

Summary of Consolidated Financial Results
for the First Quarter of the Fiscal Year Ending March 31, 2024
(Three Months Ended June 30, 2023)

[Japanese GAAP]

Company name: MKSystem Corporation Listing: Tokyo Stock Exchange
 Stock code: 3910 URL: <https://www.mks.jp>
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 Scheduled date of filing of Quarterly Report: August 9, 2023
 Scheduled date of payment of dividend: –
 Preparation of supplementary materials for quarterly financial results: None
 Holding of quarterly financial results meeting: None

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

1. Consolidated Financial Results for the First Quarter Ended June 30, 2023

(April 1, 2023 – June 30, 2023)

(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	%
Three months ended Jun. 30, 2023	509	(18.5)	(167)	–	(165)	–	(412)	–
Three months ended Jun. 30, 2022	625	7.2	(6)	–	(4)	–	(17)	–

Note: Comprehensive income (million yen) Three months ended Jun. 30, 2023: (413) (–%)

Three months ended Jun. 30, 2022: (17) (–%)

	Basic earnings per share	Diluted earnings per share
	Yen	Yen
Three months ended Jun. 30, 2023	(76.01)	–
Three months ended Jun. 30, 2022	(3.14)	–

(2) Consolidated financial position

	Total assets	Net assets	Equity ratio
	Million yen	Million yen	%
As of Jun. 30, 2023	2,231	1,070	47.7
As of Mar. 31, 2023	2,559	1,527	59.4

Reference: Shareholders' equity (million yen) As of Jun. 30, 2023: 1,063 As of Mar. 31, 2023: 1,519

2. Dividends

	Dividend per share				
	1Q-end	2Q-end	3Q-end	Year-end	Total
	Yen	Yen	Yen	Yen	Yen
Fiscal year ended Mar. 31, 2023	–	0.00	–	8.00	8.00
Fiscal year ending Mar. 31, 2024	–	–	–	–	–
Fiscal year ending Mar. 31, 2024 (forecast)	–	0.00	–	4.00	4.00

Note: Revisions to the most recently announced dividend forecast: Yes

3. Consolidated Earnings Forecasts for the Fiscal Year Ending March 31, 2024 (April 1, 2023 – March 31, 2024)

(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
First half	1,136	(14.9)	(264)	–	(267)	–	(502)	–	(92.54)
Full year	2,624	(8.5)	(180)	–	(181)	–	(441)	–	(81.36)

Note: Revisions to the most recently announced earnings forecasts: Yes

*** 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 Jun. 30, 2023:	5,428,000 shares	As of Mar. 31, 2023:	5,428,000 shares
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2) Number of treasury shares at the end of period

As of Jun. 30, 2023:	506 shares	As of Mar. 31, 2023:	506 shares
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3) Average number of shares outstanding during the period

Three months ended Jun. 30, 2023:	5,427,494 shares	Three months ended Jun. 30, 2022:	5,427,494 shares
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* 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.

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1. Qualitative Information on Quarterly Consolidated Financial Performance

(1) Explanation of Results of Operations

During the first quarter of the fiscal year ending March 31, 2024 (hereinafter “the period under review”), the Japanese economy was expected to improve the business sentiment, after business activities and private consumption behavior gradually returned to normal by easing of movement restrictions due to COVID-19. However, considering the increased downside risk caused by the global monetary tightening, the prolonged Russia and Ukraine situation, and the continuing price hikes due to yen depreciation, the Japanese economy still remained unpredictable.

In the domestic information service industry and the field of personnel and labor management, in which MKSystem Corporation and its group companies (hereinafter collectively “the Group”) are involved, the government has promoted the work-style reform, the rapid transition to teleworking as a measure against the COVID-19 infections, or furtherance of DX (digital transformation) to improve business efficiency. Against these backdrops, corporate demand for investment remained increasing, though companies took a cautious attitude toward investment as demonstrated by the postponement of some new investments because of concern about impacts of the above on the domestic and foreign economies.

Under these circumstances, as announced in “Notice of Ransomware Infection Damages by a Third Party” (available in Japanese only) on June 6, 2023, servers of the data center that provides our services were compromised by a third party using a ransomware. As a result, we were forced to shut down the system and unable to provide the services properly. Therefore, we have decided to cancel billing to the affected users for the subscription in June.

