

Alpha-Win Company Research Report

CUBE SYSTEM INC. (2335 TSE Prime)

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Alpha-Win Capital Inc. Research Department
<http://www.awincap.com>

● Summary

◆ Mid-tier system integrator with long-term, stable growth

- CUBE SYSTEM INC. (hereinafter, the “Company”) is a mid-tier system integrator (SI) listed on the TSE Prime Market. Its main customers include Nomura Research Institute (NRI) and the Fujitsu Group, and it develops systems and provides services mainly for the financial, distribution, transportation, and telecommunication industries. Its strengths are its excellent customer base, extensive experience, high credibility, and the technology and expertise that it has built up over the years. Founded in 1972, it has about 50 years of history.
- With the exception of one fiscal year, the Company has been continuously increasing sales YoY for the past 21 years. During this period, its annual sales growth rate (simple average of the rate of increase in sales) was +6.1% and its annual recurring profit growth rate (simple average) was +7.3%. It has been steadily expanding its business over the long term and has always maintained a profit. Its recurring margin has stably been around 7% and the increase in sales has been contributing directly to increases in profit, dividend, and market capitalization. In FY 2022 (note that the Company’s fiscal year is March-ending, i.e., FY 2022 ended in March 2022), it achieved record-high sales and profits. It also increased dividend for the third year in a row.
- In April 2022, its market listing was changed from the TSE First Section to the newly established Prime Market.
- In December 2022, NRI took a stake of over 20%, and the Company is expected to become an affiliate (equity-method affiliate) of NRI.

◆ Formed a capital and business alliance with Nomura Research Institute (NRI)

- In December 2022, the Company formed a capital and business alliance with Nomura Research Institute (“NRI”; securities code of 4307) and executed a third-party allotment of new shares to NRI. Additionally, NRI acquired some more shares through off-floor trading on the stock exchange. As a result, NRI’s shareholding ratio increased from 1.51% to 20.18%, making it the Company’s largest shareholder.
- NRI is a SI of the Nomura Securities group listed on the TSE Prime Market. With a market capitalization of 1.8 trillion yen and this fiscal year’s expected sales of 690 billion yen and net profit of 77 billion yen, it is a large, blue-chip company ranked as one of the top ten companies of the industry. It provides both consulting and IT solutions and has top-level profitability in the industry as well as a strong customer base particularly in the financial industry. The Company has been in a long-term cooperative relationship with NRI, which is also its most important client (51.5% of sales were to NRI in the previous fiscal year). The Company’s president Masahiro Nakanishi and two of the directors also used to work at NRI before joining the Company.
- As a result of this capital alliance, the Company was able to raise 1,636 million yen in net sum. With this raised capital, in addition to its capital on hand, it will invest a total of 2,180 million yen over four fiscal years to strengthen its production facilities and production system toward further growth (Figure 1).
- In terms of business, some of the Company’s plans are to strengthen its long-term and ongoing relationship with NRI, expand its business domain, more fully utilize its production sites, enhance and expand its production system, and exchange personnel. The alliance can be seen as a positive change contributing to the Company’s business expansion and stable growth over the medium and long term.

【Figure 1】 How the Raised Capital Will Be Used and Their Schedule (Plan)

Fiscal Year	Unit: million yen, %	FY 2023	FY 2024	FY 2025	FY 2026	Cumulative Sum	% of Entire Investment
Amount Used	Total (amount): ①=②+③	120	845	805	410	2,180	100.0%
	Percent of Entire Investment	5.5%	38.8%	36.9%	18.8%	100.0%	
Main Use of Capital	Production Facilities: Subtotal ② (breakdown shown below)	80	385	125	0	590	27.1%
	Nearshore (create new regional sites)	80	160	0	0	240	11.0%
	Nearshore (enhance existing sites)	0	100	50	0	150	6.9%
	Prepare and enhance remote work environment	0	50	0	0	50	2.3%
	Enhance offshore sites / form alliances with companies	0	50	50	0	100	4.6%
	Purchase software assets	0	25	25	0	50	2.3%
	Production System: Subtotal ③ (breakdown shown below)	40	460	680	410	1,590	72.9%
	Invest in recruitment (gain employees for production)	20	320	320	320	980	45.0%
	Invest in training (employee development)	10	30	30	30	100	4.6%
	Sophistication of production/quality management	0	60	60	60	180	8.3%
Enhance engagement (with employees)	10	50	270	0	330	15.1%	

(Note) Prepared by Alpha-Win Research Dept. based on the news release.

Short Report

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◆ **Results for the first nine months of this fiscal year: 0.6% decline in sales and 15.3% decline in operating profit YoY, mainly since there was a delay in the reallocation of resources and the measures to improve profitability had been less effective than expected**

Results for the First Nine Months: Overview

• Results for the first nine months of FY 2023 (April to December 2022; hereinafter, “the first nine months” or “Q3 YTD”) were as follows: sales of 11,972 million yen (-0.6% YoY), operating profit of 951 million yen (-15.3% YoY), recurring profit of 953 million yen (-15.8% YoY), and net profit attributable to owners of the parent (hereinafter, “net profit”) of 628 million yen (-16.8% YoY) (Figure 2).

