November 2, 2018

Summary of Consolidated Financial Results for the Second Quarter of the Fiscal Year Ending March 31, 2019 (Six Months Ended September 30, 2018)

[Japanese GAAP]

Company name: MKSystem Corporation
Listing: Tokyo Stock Exchange (JASDAQ)
Stock code: 3910
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Scheduled date of filing of Quarterly Report: November 5, 2018
Scheduled date of payment of dividend: -
Preparation of supplementary materials for quarterly financial results: Yes
Holding of quarterly financial results meeting: Yes (for institutional investors and analysts)

(All amounts are rounded down to the nearest million yen)

1. Consolidated Financial Results for the Second Quarter Ended September 30, 2018 (April 1, 2018 – September 30, 2018)

(1) Consolidated operating results (Percentages represent year-on-year changes)

	Net sales		Operating profit		Ordinary profit		Profit attributable to owners of parent	
	Million yen	%	Million yen	%	Million yen	%	Million yen	%
Six months ended Sep. 30, 2018	946	2.4	78	(45.6)	77	(46.6)	(11)	-
Six months ended Sep. 30, 2017	924	-	144	-	144	-	90	-

Note: Comprehensive income (million yen)
Six months ended Sep. 30, 2018: (18) (-%)
Six months ended Sep. 30, 2017: 91 (-%)

	Basic earnings per share	Diluted earnings per share
	Yen	Yen
Six months ended Sep. 30, 2018	(2.17)	-
Six months ended Sep. 30, 2017	16.74	-

Note: MKSystem conducted a 2-for-1 split of its common stock with an effective date of April 1, 2018. Basic earnings per share was calculated based on the assumption that the stock split had been conducted at the beginning of the previous fiscal year.

(2) Consolidated financial position

	Total assets	Net assets	Shareholders' equity ratio
	Million yen	Million yen	%
As of Sep. 30, 2018	1,950	1,042	50.9
As of Mar. 31, 2018	2,178	1,136	48.9

Reference: Shareholders' equity (million yen) As of Sep. 30, 2018: 933 As of Mar. 31, 2018: 1,065

2. Dividends

	Dividend per share				
	1Q-end	2Q-end	3Q-end	Year-end	Total
	Yen	Yen	Yen	Yen	Yen
Fiscal year ended Mar. 31, 2018	-	0.00	-	22.00	22.00
Fiscal year ending Mar. 31, 2019	-	0.00			
Fiscal year ending Mar. 31, 2019 (forecast)			-	8.00	8.00

Note: Revisions to the most recently announced dividend forecast: None

Note: MKSystem conducted a 2-for-1 split of its common stock with an effective date of April 1, 2018. Dividends for the fiscal year ended March 31, 2018 were based on the number of shares before the stock split.

3. Consolidated Earnings Forecasts for the Fiscal Year Ending March 31, 2019 (April 1, 2018 – March 31, 2019)

(Percentages represent year-on-year changes)

	Net sales		Operating profit		Ordinary profit		Profit attributable to owners of parent		Basic earnings per share
	Million yen	%	Million yen	%	Million yen	%	Million yen	%	Yen
Full year	2,098	11.2	216	(31.0)	216	(31.8)	75	(63.0)	13.95

Note: Revisions to the most recently announced earnings forecasts: None

*** Notes**

(1) Changes in significant subsidiaries during the period (changes in scope of consolidation): None

(2) Application of special accounting methods for presenting quarterly consolidated financial statements: None

(3) Changes in accounting policies and accounting-based estimates, and restatements

1) Changes in accounting policies due to revisions in accounting standards, others: None

2) Changes in accounting policies other than 1) above: None

3) Changes in accounting-based estimates: None

4) Restatements: None

(4) Number of issued shares (common stock)

1) Number of shares issued at the end of period (including treasury shares)

As of Sep. 30, 2018:	5,428,000 shares	As of Mar. 31, 2018:	5,428,000 shares

2) Number of treasury shares at the end of period

As of Sep. 30, 2018:	312 shares	As of Mar. 31, 2018:	238 shares

3) Average number of shares during the period

Six months ended Sep. 30, 2018:	5,427,731 shares	Six months ended Sep. 30, 2017:	5,427,908 shares

Note: MKSystem conducted a 2-for-1 split of its common stock with an effective date of April 1, 2018. Number of shares issued at the end of period, number of treasury shares at the end of period, and average number of shares during the period were calculated based on the assumption that the stock split had been conducted at the beginning of the previous fiscal year.

* This quarterly financial report is not subject to quarterly review by certified public accountants or auditing firms.