In recovering the system, we are going to remove the infected servers in the data center, as we have decided to migrate our services to a cloud computing platform. In addition, unexpected expenses were incurred for investigation by an external specialized agency, reconstruction of system infrastructure, and security enhancement. Accordingly, we recognized 125 million yen of loss on retirement of non-current assets and 103 million yen of system failure response expenses both as extraordinary losses.

As a result, for the period under review, the Group reported net sales of 509 million yen (down 18.5% year on year), gross profit of 114 million yen (down 60.9%), operating loss of 167 million yen (compared with operating loss of 6 million yen for the same period of the previous fiscal year), ordinary loss of 165 million yen (compared with ordinary loss of 4 million yen for the same period of the previous fiscal year), and loss attributable to owners of parent of 412 million yen (compared with loss attributable to owners of parent of 17 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, came in at minus 31.9% (down 30.7 percentage points year on year) on a consolidated basis, and minus 25.9% (compared with positive 1.1% for the same period of the previous fiscal year) on a non-consolidated basis.

Results by business segment were as follows.

The Shalom Business

We provide software to support business of labor and social security attorney offices, labor insurance administration associations, and general corporations by facilitating their operations and processes for the social security insurance, labor insurance, and payroll calculation. Our products mainly consist of the following cloud services: Shalom series as our flagship product, MYNABOX series as a My Number management system, and eNEN as a web-based year-end adjustment filing system.

A growing number of companies as well as labor and social security attorney offices, our main customers, are motivated to introduce relevant systems from an increasing need for operational efficiency for the work-style reforms including teleworking. At the same time, we expect an intensified competition and pricing pressure as we witness active entries in the market.

In this segment, as mentioned earlier, we were unable to provide proper services to most of roughly 3,400 users due to the unauthorized access to the servers in our data center by a third party using a ransomware. As a result of the incident, net sales decreased due to cancellation of billing to the affected users for the subscription in June.

Net sales of the segment consist of those from the cloud services of 361 million yen (down 29.0% year on year), of which the ASP services under the subscription model amounted to 347 million yen (down 28.2%), and the system construction services amounted to 14 million yen (down 44.0%); and those from the system products of 20 million yen (down 0.7%).

Gross profit and operating profit significantly decreased year on year due to a decrease in net sales for the above mentioned reason.

As a result, the segment recorded net sales of 387 million yen (down 27.4% year on year), gross profit of 89 million yen (down 67.8%), and operating loss of 144 million yen (compared with operating profit of 21 million yen for the same period of the previous fiscal year). The ratio of operating profit to net sales, one of the KPIs for the Group, came in at minus 37.5% (compared with positive 4.1% for the same period of the previous fiscal year).

The CuBe Business

We have been engaged in the contracted development of front-end systems, customized to needs of an individual company, for the personnel and general affairs divisions of large companies to improve their business processes. The CuBe Business also provides cloud services, GooooN, which brings the convenience to small- and medium-sized companies by leveraging our know-how gained through the contracted development of systems for large companies.

In the contracted development of front-end systems, sales of maintenance business ordered by large companies and local governments have steadily increased. Meanwhile, the number of new development projects that respond to demand for investment in updating systems has piled up at the pace faster than that for the past years. In the cloud service business GooooN, we focused on functional enhancement and cultivation of sales channels.

While we are continuing to work on reducing costs, the segment recorded operating loss due to incurrence of upfront costs consisting mainly of outsourcing expenses and promotion expenses.

As a result, the segment recorded net sales of 125 million yen (up 34.8% year on year), gross profit of 25 million yen (up 55.5%), and operating loss of 27 million yen (compared with operating loss of 31 million yen for the same period of the previous fiscal year). Operating loss of the CuBe Business reflects amortization of goodwill of 9 million yen.

(2) Explanation of Financial Position

Assets

The balance of current assets at the end of the period under review was 1,070 million yen (down 13.2% from the end of the previous fiscal year), consisting primarily of 683 million yen in cash and deposits and 264 million yen in accounts receivable-trade.

The balance of non-current assets was 1,161 million yen (down 12.5% from the end of the previous fiscal year), consisting primarily of 464 million yen in software, 155 million yen in guarantee deposits, and 126 million yen in goodwill.

As a result, the balance of total assets was 2,231 million yen (down 12.8% from the end of the previous fiscal year).