- Both sales and profits had fallen short of the initial plan in the first half, and results in Q3 (October to December) were also not enough to catch up to the plan. Consequently, the first nine months’ results also fell short of the plan.
- The reasons for the profit decline and the underachievement of the plan were the following: (1) there were delays in the reallocation of resources, such as shifting resources to other projects (employees and business partners), acquiring technological elements that will lead to gaining new projects, and developing the company structure, and (2) measures to improve profitability, such as price negotiations, automation of software development, and multi-tasking, were less effective than expected.
- Although sales and profits declined in the first nine months of this fiscal year, they still reached the second highest levels in the Company’s history following the record-high sales and profits of the previous fiscal year’s first nine months.

【Figure 2】 Summary of Results for the First Nine Months

Consolidated	Results for the First Nine Months		First Nine Months of FY 2022	First Nine Months of FY 2023	Change in Amount / Diff.	% Change	% of Total Amount of Change	% of Total
	Unit: million yen		Apr-Dec 2021	Apr-Dec 2022	YoY: million yen / %	YoY: %	%	%
Category	Consolidated Sales	Service/Category Name	12,041	11,972	-69	-0.6	-100.0	100.0
By Service Category	Sales	System Integration: SIS	9,019	8,781	-238	-2.6	-344.9	73.3
		System Outsourcing: SOS	1,396	1,314	-82	-5.9	-118.8	11.0
		Professional: ProS	1,624	1,876	251	15.5	363.8	15.7
	Operating Profit	System Integration: SIS	849	665	-184	-21.7	-107.6	69.9
		System Outsourcing: SOS	110	89	-21	-19.1	-12.3	9.4
		Professional: ProS	162	196	34	21.2	19.9	20.6
	Operating Margin (%)	System Integration: SIS	9.4	7.6	-1.8			
System Outsourcing: SOS	7.9	6.8	-1.1					
Professional: ProS	10.0	10.5	0.5					
By Industry	Sales	Finance	2,848	3,571	723	25.4	1,047.8	29.8
		Distribution	2,504	2,561	57	2.3	82.6	21.4
		Telecommunication & Transportation	3,266	2,267	-998	-30.6	-1,446.4	18.9
		Manufacturing (other)	930	1,116	186	20.0	269.6	9.3
		Government (other)	679	637	-42	-6.2	-60.9	5.3
		Other (other)	1,812	1,817	5	0.3	7.2	15.2
	Operating Profit	Finance	209	310	100	48.2	58.5	32.6
		Distribution	224	194	-30	-13.1	-17.5	20.4
		Telecommunication & Transportation	443	210	-233	-52.6	-136.3	22.1
		Manufacturing (other)	45	45	0	1.9	0.0	4.7
		Government (other)	53	34	-19	-35.7	-11.1	3.6
		Other (other)	146	154	8	6.0	4.7	16.2
	Operating Margin (%)	Finance	7.4	8.7	1.3			
		Distribution	9.0	7.6	-1.4			
		Telecommunication & Transportation	13.6	9.3	-4.3			
Manufacturing (other)		4.8	4.1	-0.7				
Government (other)		7.9	5.4	-2.5				
Other (other)		8.1	8.5	0.4				
By Business Model	Sales	Digital Business	226	408	181	80.5	262.3	3.4
		SI Business	3,516	2,905	-611	-17.4	-885.5	24.3
		Enhancement Business	8,299	8,659	360	4.3	521.7	72.3
	Operating Profit	Digital Business	10	14	4	41.8	2.3	1.5
		SI Business	434	174	-259	-59.8	-151.5	18.3
		Enhancement Business	677	761	83	12.4	48.5	80.0
	Operating Margin (%)	Digital Business	4.4	3.4	-1.0			
		SI Business	12.3	6.0	-6.4			
		Enhancement Business	8.2	8.8	0.6			
Consolidated	Gross Profit	2,581	2,568	-12	-0.5			
	Gross Margin (%)	21.4	21.5	0.1				
	SG&A Expenses	1,458	1,617	159	10.9			
	SG&A Expenses Ratio (%)	12.1	13.5	1.4				
	Operating Profit	1,122	951	-171	-15.3			
	Operating Margin (%)	9.3	7.9	-1.4				
	Recurring Profit	1,133	954	-179	-15.8			
	Recurring Margin (%)	9.4	8.0	-1.4				
	Net Profit	755	628	-127	-16.8			
	Net Margin (%)	6.3	5.2	-1.1				

