okinawa Cross Head Co., Ltd. launched "OCH POWER," a remote monitoring service for data center equipment conditions, with collaboration with JB Service Corporation

Second quarter ended September 30, 2017

- CROSS HEAD launched "Preparation Courses for the IT Passport Examination" at the Yozemi license school operated by the Takamiya Gakuen Yoyogi Seminar
- Okinawa Cross Head Co., Ltd. launched JPIX Okinawa, which will offer IX service in Okinawa Prefecture in collaboration with Japan Internet Exchange Co., Ltd.
- Launched the on-premise version of "Menlo Security Isolation Platform," the web isolation and data sanitization platform of U.S.-based Menlo Security
- As for "∴TRINITY," the security operation and monitoring service, launched a security operation and monitoring service for "VM-Series on AWS," a next-generation firewall virtualization product of U.S.-based Palo Alto Networks, Inc. for the Amazon Web Services (AWS) environment
- Launched an automatic traffic control service for Microsoft Corporation's cloud-version groupware service, Office 365 including e-mail, as a new service that integrates the next-generation firewalls of U.S.-based Palo Alto Networks, Inc. and "Techma Cloud," our cloud service

◇ Application Services Business

First quarter ended June 30, 2017

- CRM field: Concluded a sales partnership agreement with LINE Corporation for "LINE Customer

Connect," a customer support service

- Software Quality Assurance field: Concluded a partnership agreement with Agileware Inc. to launch "Lychee Redmine," software to visualize project management
- Software Quality Assurance field: Launched "Parasoft SOAtest/Virtualize" of U.S.-based Parasoft Corporation, a tool to improve efficiency for API development

Second quarter ended September 30, 2017

- CRM field: Launched a solution that integrates the FAX system, "My Talk Center Hybrid," which is developed and provided by Intercom, Inc., with "FastHelp," our CRM system for contact centers
- CRM field: Announced the launch of "FastAnswer2," an enhanced version of the FAQ knowledge system

2) We accelerated our efforts in expanding our stock-type business by capturing orders for our maintenance, operation and monitoring services, expanding sales in our cloud services (SaaS) in the CRM, Healthcare and Internet Services fields, and also promoting sales of Ichigo LLC services, among other activities.

3) We strengthened proposals for cost-reducing IT investment such as cloud service (SaaS) and virtualization solutions, and promoted integration for cloud service providers.

4) The Group continued to work on maximizing synergies with CROSS HEAD, Okinawa Cross Head Co., Ltd., Ichigo LLC and CASAREAL, Inc., and on realizing the combined capabilities of the Group. In particular, we have been promoting self-independence in the Group by bringing back to the Group such functions as maintenance, operation and monitoring services, and contracted development that were previously outsourced.

5) The Group worked on initiatives such as contracted development of applications for smartphones and other new types of mobile platforms, and training services for open-source programming techniques.

6) The Group promoted measures to drive business expansion in fields such as cloud services in overseas markets, primarily Asian emerging countries that are continuing to grow.

7) During the second quarter ended September 30, 2017, the new ERP (core system) went into operation. The sharing of more integrated data by the business and administrative divisions resulted in the realization of smooth business flow between divisions, prompt decision-making, and the reinforcement of internal controls.

As a result of the above, the consolidated net sales during the six months ended September 30, 2017 increased ¥631 million (6.1%) year on year to a record high of ¥11,028 million. Gross profit amounted to ¥3,615 million, up ¥107 million (3.1%) year on year. Selling, general and administrative expenses were ¥3,059 million, up ¥146 million (5.0%) year on year due to an increase in personnel expense and other factors. Accordingly, operating income decreased ¥38 million (6.5%) year on year to ¥556 million.

Non-operating income was ¥164 million due to gain from the investment partnership of ¥149 million and other factors. Accordingly, ordinary income increased ¥89 million (14.6%) year on year to ¥697 million.

Consequently, income before income taxes was ¥696 million, up ¥92 million (15.2%) year on year, and profit attributable to owners of the parent was ¥447 million, up ¥58 million (15.0%) year on year.