Liabilities

The balance of current liabilities at the end of the period under review was 973 million yen (up 17.1% from the end of the previous fiscal year), consisting primarily of 400 million yen in short-term borrowings, 185 million yen in accounts payable-other, and 141 million yen in advances received.

The balance of non-current assets was 187 million yen (down 6.7% from the end of the previous fiscal year), consisting primarily of 180 million yen in long-term borrowings.

As a result, the balance of total liabilities was 1,161 million yen (up 12.4% from the end of the previous fiscal year).

Net assets

The balance of shareholder's equity at the end of the period under review was 1,063 million yen (down 30.0% from the end of the previous fiscal year), consisting primarily of 219 million yen in share capital, 202 million yen in capital surplus, and 642 million yen in retained earnings.

As a result, the balance of net assets was 1,070 million yen (down 29.9% from the end of the previous fiscal year).

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

For the consolidated earnings forecast for the fiscal year ending March 31, 2024, we announced on the release titled "Notice of Revision to Earnings Forecasts" (available in Japanese only) dated June 29, 2023 that the consolidated earnings forecasts for the first half and full year of the fiscal year ending March 31, 2024 were undecided. On August 8, 2023, we revised the forecasts by announcing the release titled "Notice of Recognition of Extraordinary Losses, Revision to Earnings Forecast and Dividend Forecast, and Reduction of Remuneration for Directors" (available in Japanese only).

The consolidated earnings forecasts are based mainly on the information currently available to us. Actual results may differ significantly from these forecasts for a number of reasons.

If the future development of business performance causes us to decide to revise the consolidated earnings forecasts for the first half and full year of the fiscal year ending March 31, 2024, we will disclose them promptly.

2. Quarterly Consolidated Financial Statements and Notes
(1) Quarterly Consolidated Balance Sheet

(Thousands of yen)

	FY3/23 (As of Mar. 31, 2023)	First quarter of FY3/24 (As of Jun. 30, 2023)
Assets		
Current assets		
Cash and deposits	609,336	683,934
Accounts receivable-trade	507,988	264,058
Merchandise	29,154	30,312
Work in process	29,966	29,918
Supplies	440	420
Prepaid expenses	47,293	41,960
Other	8,350	19,904
Total current assets	1,232,530	1,070,510
Non-current assets		
Property, plant and equipment		
Buildings, net	112,613	109,732
Vehicles, net	0	0
Tools, furniture and fixtures, net	144,907	34,006
Total property, plant and equipment	257,520	143,739
Intangible assets		
Software	485,234	464,956
Software in progress	249,092	251,094
Trademark right	855	798
Telephone subscription right	1,218	1,218
Goodwill	136,016	126,301
Total intangible assets	872,417	844,369
Investments and other assets		
Investments in capital	60	60
Guarantee deposits	163,022	155,946
Deferred tax assets	33,216	16,038
Other	1,176	1,176
Total investments and other assets	197,475	173,221
Total non-current assets	1,327,414	1,161,330
Total assets	2,559,945	2,231,840

(Thousands of yen)

	FY3/23 (As of Mar. 31, 2023)	First quarter of FY3/24 (As of Jun. 30, 2023)
Liabilities		
Current liabilities		
Accounts payable-trade	78,633	36,001
Short-term borrowings	200,000	400,000
Current portion of long-term borrowings	115,592	73,928
Accounts payable-other	125,321	185,018
Accrued expenses	17,838	41,542
Income taxes payable	77,519	1,133
Accrued consumption taxes	25,688	3,007
Advances received	111,909	141,459
Provision for system failure response expenses	–	42,383
Provision for bonuses	71,228	35,925
Other	8,001	13,190
Total current liabilities	831,733	973,591
Non-current liabilities		
Long-term borrowings	195,000	180,000
Retirement benefit liability	6,010	7,550
Total non-current liabilities	201,010	187,550
Total liabilities	1,032,743	1,161,142
Net assets		
Shareholders' equity		
Share capital	219,110	219,110
Capital surplus	202,122	202,122
Retained earnings	1,098,920	642,936
Treasury shares	(499)	(499)
Total shareholders' equity	1,519,653	1,063,669
Non-controlling interests	7,548	7,028
Total net assets	1,527,201	1,070,698
Total liabilities and net assets	2,559,945	2,231,840