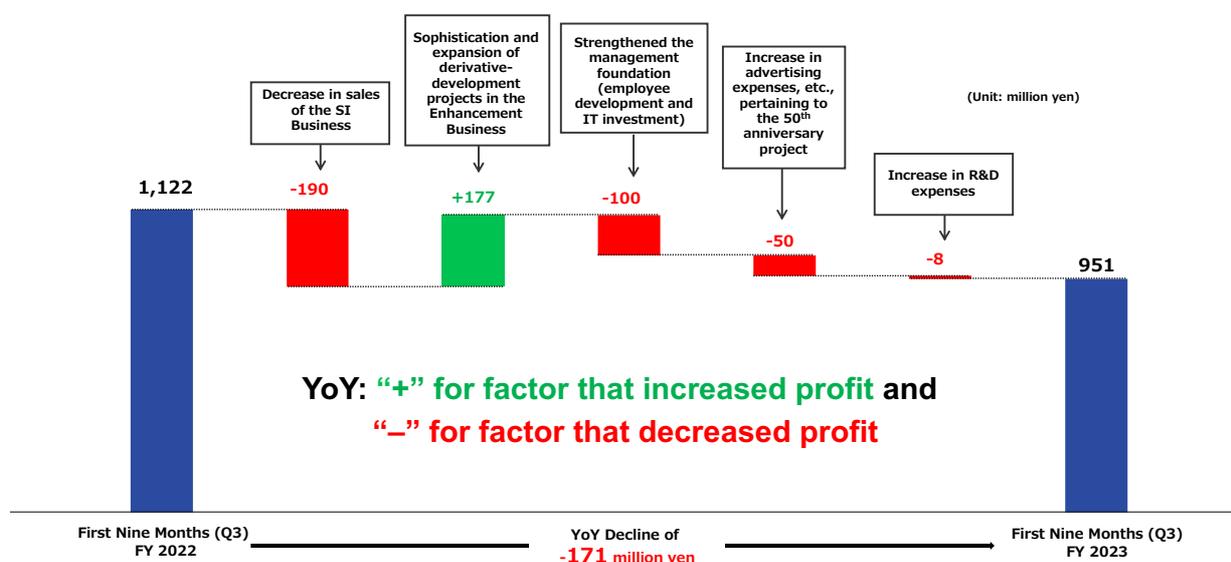
(Note) Prepared by Alpha-Win Research Dept. based on the financial results summary and the financial results briefing supplemental materials. Throughout this report, due to processing of data during calculations, values for the same item may slightly differ (the same applies hereinafter). Note that the percent of total amount of change is the proportion of the absolute amount of change.

- Since the gross margin improved by 0.8 percentage point YoY to 22.5% in Q3 (October to December), the first nine months' gross margin also improved by 0.1 percentage point to 21.5%. On the other hand, the SG&A expenses increased by 159 million yen (+10.9% YoY) from 1,458 million yen to 1,617 million yen, and the SG&A expenses ratio rose from 12.1% to 13.5%. As a result, the operating margin fell by 1.4 percentage points from 9.3% to 7.9%.
- The amount of non-operating profit shrunk from 11 million yen to 3 million yen in this fiscal year's first nine months due to a foreign exchange loss of 7 million yen on transactions, such as those with the Vietnamese subsidiary, caused by the weaker yen (the difference in the exchange rate at the time of contract and settlement) and also because stock issuance expenses of 6 million yen associated with the increase in capital were recorded.
- There was no extraordinary income or loss recorded, and net profit also resulted in a decline of around 17% like the operating and recurring profits.

Results for the First Nine Months: Factors that Contributed to Increase/Decrease in Operating Profit

- The factors that increased or decreased operating profit in the first nine months of this fiscal year are shown in Figure 3. Despite sophistication and the expansion of derivative development projects in the Enhancement Business (improved profit by +177 million yen), profit was decreased by a decline in the SI Business' sales (decreased profit by -190 million yen), an increase in costs to strengthen its management foundation such as employee development and IT investments (similarly, -100 million yen), and an increase in advertising expenses and other expenses pertaining to the 50th anniversary commemoration project (similarly, -50 million yen). As a result, operating profit declined by 171 million yen YoY (-15.3% YoY).
- The total number of employees in Japan and overseas was 860 as of the end of December 2022, having increased by 45 employees YoY (+5.5% YoY). This caused personnel expenses to increase.

【Figure 3】 Factors that Increased/Decreased Operating Profit in the First Nine Months



(Note) From the financial results briefing supplemental materials, with partial additions.

Results for the First Nine Months: Progress in Results

- The Company has revised its full-year forecasts downward (described later on page 7). In terms of achieving the new forecasts, the progress during the first nine months was 73.9% for sales and 67.0% for operating profit. Since the average progress over the past nine years was 72.3% and 66.5%, respectively, the current progress is at about the same level as past years (this also means that the full-year forecast was revised in accordance with the results during the first nine months).

Results for the First Nine Months: By Segment

- Overall, sales decreased by 69 million yen YoY in the first nine months. In addition, costs increased and profit margins worsened, and operating profit ended up decreasing by 171 million yen YoY. Below is the analysis of results for the first nine months by segment.