Results by operating segment were as follows:

(1) Information Infrastructure Business

Demand for load balancers picked up primarily for major internet service providers and its sales remained strong as a result of developing new demands of solutions integrated with Office 365 provided by Microsoft Corporation. Sales of the mainstay next-generation firewalls, intrusion prevention appliances and antivirus products were favorable for the public and private sectors, with increasing orders for large-scale projects due in part to the growing threat from cyber-attacks represented by Advance Persistent Threat (APT) such as ransomware attacks. For governments and other public agencies, we increased sales of automatic data exchange tool for Secure Data Sanitization. Sales of security-related operation and monitoring services also increased. Demand for security is strong from governments, other public agencies, local governments, educational institutions and the private sector.

Regarding state-of-the-art security-related product including the next-generation mail security product and the next-generation antivirus products utilizing AI launched in the previous fiscal year, orders are increasing steadily. In terms of the cyber security platform for Endpoint, we succeeded in receiving a large-scale order from a financial institution.

As large-scale orders of scale-out network-attached storage (NAS) to the media and entertainment industry were a success, we could expect further sales in the industry.

While CROSS HEAD received continuous orders in the maintenance, operation and monitoring services, profitability deteriorated due to the decline of temporary utilization rate of technical experts, associated with restructuring of SES business during the three months ended June 30, 2017. However, the utilization rate has been improving from the second quarter onwards.

At Okinawa Cross Head Co., Ltd., sales of security-related products and original value-added services were strong.

As a result, net sales of the business amounted to ¥7,360 million, up ¥291 million (4.1%) year on year, and operating income amounted to ¥519 million, down ¥69 million (11.8%) year on year.

(2) Application Services Business

In the Internet Service field, there were some unprofitable projects in large-scale orders for existing customers. In addition, acquiring new customers for new cloud services was lower than expected. However, system development for financial institutions is favorable. At CASAREAL, Inc., owing to continuing contract development for existing customers, net sales remained robust. In training services, orders for training for new hires as well as for technical trainings held periodically for companies increased, reflecting the effectiveness of developing new training programs and scouting for partners, etc.

In the Software Quality Assurance field, with the progress of IT in automobiles, the necessity for improvement of the quality of embedded software and functional safety is increasing further in the manufacturing industry such as in-vehicle software. Orders for software testing tools are robust.

In the Healthcare field, inquiries for “NOBORI,” a cloud service for healthcare information, have remained strong. As revenue for this service is recognized in proportion to the corresponding service period, net sales have tended to increase gradually with an increase in the number of contracted facilities. Cumulative contracted facilities are increasing steadily. At Ichigo LLC, the number of contracted facilities, teleradiology orders, and pay-as-you-go payments has steadily increased as a result of the progress of initiatives in gaining customers from health checkup facilities and business expansion in the pathology sector, in addition to the conventional service provision for hospitals due to rising demand for teleradiology.

In the CRM field, orders increased steadily thanks to the business collaboration with a major system integrator, expanding demand for cloud services, improved name recognition and the expansion of business performance. Meanwhile, there were some unprofitable projects in large-scale orders for specific customers.

As a result, net sales of the business amounted to ¥3,668 million, up ¥340 million (10.2%) year on year, and operating income amounted to ¥37 million, up ¥31 million (554.8%) year on year.

(2) Qualitative Information on Consolidated Financial Position

Current assets increased ¥73 million (0.5%) from March 31, 2017 to ¥13,416 million as of September 30, 2017. The principal factor in this change was an increase of ¥408 million in advance payment-cost of maintenance service. Non-current assets stood at ¥3,944 million, an increase of ¥7 million (0.2%) from March 31, 2017. The principal factor in this change was an increase of ¥281 million in software under other of intangible assets. As a result, total assets amounted to ¥17,360 million, an increase of ¥80 million (0.5%) from March 31, 2017.

Current liabilities stood at ¥8,935 million, an increase of ¥49 million (0.6%) from March 31, 2017. The principal factor in this change was an increase of ¥495 million in advance received-sales of maintenance service. Non-current liabilities decreased ¥202 million (5.7%) from March 31, 2017 to ¥3,337 million. The principal factor in this change was a ¥150 million decrease in long-term loans payable. As a result, total liabilities amounted to ¥12,273 million, a decrease of ¥153 million (1.2%) from March 31, 2017.

Net assets were ¥5,087 million, up ¥233 million (4.8%) from March 31, 2017, primarily due to a ¥187 million increase in retained earnings. As a result, the equity ratio rose from 27.9% as of March 31, 2017 to 29.0%.