(2) Quarterly Consolidated Statements of Income and Comprehensive Income
**Quarterly Consolidated Statement of Income
(For the Three-month Period)**

	(Thousands of yen)	
	First three months of FY3/23 (Apr. 1, 2022 – Jun. 30, 2022)	First three months of FY3/24 (Apr. 1, 2023 – Jun. 30, 2023)
Net sales	625,028	509,123
Cost of sales	331,615	394,531
Gross profit	293,412	114,592
Selling, general and administrative expenses	299,893	282,091
Operating loss	(6,481)	(167,499)
Non-operating income		
Dividend income	1	1
Rental income	10,701	10,249
Purchase discounts	5	–
Outsourcing service income	1,500	1,500
Other	–	8
Total non-operating income	12,207	11,758
Non-operating expenses		
Interest expenses	450	644
Rental costs	9,507	9,209
Total non-operating expenses	9,957	9,853
Ordinary loss	(4,231)	(165,593)
Extraordinary losses		
Loss on retirement of non-current assets	–	125,934
System failure response expenses	–	103,780
Total extraordinary losses	–	229,715
Loss before income taxes	(4,231)	(395,308)
Income taxes-current	597	597
Income taxes-deferred	12,826	17,178
Total income taxes	13,423	17,775
Loss	(17,655)	(413,083)
Loss attributable to non-controlling interests	(611)	(519)
Loss attributable to owners of parent	(17,043)	(412,564)

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

	(Thousands of yen)	
	First three months of FY3/23 (Apr. 1, 2022 – Jun. 30, 2022)	First three months of FY3/24 (Apr. 1, 2023 – Jun. 30, 2023)
Loss	(17,655)	(413,083)
Comprehensive income	(17,655)	(413,083)
Comprehensive income attributable to		
Comprehensive income attributable to owners of parent	(17,043)	(412,564)
Comprehensive income attributable to non-controlling interests	(611)	(519)

(3) Notes to Quarterly Consolidated Financial Statements

Going Concern Assumption

Not applicable.

Significant Changes in Shareholders' Equity

Not applicable.

Segment Information

First three months of FY3/23 (Apr. 1, 2022 – Jun. 30, 2022)

Information related to net sales and profit/loss for each reportable segment

(Thousands of yen)

	Shalom Business	CuBe Business	Total	Adjustment (Note)	Amounts recorded in quarterly consolidated statement of income
Net sales					
External sales	532,893	92,134	625,028	–	625,028
Inter-segment sales and transfers	570	765	1,335	(1,335)	–
Total	533,463	92,900	626,364	(1,335)	625,028
Segment profit (loss)	21,950	(31,727)	(9,777)	3,295	(6,481)

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 loss presented on the quarterly consolidated statement of income.

First three months of FY3/24 (Apr. 1, 2023 – Jun. 30, 2023)

Information related to net sales and profit/loss for each reportable segment

(Thousands of yen)

	Shalom Business	CuBe Business	Total	Adjustment (Note)	Amounts recorded in quarterly consolidated statement of income
Net sales					
External sales	386,386	122,737	509,123	–	509,123
Inter-segment sales and transfers	690	2,460	3,150	(3,150)	–
Total	387,076	125,197	512,273	(3,150)	509,123
Segment loss	(144,972)	(27,739)	(172,712)	5,213	(167,499)

Notes: 1. The adjustment to segment loss is the elimination of inter-segment transactions.

2. Segment loss is adjusted to be consistent with operating profit presented on the quarterly consolidated statement of income.

Significant Subsequent Events

Large amount of borrowings

At the Board of Directors held on August 8, 2023, we resolved the borrowing of funds as described below.

- 1) Use of the borrowing: Long-term working capital
- 2) Lender: Resona Bank, Limited
- 3) Amount to be borrowed: 500,000 thousand yen.
- 4) Borrowing rate: Base interest rate (1-month Japanese Yen TIBOR) + 0.450%.
- 5) Draw-down date: August 10, 2023.
- 6) Repayment date: July 31, 2028
- 7) Repayment method: Equal principal repayment
- 8) Collateral: None

This financial report is solely a translation of MKSystem's Kessan Tanshin (including attachments) in Japanese, which has been prepared in accordance with accounting principles and practices generally accepted in Japan, for the convenience of readers who prefer an English translation.