Results by Service Category (three categories: upper rows of Figure 2 on page 2)

- Regarding the System Integration Services (SIS), which is its core business, sales fell by 238 million yen YoY (-2.6% YoY) to 8,781 million yen. Although the system building project for an oil company in the manufacturing industry expanded, the project for a shipping company in the transportation industry was scaled down. Operating margin fell from 9.4% in the first nine months of the previous fiscal year to 7.6% in this fiscal year's first nine months (the same order applies hereinafter). Similarly, operating profit fell by 184 million yen YoY (-21.7% YoY) to Y665 million.
- In the System Outsourcing Services (SOS), too, the project for a general merchandise store of the distribution industry was scaled down, so sales fell by 82 million yen (-5.9% YoY) to 1,314 million yen. Operating margin declined from 7.9% to 6.8%, and operating profit declined by 21 million yen (-19.1% YoY) to 89 million yen.
- On the other hand, in the Professional Services (ProS), sales increased by 251 million yen (+15.5% YoY) to 1,876 million yen and operating profit rose by 34 million yen (+21.2% YoY) to 196 million yen due to the expansion of system building projects for a postal service company in the telecommunication industry and for the manufacturing industry. It was the only service category whose operating margin rose, from 10.0% to 10.5%.

Results by Industry (four industries: middle rows of Figure 2 on page 2)

- By industry, the financial industry was the only one for which there was both sales and profit growth. In the business with the financial industry, which accounted for about 30% of total sales, there was a significant increase in sales by 723 million yen YoY (+25.4% YoY) to 3,571 million yen due to the expansion of system building projects for an insurance company and a megabank. In addition, it was the only industry among the four industry segments whose operating margin improved, from 7.4% to 8.7%. Consequently, its operating profit rose substantially by 100 million yen (+48.2% YoY) to 310 million yen.
- Sales to the distribution industry and other industries rose slightly at single-digit rates, but their operating margins declined, resulting in slight operating profit declines for each. Sales to the transportation & telecommunication industries fell sharply by 998 million yen (-30.6% YoY) to 2,267 million yen, partly in a fallback from their large contribution to earnings in the previous fiscal year (impact from the scale-down of the systems-related project for a shipping company). As a result, its operating profit fell by half from 443 million yen to 210 million yen, pushing down the overall profit.

Results by Business Model (three models: lower rows of Figure 2 on page 2)

- Regarding the Enhancement Business, which accounted for 72% of sales and 80% of operating profit, sales were solid and rose by 360 million yen (+4.3% YoY) to 8,659 million yen due to the expansion of the projects for a postal service company, a cooperative, an online bank, and a credit card company. In addition to this increase in sales, process management was improved, causing the operating margin to rise from 8.2% to 8.8%. As a result, operating profit increased by 83 million yen (+12.4%) to 761 million yen.
- In the SI Business (Lift & Shift: moving from the legacy environment to the cloud environment in "Lift," and stepwise system restructuring with optimization for the cloud environment in "Shift"), which accounted for 24% of sales and 18% of operating profit, sales declined by 17.4% (-611 million yen) to 2,905 million yen and operating profit fell sharply by 59.8% (-259 million yen) to 174 million yen since the system building project for a shipping company was scaled down, despite the expansion of the project for an oil company. The operating margin was halved from 12.3% to 6.0%.
- The Digital Business is small in scale, accounting for only 4% of total sales. However, due to new DX projects for the distribution industry and for retailers targeting end-users and the expansion of a DX project for the construction industry, sales grew by 80.5% (+181 million yen) to 408 million yen. Operating profit of this business slightly increased from 10 million yen to 14 million yen (+4 million yen). Performance of both the Digital Business and the Enhancement Business was solid with sales and profit growth, so the decline in sales and profits for the first nine months was due to the SI Business.

Results for the First Nine Months: Balance Sheet

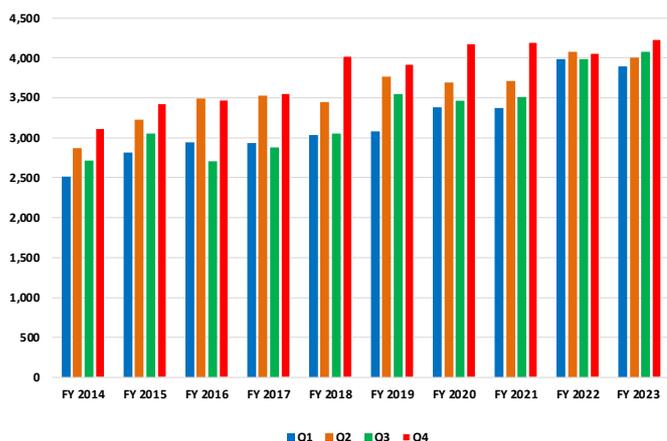
- The balance sheet as of the end of Q3 was marked by an increase in capital due to the third-party allotment of new shares to NRI. Net assets increased from 7.2 billion yen as of the end of March 2022 to 9.1 billion yen and the equity ratio rose from 71% to 77%. The current ratio was also at 482%, indicating the Company’s solid financial position.
- With the capital increase, cash and deposits also increased from 5.1 billion yen to 6.6 billion yen and the Company has ample liquidity on hand (equivalent to 4.9 months of average monthly sales; with a debt of 240 million yen, it is essentially debt-free).
- The effective use of its excess capital had been a key point for the Company. It has now specifically announced its plan to invest a total of 2,180 million yen (1,636 million yen raised + 544 million yen of its capital on hand) from January 2023 to March 2026 for augmentation toward future growth (mainly to increase capacity in terms of human resources and facilities) (Figure 1 on page 1).