* Explanation of appropriate use of earnings forecasts, and other special items

Forecasts of future performance in this report are based on assumptions judged to be valid and information available to the MKSystem's management at the time the materials were prepared but are not promises by MKSystem regarding future performance. Actual results may differ significantly from these forecasts for a number of reasons. Please refer to "1. Qualitative Information on Quarterly Consolidated Financial Performance, (3) Explanation of Consolidated Earnings Forecasts and Other Forward-looking Statements" on page 4 for forecast assumptions and notes of caution for usage.

Contents of Attachments

1. Qualitative Information on Quarterly Consolidated Financial Performance

(1) Explanation of Results of Operations

In the first half of the fiscal year ending March 31, 2019 (hereinafter "the period under review"), the Japanese economy remained on a gradual recovery trend against a backdrop of continued improvement in employment and capital investment driven by improved corporate earnings. On the other hand, economic consequences of a series of the natural disasters should warrant the attention. Meanwhile, sufficient attention should also be paid to the impacts of precarious development of the trade negotiations and fluctuations in the financial and capital markets on the global economy.

The domestic information service industries have been seeing an accelerated trend of providing services typically through the cloud computing. Amid such a trend, these industries utilize the latest technologies such as AI (Artificial Intelligence) and RPA (Robotic Process Automation). Specifically in the field of the personnel and labor management, which MKSystem Corporation and its group companies (hereinafter collectively "the Group") involve, companies are increasingly motivated to invest in "HR Technology" to realize efficient and diversified ways of working in line with the government-promoted "work style reform." In this context, "HR Technology" refers to cloud personnel and labor related systems including business operation systems and talent management systems for human resources management.

Under these circumstances, the Group worked to expand its business by promoting sales of the Shalom System (which literally means a dream system for labor and social security attorneys) in the Shalom Business and by starting to provide a new cloud service called "Jinzai (human resources) CuBe Cloud" in the CuBe Business. On the other hand, the Shalom Business reported extraordinary loss of 94 million yen as a penalty concerning license fees incurred in prior periods.

As a result, for the period under review, the Group reported net sales of 946 million yen (up 2.4% year on year), cost of sales of 421 million yen (up 17.1% year on year), the ratio of cost of sales to net sales of 44.5% (up 5.6 percentage points year on year), gross profit of 524 million yen (down 7.0% year on year), operating profit of 78 million yen (down 45.6% year on year), the ratio of operating profit to net sales of 8.3% (down 7.3 percentage points year on year), ordinary profit of 77 million yen (down 46.6% year on year), and loss attributable to owners of parent of 11 million yen (compared with profit attributable to owners of parent of 90 million yen for the same period of the previous fiscal year). In addition, the return on equity (ROE), one of the KPIs for the Group, was 3.8% (compared with 11.6% for the same period of the previous fiscal year) on a non-consolidated basis and negative 1.1% (compared with 9.7% for the same period of the previous fiscal year) on a consolidated basis as a result of reporting a net loss due to the recognition of extraordinary loss.

Results by business segment were as follows.

The Shalom Business

Amid a movement to simplify overall administrative procedures promoted by the government, a growing number of companies as well as labor and social security attorney offices, our main customers, are motivated to introduce systems available for electronic application. The movement is primarily driven by an official announcement by the Ministry of Heath, Labour and Welfare that the Ministry will require large-scale corporations to introduce an electronic application system for their social insurance-related procedures from 2020. At the same time, we expect an intensified competition as we witness an increasing number of new entrants in the market for electronic application services.

Under these circumstances, we have worked to respond to revisions to various laws and regulations and encouraged customers to adopt the Shalom System by offering a campaign to discount the initial cost.

As a result, sales of the cloud service were 661 million yen (up 8.4% year on year). The amount comprises of 586 million yen (up 16.7% year on year) from ASP services thanks to the accumulation of monthly subscription fee along with a steady increase in the number of customers who use our main services. On the other hand, we did not receive as many orders using the subsidies under the Project to Support Introduction of IT for Improvement of Service Productivity as we did in the same period of the previous fiscal year mainly due to a reduced amount of the subsidy, resulting in sales of system construction services of 74 million yen (down 30.1% year on year).

In addition, sales from system products were 48 million yen (up 4.8% year on year), and those from the other services were 2 million yen (up 57.7% year on year) due to an increased demand for My Number acquisition agent services as a result of the government's decision to require My Number information for employment insurance related filings.

Meanwhile, both cost of sales and selling and administrative expenses increased year on year as a result of strengthening sales activities for corporate customers and expanding our service providing structure with an increased number of workforce.