2. Quarterly Consolidated Financial Statements and Primary Notes

(1) Quarterly Consolidated Balance Sheets

(Thousand yen)

	As of March 31, 2017	As of September 30, 2017
Assets		
Current assets		
Cash and deposits	5,458,743	5,083,085
Notes and accounts receivable - trade	3,991,295	4,135,142
Inventories	320,630	243,834
Advance payment-cost of maintenance service	2,807,471	3,215,658
Other	765,765	739,239
Allowance for doubtful accounts	(337)	(354)
Total current assets	13,343,568	13,416,606
Non-current assets		
Property, plant and equipment	1,205,671	1,147,432
Intangible assets		
Goodwill	126,015	74,070
Other	1,085,863	1,247,562
Total intangible assets	1,211,878	1,321,633
Investments and other assets	1,519,546	1,475,117
Total non-current assets	3,937,095	3,944,182
Total assets	17,280,664	17,360,789

(Thousand yen)

	As of March 31, 2017	As of September 30, 2017
Liabilities		
Current liabilities		
Accounts payable - trade	1,081,157	1,005,352
Short-term loans payable	450,000	450,000
Current portion of long-term loans payable	300,000	300,000
Income taxes payable	451,070	231,395
Advance received-sales of maintenance service	4,432,967	4,928,457
Provision for bonuses	477,289	525,741
Other	1,693,908	1,494,579
Total current liabilities	8,886,394	8,935,527
Non-current liabilities		
Long-term loans payable	1,750,000	1,600,000
Provision for executive officers' retirement benefits	55,133	52,206
Net defined benefit liability	961,820	973,482
Other	773,807	712,137
Total non-current liabilities	3,540,761	3,337,826
Total liabilities	12,427,155	12,273,354
Net assets		
Shareholders' equity		
Capital stock	1,298,120	1,298,120
Capital surplus	1,252,223	1,252,888
Retained earnings	5,426,604	5,613,796
Treasury shares	(3,126,973)	(3,126,465)
Total shareholders' equity	4,849,974	5,038,339
Accumulated other comprehensive income		
Valuation difference on available-for-sale securities	68,719	87,923
Remeasurements of defined benefit plans	(104,765)	(97,352)
Total accumulated other comprehensive income	(36,046)	(9,429)
Subscription rights to shares	14,758	22,624
Non-controlling interests	24,822	35,899
Total net assets	4,853,508	5,087,434
Total liabilities and net assets	17,280,664	17,360,789

(2) Quarterly Consolidated Statements of Income and Comprehensive Income

Quarterly Consolidated Statements of Income

(Thousand yen)

	For the six months ended September 30, 2016	For the six months ended September 30, 2017
Net sales	10,397,463	11,028,711
Cost of sales	6,889,629	7,412,919
Gross profit	3,507,833	3,615,791
Selling, general and administrative expenses	2,912,637	3,059,041
Operating income	595,196	556,750
Non-operating income		
Interest income	220	162
Dividend income	1,314	1,620
Foreign exchange gains	16,759	-
Subsidy income	8,054	10,201
Gain on investments in partnership	-	149,490
Other	4,831	3,078
Total non-operating income	31,180	164,553
Non-operating expenses		
Interest expenses	12,935	13,238
Compensation expenses	-	5,518
Other	4,856	4,855
Total non-operating expenses	17,792	23,612
Ordinary profit	608,584	697,691
Extraordinary losses		
Loss on retirement of non-current assets	381	1,032
Office transfer expenses	2,613	-
Special payment for disaster	1,000	-
Total extraordinary losses	3,994	1,032
Profit before income taxes	604,589	696,658
Income taxes - current	182,759	187,406
Income taxes - deferred	28,957	50,430
Total income taxes	211,716	237,837
Profit	392,873	458,820
Profit attributable to non-controlling interests	3,524	11,077
Profit attributable to owners of parent	389,349	447,743

Quarterly Consolidated Statements of Comprehensive Income

(Thousand yen)

	For the six months ended September 30, 2016	For the six months ended September 30, 2017
Profit	392,873	458,820
Other comprehensive income		
Valuation difference on available-for-sale securities	(8,595)	19,203
Remeasurements of defined benefit plans, net of tax	6,353	7,413
Total other comprehensive income	(2,242)	26,616
Comprehensive income	390,630	485,437
Comprehensive income attributable to:		
Comprehensive income attributable to owners of parent	387,106	474,360
Comprehensive income attributable to non-controlling interests	3,524	11,077