◆Quarterly Transition in Results: Improving Momentum

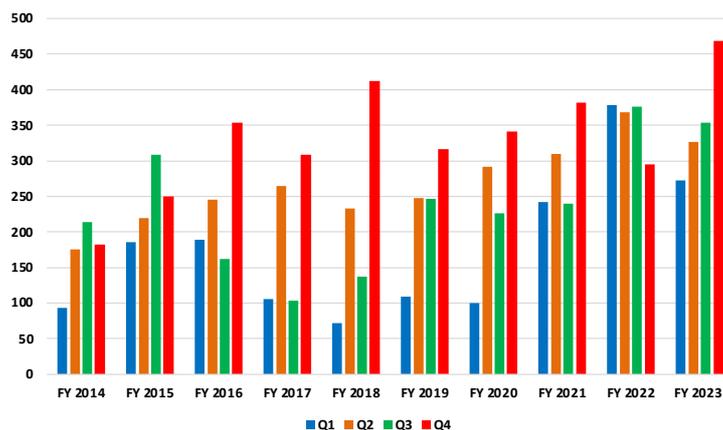
Quarterly Financial Performance: Results

- The transition in quarterly results (three-months basis) is shown in Figures 4 to 6 and Figure 7 on page 6.
- The momentum of financial performance (YoY rate of change) has been improving every quarter. Comparing Q1, Q2, and Q3, the rate of increase/decrease in sales has been improving from -2.4% ⇒ -1.8% ⇒ +2.5%. Similarly, the rates of decline for operating profit and net profit have been improving from -28.1% ⇒ -11.1% ⇒ -6.1% and from -34.0% ⇒ -9.5% ⇒ -5.4%, respectively (Figure A on page 10).

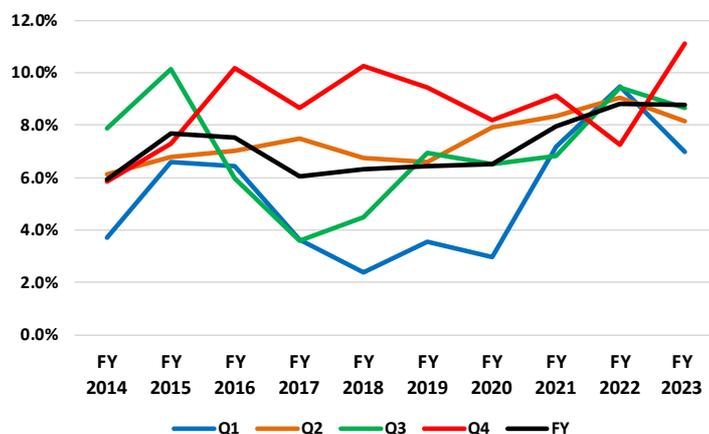
【Figure 4】 Quarterly Change in Sales (Unit: million yen)



【Figure 5】 Quarterly Change in Operating Profit (Unit: million yen)



【Figure 6】 Quarterly Change in Operating Margin (Unit: %)



(Note) Figures 4-6: Prepared by Alpha-Win Research Dept. based on the financial results summary and the financial results briefing supplemental materials. Q4 FY 2023 is the Company’s forecast.

Q4: Forecast

- In Q4 (January to March 2023), the Company expects sales of 4,228 million yen (+170 million yen or +4.2% YoY), operating profit of 469 million yen (+174 million yen or +58.9% YoY), operating margin of 11.1% (+3.8 percentage points YoY), and net profit of 322 million yen (+133 million yen or +70.3% YoY). It is expecting a relatively high profit margin and significant increases in profits (Figure 7). It plans to achieve record highs for a quarter for sales and each of the profit.
- Companies have generally been actively conducting strategic IT investments, especially in DX. Due to this strong demand, the order backlog is at a high level, having increased to 4,120 million yen (+151 million yen or +3.8% YoY) as the end of this Q3. By segment, the order backlog has been increasing for the Digital Business and the SI Business. By industry, it has been increasing for all industries except the transportation & telecommunication industries.
- The expected profit seems to be an achievable level since the Company has an order backlog amounting to 97% of Q4's expected sales, improvements have been seen in the profitability of the Enhancement Business since Q1, and profitability improvement is expected as new employees begin work.
- The Company's quarterly financial performance has been characterized by seasonal fluctuations, although the rate of variation has been becoming smaller. Q4 (January to March) has accounted for the highest percentage of the entire year (27.7% of sales and 33.5% of operating profit on average over the past nine years including the previous fiscal year). This is followed by Q2 (July to September; 26.0% and 27.3%, respectively), Q3 (October to December; 23.5% and 23.1%, respectively), and Q1 (April to June; 22.8% and 16.1%, respectively).
- Based on the forecasts for Q4 of this fiscal year, sales and operating profit would be 26.1% and 33.0% of the Company's new plan for the full fiscal year, respectively. These levels seem reasonable considering the past results and trends.