Consequently, the segment recorded net sales of 711 million yen (up 8.3% year on year), gross profit of 474 million yen (up 5.1% year on year) and operating profit of 156 million yen (down 1.5% year on year). The rate of operating profit to net sales, one of the KPIs for the Group, was 22.0% (down 2.2 percentage points year on year).

The CuBe Business

On top of developing customized front-end systems for personnel and general affairs divisions of large companies for each customer to enhance their operational efficiency that we have been offering for the past years, the CuBe Business has started to provide cloud services that enable small and medium-sized companies to improve their usability by leveraging our know-how we have obtained through the projects customized for large companies. These front-end systems help improve operational efficiency of not only personnel and general affairs divisions but also the customer's entire organization, and they are relevant to the purpose of the government-promoted "work style reform."

In the period under review, the segment suffered a year-on-year decrease in sales due to a reduction in large-scale project deliveries. Additionally, profit margin for the contracted development business substantially worsened because some of the large-scale projects turned out to require more development cost than initially estimated, making us difficult to secure sufficient profit.

In the cloud service business, we have already offered the "Jinzai CuBe Cloud" since April 2018 with a successful introduction to large group companies of our main customers for contracted development. We are also engaged in enhancement of the service functions and tasks to respond to revisions to laws and regulations for "Nenmatsu-chosei (year-end tax adjustment) CuBe Cloud," which we started offering in the previous fiscal year. However, while we need upfront investments and costs for service design, development, and sales activities, sales of cloud service tend to generate and accumulate only gradually.

As a result, the segment recorded net sales of 235 million yen (down 12.1% year on year), gross profit of 50 million yen (down 43.0% year on year), and operating loss of 79 million yen (compared with operating loss of 15 million yen for the same period of the previous fiscal year). Operating loss of the CuBe Business reflects amortization of goodwill of 19 million yen.

(2) Explanation of Financial Position

Cash Flows

The balance of cash and cash equivalents (hereinafter "net cash") at the end of the period under review decreased 276 million yen from the end of the previous fiscal year to 376 million yen. The details of cash flows from each activity and the major components of changes are as follows.

Cash flows from operating activities

Net cash used in operating activities was 490 million yen (compared with net cash provided of 309 million yen for the same period of the previous fiscal year). Major positive factors include depreciation of 57 million yen and a 44 million yen decrease in notes and accounts receivable-trade, while major negative factors include a 479 million yen decrease in accounts payable-other and income taxes paid of 71 million yen.

Cash flows from investing activities

Net cash used in investing activities was 135 million yen (compared with net cash used of 156 million yen for the same period of the previous fiscal year). Major positive factors include proceeds from withdrawal of time deposits of 40 million yen, while major negative factors include purchase of intangible assets of 167 million yen and purchase of property, plant and equipment of 9 million yen.

Cash flows from financing activities

Net cash provided by financing activities was 348 million yen (compared with net cash used of 112 million yen for the same period of the previous fiscal year). Major positive factors include proceeds from long-term loans payable of 500 million yen, while major negative factors include repayments of long-term loans payable of 74 million yen and cash dividends paid of 59 million yen.

Assets, liabilities and net assets

The balance of total assets at the end of the period under review decreased 227 million yen from the end of the previous fiscal year to 1,950 million yen.

Current assets

The balance of current assets at the end of the period under review decreased 320 million yen from the end of the previous fiscal year to 846 million yen mainly due to a decrease of 316 million yen in cash and deposits.

Non-current assets

The balance of non-current assets at the end of the period under review increased 92 million yen from the end of the previous fiscal year to 1,103 million yen mainly due to increases of 99 million yen in software in progress and 25 million yen in software, despite there was a decrease of 19 million yen in goodwill.

Current liabilities

The balance of current liabilities at the end of the period under review decreased 468 million yen from the end of the previous fiscal year to 522 million yen mainly due to decreases of 484 million yen in accounts payable-other and 80 million yen in income taxes payable, which were partly offset by an increase of 90 million yen in current portion of long-term loans payable.

Non-current liabilities

The balance of non-current liabilities at the end of the period under review increased 335 million yen from the end of the previous fiscal year to 385 million yen due to an increase of 335 million yen in long-term loans payable.

Net assets

The balance of net assets at the end of the period under review decreased 93 million yen from the end of the previous fiscal year to 1,042 million yen mainly due to decreases of 59 million yen in retained earnings following the payment of cash dividends, 22 million yen in non-controlling interests and 11 million yen in retained earnings caused by recording of loss attributable to owners of parent.

(3) Explanation of Consolidated Earnings Forecasts and Other Forward-looking Statements

We have revised the consolidated earnings forecast for the fiscal year ending March 31, 2019 as announced in the “Revisions to Earnings Forecast” (Japanese version only) on October 30, 2018.