[Figure 7] Quarterly Transition in Results (Unit: million yen)

Consolidated	Quarterly Results	Q1 FY 2022		Q2 FY 2022		Q3 FY 2022		Q4 FY 2022		Q1 FY 2023		Q2 FY 2023		Q3 FY 2023		Q4 FY 2023		
		Results	Results	Results	Results	Results	Results	Results	Results	Results	Results	Results	Results	Results	Results	Results	Results	
Category	Unit: million yen, %	Apr-Jun 2021	Jul-Sep 2021	Oct-Dec 2021	Jan-Mar 2022	Apr-Jun 2022	Jul-Sep 2022	Oct-Dec 2022	Jan-Mar 2023	Apr-Jun 2023	Jul-Sep 2023	Oct-Dec 2023	Jan-Mar 2023	YoY: Amount	YoY: %	YoY: Amount	YoY: %	
By Service Category	Total Sales	3,087	4,073	3,981	4,058	3,892	4,000	4,090	4,228	3,991	4,088	4,090	4,228	99	2.5	170	4.2	
	Sales	System Integration: SIS	2,985	3,082	2,952	2,949	2,821	2,913	3,047	3,047	2,985	3,082	3,047	3,047	95	3.2	174	5.7
		System Outsourcing: SOS	493	443	460	438	440	448	426	426	493	443	426	426	-34	-7.4	-35	-7.4
		Professional: ProS	508	548	568	672	631	638	607	607	508	548	607	607	39	6.9	170	4.2
		System Integration: SIS	311	278	260	195	172	226	267	267	311	278	267	267	7	2.7	174	5.7
	Operating Profit	System Outsourcing: SOS	37	31	42	26	34	28	27	27	37	31	27	27	-15	-35.7	-15	-35.7
		Professional: ProS	30	58	74	74	64	73	59	59	30	58	59	59	-15	-20.3	174	5.7
		System Integration: SIS	10.4	9.0	8.8	6.6	6.1	7.8	8.8	8.8	10.4	9.0	8.8	8.8	-0.0	0.0	174	5.7
		System Outsourcing: SOS	7.5	7.0	9.1	5.9	7.9	6.3	6.3	6.3	7.5	7.0	6.3	6.3	-2.8	-37.3	-2.8	-37.3
	Operating Margin (%)	Professional: ProS	6.1	10.6	13.0	11.0	10.3	11.4	9.7	9.7	6.1	10.6	9.7	9.7	-3.3	-31.2	174	5.7
Finance		934	927	987	1,061	1,128	1,209	1,234	1,229	934	927	987	987	247	25.0	168	15.8	
Distribution		815	881	808	838	838	785	873	903	815	881	808	808	95	11.8	201	24.0	
Telecommunication & Transportation		1,062	1,104	1,100	1,019	826	745	696	633	1,062	1,104	1,100	1,100	-404	-36.7	-386	-37.9	
By Industry	Sales	Manufacturing (other)	318	339	273	293	344	379	393	393	318	339	379	379	120	44.0	190	16.7
		Government (other)	244	232	203	239	206	221	210	1,330	244	232	203	203	7	3.4	190	16.7
		Other (other)	610	591	611	608	641	572	644	644	610	591	611	611	33	5.4	190	16.7
		Finance	75	67	67	67	101	101	108	108	75	67	67	67	41	61.2	190	16.7
	Operating Profit	Distribution	84	79	61	51	49	65	80	80	84	79	61	61	19	31.1	190	16.7
		Telecommunication & Transportation	148	137	158	89	70	77	63	63	148	137	158	158	-95	-60.1	190	16.7
		Manufacturing (other)	20	14	11	6	5	12	28	28	20	14	11	11	17	154.5	190	16.7
		Government (other)	24	16	13	17	11	12	11	11	24	16	13	13	-2	-15.4	190	16.7
	Operating Margin (%)	Other (other)	24	56	66	44	34	57	63	63	24	56	66	66	-3	-4.5	190	16.7
		Finance	8.1	7.2	6.8	8.2	9.0	8.4	8.8	8.8	8.1	7.2	6.8	6.8	2.0	2.0	190	16.7
Distribution		10.4	9.0	7.5	6.1	6.3	7.4	8.9	8.9	10.4	9.0	7.5	7.5	1.3	1.3	190	16.7	
Telecommunication & Transportation		14.0	12.4	14.4	8.7	8.5	10.3	9.1	9.1	14.0	12.4	14.4	14.4	-5.3	-37.5	190	16.7	
By Business Model	Sales	Manufacturing (other)	6.5	4.1	4.0	2.0	1.7	3.2	7.1	7.1	6.5	4.1	4.0	4.0	3.1	3.1	190	16.7
		Government (other)	10.2	6.9	6.4	7.1	5.4	5.4	5.2	5.2	10.2	6.9	6.4	6.4	-1.2	-11.8	190	16.7
		Other (other)	4.0	9.5	10.8	7.2	5.7	10.0	9.8	9.8	4.0	9.5	10.8	10.8	-1.0	-10.3	190	16.7
		Finance	8.1	7.2	6.8	8.2	9.0	8.4	8.8	8.8	8.1	7.2	6.8	6.8	2.0	2.0	190	16.7
	Operating Profit	Distribution	175	169	140	88	84	56	84	84	175	169	140	140	-55	-40.0	190	16.7
		SI Business	1,082	1,207	1,227	1,123	854	979	1,072	1,195	1,082	1,207	1,227	1,227	153	13.6	66	5.8
		Enhancement Business	2,840	2,792	2,667	2,804	2,878	2,936	2,845	2,791	2,840	2,792	2,667	2,667	178	6.7	-43	-1.5
		Digital Business	0	1	9	6	4	9	9	9	0	1	9	9	0	0.0	0	0.0
	Operating Margin (%)	SI Business	11.6	14.0	11.4	7.8	4.0	5.7	7.8	7.8	11.6	14.0	11.4	11.4	-3.6	-24.3	190	16.7
		Enhancement Business	8.9	7.1	8.5	7.1	8.2	9.0	9.1	9.1	8.9	7.1	8.5	8.5	0.6	0.6	190	16.7
Digital Business		0.0	1.3	10.3	4.8	-3.9	6.4	5.5	5.5	0.0	1.3	10.3	10.3	-4.9	-47.8	190	16.7	
SI Business		11.6	14.0	11.4	7.8	4.0	5.7	7.8	7.8	11.6	14.0	11.4	11.4	-3.6	-24.3	190	16.7	
Consolidated	Gross Profit	863	856	862	870	785	866	917	917	863	856	862	862	55	6.4	174	5.7	
		Gross Margin (%)	21.6	21.0	21.7	21.4	20.2	21.6	22.5	22.5	21.6	21.0	21.7	21.7	0.8	3.8	174	5.7
	SG&A Expenses	488	488	487	574	513	540	565	565	488	488	487	487	78	16.0	174	5.7	
		SG&A Expenses Ratio (%)	12.1	12.0	12.2	14.2	13.2	13.5	13.8	13.8	12.1	12.0	12.2	12.2	1.6	1.6	174	5.7
	Operating Profit	379	367	375	295	272	326	353	469	469	379	367	375	375	-2	-0.5	174	5.7
		Operating Margin (%)	9.5	9.0	9.4	7.3	7.0	8.2	8.6	11.1	9.5	9.0	9.4	9.4	-0.5	-5.3	174	5.7
	Recurring Profit	390	362	380	299	271	324	359	491	491	390	362	380	380	-31	-8.5	190	16.7
		Recurring Margin (%)	9.8	8.9	9.5	7.4	7.0	8.1	8.5	11.6	9.8	8.9	9.5	9.5	-0.7	-7.1	190	16.7
	Net Profit	264	238	253	189	173	215	240	322	322	264	238	253	253	-14	-5.4	133	70.3
		Net Margin (%)	6.6	5.8	6.4	4.7	4.9	5.4	5.9	7.6	6.6	5.8	6.4	6.4	-0.5	-8.3	133	70.3

(Note) Prepared by Alpha-Win Research Dept. based on the financial results briefing supplemental materials.

◆ Revised the initial full-year forecast downward, but maintained its plan to increase sales and profit and also kept dividend the same

Full Fiscal Year: Company Forecast

- At the beginning of the fiscal year, the Company had forecasted full-year sales of 17,300 million yen (+7.5% YoY), operating profit of 1,530 million yen (+7.9% YoY), net profit of 1,000 million yen (+5.9% YoY), and operating margin of 8.8% (no change from 8.8% in the previous fiscal year).
- However, although the Enhancement Business performed well, the reallocation of resources in the SI Business was not enough to catch up to the unexpectedly large change in the corporate clients' IT investment policies. Consequently, the Company lowered its forecast for sales by 1,100 million yen (-6.4% compared to the initial forecast) to 16,200 million yen, operating profit by 110 million yen (-7.2%) to 1,420 million yen, and net profit by 50 million yen (-5.0%) to 950 million yen. The shortage of employees to handle the rapidly increasing, sophisticated DX projects, as well as the delay in their recruitment, seemed to have been a factor behind this downward revision.
- There was no revision to the forecasted operating margin of 8.8%. In the revised forecast, although this fiscal year's YoY increases in sales and profits are expected to be very small, the Company expects to achieve record-high sales and profits in consecutive years.
- By industry, the full-year sales forecast for the financial industry was revised upward (from the initial forecast ⇒ the revised forecast; the same order applies hereinafter) from 4,420 million yen ⇒ 4,800 million yen (+380 million yen or +8.6% from the initial forecast) due to strong orders from banks and insurance companies. Sales forecast for the distribution industry was also raised upward from 3,550 million yen ⇒ 3,600 billion yen (similarly, +50 million yen or +1.4%). On the other hand, the sales forecast for the transportation & telecommunication industries was revised downward from 3,910 million yen ⇒ 2,900 million yen (similarly, -1,010 million yen or -25.8%) and the other industries were also significantly revised down from 5,420 million yen ⇒ 4,900 million yen (similarly, -520 million yen or -9.6%) (Figure 8).
- By business model, the Company revised upward the sales of the Enhancement Business by 70 million yen (+0.6%) compared to the initial forecast, while it revised downward the sales of the SI Business by 1,040 million yen (-20.2%) and the Digital Business by 130 million yen (-16.7%).
- As for the annual dividend, there has been no change from the plan to raise dividend from 23 yen/share (ordinary dividend only) in the previous fiscal year to 50 yen/share (ordinary dividend of 26 yen/share + commemorative dividend of 24 yen/share for the Company's 50th anniversary) in the current fiscal year.