2. Quarterly Consolidated Financial Statements and Notes

(1) Quarterly Consolidated Balance Sheet

(Thousands of yen)

	FY3/18 (As of Mar. 31, 2018)	Second quarter of FY3/19 (As of Sep. 30, 2018)
Assets		
Current assets		
Cash and deposits	720,192	403,216
Accounts receivable-trade	391,808	346,917
Merchandise	5,011	4,316
Work in process	9,718	28,979
Supplies	299	258
Prepaid expenses	26,723	18,252
Other	13,320	45,055
Total current assets	1,167,074	846,997
Non-current assets		
Property, plant and equipment		
Buildings, net	24,540	23,771
Vehicles, net	5,863	4,887
Tools, furniture and fixtures, net	49,221	41,579
Leased assets, net	821	-
Total property, plant and equipment	80,447	70,239
Intangible assets		
Software	139,035	164,062
Software in progress	216,627	315,796
Trademark right	1,384	1,515
Telephone subscription right	1,218	1,218
Goodwill	330,326	310,895
Total intangible assets	688,592	793,488
Investments and other assets		
Investments in capital	70	70
Guarantee deposits	53,846	52,004
Insurance funds	23,881	23,881
Deferred tax assets	164,309	163,938
Other	98	98
Total investments and other assets	242,206	239,993
Total non-current assets	1,011,245	1,103,721
Total assets	2,178,320	1,950,718

(Thousands of yen)

	FY3/18 (As of Mar. 31, 2018)	Second quarter of FY3/19 (As of Sep. 30, 2018)
Liabilities		
Current liabilities		
Accounts payable-trade	37,527	21,941
Short-term loans payable	100,000	100,000
Current portion of long-term loans payable	112,985	203,666
Lease obligations	1,254	-
Accounts payable-other	542,594	57,748
Accrued expenses	33,039	30,500
Income taxes payable	82,510	1,985
Accrued consumption taxes	-	3,436
Advances received	24,083	43,867
Provision for bonuses	48,926	49,119
Other	8,855	10,520
Total current liabilities	991,776	522,785
Non-current liabilities		
Long-term loans payable	50,315	385,632
Total non-current liabilities	50,315	385,632
Total liabilities	1,042,091	908,417
Net assets		
Shareholders' equity		
Capital stock	219,110	219,110
Capital surplus	198,290	198,169
Retained earnings	648,098	576,600
Treasury shares	(265)	(327)
Total shareholders' equity	1,065,232	993,552
Non-controlling interests	70,996	48,748
Total net assets	1,136,229	1,042,300
Total liabilities and net assets	2,178,320	1,950,718

(2) Quarterly Consolidated Statements of Income and Comprehensive Income

Quarterly Consolidated Statement of Income
(For the Six-month Period)

(Thousands of yen)

	First six months of FY3/18 (Apr. 1, 2017 – Sep. 30, 2017)	First six months of FY3/19 (Apr. 1, 2018 – Sep. 30, 2018)
Net sales	924,747	946,740
Cost of sales	360,094	421,762
Gross profit	564,652	524,977
Selling, general and administrative expenses	419,890	446,243
Operating profit	144,762	78,733
Non-operating income		
Interest income	7	5
Dividend income	1	1
Trademark fee income	300	-
Insurance premiums refunded cancellation	-	9
Purchase discounts	870	5
Other	70	61
Total non-operating income	1,248	82
Non-operating expenses		
Interest expenses	1,253	1,482
Other	60	2
Total non-operating expenses	1,314	1,485
Ordinary profit	144,697	77,331
Extraordinary losses		
Penalty	-	94,121
Total extraordinary losses	-	94,121
Profit (loss) before income taxes	144,697	(16,790)
Income taxes - current	75,878	1,009
Income taxes - deferred	(22,541)	370
Total income taxes	53,337	1,380
Profit (loss)	91,360	(18,170)
Profit (loss) attributable to non-controlling interests	513	(6,377)
Profit (loss) attributable to owners of parent	90,847	(11,792)

Quarterly Consolidated Statement of Comprehensive Income

(For the Six-month Period)

(Thousands of yen)

	First six months of FY3/18 (Apr. 1, 2017 – Sep. 30, 2017)	First six months of FY3/19 (Apr. 1, 2018 – Sep. 30, 2018)
Profit (loss)	91,360	(18,170)
Comprehensive income	91,360	(18,170)
Comprehensive income attributable to		
Comprehensive income attributable to owners of parent	90,847	(11,792)
Comprehensive income attributable to non-controlling interests	513	(6,377)

(3) Quarterly Consolidated Statements of Cash Flows

(Thousands of yen)

	First six months of FY3/18 (Apr. 1, 2017 – Sep. 30, 2017)	First six months of FY3/19 (Apr. 1, 2018 – Sep. 30, 2018)
Cash flows from operating activities		
Profit (loss) before income taxes	144,697	(16,790)
Depreciation	41,238	57,371
Amortization of goodwill	19,430	19,430
Increase (decrease) in provision for bonuses	3,363	192
Interest and dividend income	(8)	(6)
Interest expenses	1,253	1,482
Decrease (increase) in notes and accounts receivable - trade	112,360	44,891
Decrease (increase) in inventories	1,639	(18,525)
Increase (decrease) in notes and accounts payable - trade	(84,768)	(15,585)
Increase (decrease) in accrued consumption taxes	(6,470)	(27,857)
Increase (decrease) in accounts payable - other	70,311	(479,282)
Other, net	51,709	17,007
Subtotal	354,757	(417,671)
Interest and dividend income received	7	6
Interest expenses paid	(1,253)	(1,482)
Income taxes paid	(48,182)	(71,605)
Income taxes refund	4,639	-
Net cash provided by (used in) operating activities	309,968	(490,753)
Cash flows from investing activities		
Payments into time deposits	(20,000)	-
Proceeds from withdrawal of time deposits	-	40,013
Purchase of property, plant and equipment	(30,534)	(9,428)
Purchase of intangible assets	(105,731)	(167,625)
Payments for lease and guarantee deposits	(130)	-
Proceeds from collection of lease and guarantee deposits	-	1,842
Net cash provided by (used in) investing activities	(156,395)	(135,197)
Cash flows from financing activities		
Proceeds from long-term loans payable	-	500,000
Repayments of long-term loans payable	(57,075)	(74,002)
Repayments of lease obligations	(3,642)	(1,254)
Payments from changes in ownership interests in subsidiaries that do not result in change in scope of consolidation	-	(15,990)
Purchase of treasury shares	-	(62)
Cash dividends paid	(51,565)	(59,705)
Net cash provided by (used in) financing activities	(112,282)	348,986
Net increase (decrease) in cash and cash equivalents	41,290	(276,964)
Cash and cash equivalents at beginning of period	630,397	653,043
Cash and cash equivalents at end of period	671,687	376,078

(4) Notes to Quarterly Consolidated Financial Statements

Going Concern Assumption

Not applicable.

Significant Changes in Shareholders' Equity

Not applicable.

Additional Information

Application of Partial Amendments to Accounting Standard for Tax Effect Accounting, etc.

Effective from the beginning of the first quarter under review, MKSystem applied the Partial Amendments to Accounting Standard for Tax Effect Accounting (Accounting Standards Board of Japan (ASBJ) Statement No. 28, February 16, 2018) and other related pronouncements. Accordingly, deferred tax assets have been presented in the investments and other assets section of the consolidated balance sheet.

Segment and Other Information

Segment information

First six months of FY3/18 (Apr. 1, 2017 – Sep. 30, 2017)
Information related to net sales and profit/loss for each reportable segment

(Thousands of yen)

	Reportable segment			Adjustment (Note)	Amounts recorded in quarterly consolidated statement of income
	Shalom Business	CuBe Business	Total		
Net sales					
External sales	656,962	267,784	924,747	-	924,747
Inter-segment sales and transfers	356	94	450	(450)	-
Total	657,318	267,879	925,197	(450)	924,747
Segment profit (loss)	159,328	(15,676)	143,652	1,110	144,762

Notes: 1. The adjustment to segment profit (loss) is the elimination of inter-segment transactions.
2. Segment profit (loss) is adjusted to be consistent with operating profit presented on the quarterly consolidated statement of income.

First six months of FY3/19 (Apr. 1, 2018 – Sep. 30, 2018)
Information related to net sales and profit/loss for each reportable segment

(Thousands of yen)

	Reportable segment			Adjustment (Note)	Amounts recorded in quarterly consolidated statement of income
	Shalom Business	CuBe Business	Total		
Net sales					
External sales	711,438	235,302	946,740	-	946,740
Inter-segment sales and transfers	276	156	432	(432)	-
Total	711,714	235,458	947,173	(432)	946,740
Segment profit (loss)	156,875	(79,401)	77,473	1,260	78,733

Notes: 1. The adjustment to segment profit (loss) is the elimination of inter-segment transactions.
2. Segment profit (loss) is adjusted to be consistent with operating profit presented on the quarterly consolidated statement of income.