【Figure 8】 Financial Forecast for the Full Fiscal Year

Unit: million yen, %		FY 2022	FY 2023: Old CE	FY 2023: New CE	Diff. from Old Forecast (amount)	% Difference (%)	FY 2023: Old E	Diff. in Amount between Old E and New CE	% Difference (%)
			A	B	C=B-A	C/A	D	F=B-D	F/D
Sales		16,100	17,300	16,200	-1,100	-6.4	17,100	-900	-5.3
Gross Profit		3,450					3,710		
Gross Margin		21.4%					21.7%		
SG&A Expenses		2,032					2,230		
	(ratio to sales)	12.6%					13.4%		
Operating Profit		1,417	1,530	1,420	-110	-7.2	1,480	-60	-4.1
	(ratio to sales)	8.8%	8.8%	8.8%			7.6%	1.1%	
Recurring Profit		1,432	1,545	1,445	-100	-6.5	1,495	-50	-3.3
	(ratio to sales)	8.9%	8.9%	8.9%			7.8%	1.1%	
Net Profit		944	1,000	950	-50	-5.0	970	-20	-2.1
	(ratio to sales)	5.9%	5.8%	5.9%			5.3%	0.6%	
Sales Composition									
By Industry	Finance	3,909	4,420	4,800	380	8.6	4,550	250	5.5
	Distribution	3,342	3,550	3,600	50	1.4	3,550	50	1.4
	Telecommunication & Transportation	4,285	3,910	2,900	-1,010	-25.8	3,600	-700	-19.4
	Other	4,562	5,420	4,900	-520	-9.6	5,400	-500	-9.3
By Business Model	Digital Business	350	780	650	-130	-16.7	750	-100	-13.3
	SI Business	4,645	5,140	4,100	-1,040	-20.2	5,000	-900	-18.0
	Enhancement Business	11,103	11,380	11,450	70	0.6	11,350	100	0.9
Sales (% YoY growth)	8.9%	7.5%	0.6%	-6.9%		6.2%	-5.6%		
Gross Margin (% YoY diff.)	2.2%								
SG&A Expenses (% YoY growth)	22.0%								
Operating Profit (% YoY growth)	20.6%	7.9%	0.1%	-7.8%		4.4%	-4.3%		
Recurring Profit (% YoY growth)	10.6%	7.8%	0.9%	-6.9%		4.4%	-3.5%		
Net Profit (% YoY growth)	11.8%	5.9%	0.6%	-5.3%		2.8%	-2.2%		

(Note) Prepared by Alpha-Win Research Dept. based on the financial results summary and financial results briefing supplemental materials.

Full Fiscal Year: Alpha-Win Research Department's Forecast

- Due to concerns about another outbreak of COVID-19 (the eighth wave) and the uncertainty of the global situation, some companies with deteriorating business performance have been holding down their IT investments. On the other hand, there are many companies with strong financial performance and companies that are more actively making strategic DX investments (business and process transformation). There seems to be a polarization in IT investments.
- In this environment, the Company has been strategically strengthening measures to receive orders for systems-related projects from the latter group of companies. It has also been shifting to high-profit projects and improving resource efficiency.
- The Company has generally been seeing no signs of slowdown regarding negotiations or in receiving orders. There has also been a recovery in demand from the previously stagnant industries such as the financial industry, and the Company has been receiving more new orders for DX and upstream processes. It also seems to have some leeway in terms of controlling its results and has a stable, order-receiving business model. Therefore, we had believed that its downside risk was limited in terms of both sales and profits for this fiscal year.
- In our previous report, we had revised our full-year forecast downward, considering the underachievement of results in the first half of this fiscal year as well as the Company's goals for the second half of this fiscal year that seemed somewhat high for both sales and operating profit. However, the Company's revised forecast is now lower than our forecast by 5.3% (900 million yen) for sales and by 2% to 4% (20 million yen to 60 million yen) for each of the profit. Considering the Company's downward revision to its full-year forecast, which was mainly due to employee shortages, we also lowered our forecasts for both sales and profits to the same amount as the Company's forecasts.
- Given that the order backlog at the end of Q3 is almost the same level as the expected sales in Q4, as well as the increasing profitability of especially the Enhancement Business, we believe that the Company's revised forecasts are mostly achievable.
- From our previous forecast ⇒ current forecast (same as the Company's revised forecast), we revised our forecast for sales from 17,100 million yen (-200 million yen from the Company's initial plan) ⇒ 16,200 million yen, operating profit from 1,480 million yen (similarly, -50 million yen) ⇒ 1,420 million yen, net profit from 970 million yen (similarly, -30 million yen) ⇒ 950 million yen, and operating margin from 8.7% (similarly, -0.1%) ⇒ 8.8% (Figure 8 on page 7).

Medium Term: Forecast

- Over the medium to long term, the Company intends to build a stable and sustainable business foundation through its proposal-based and contract-based businesses. It also plans to shift its business portfolio to the Digital Business and the SI Business in which high growth is expected.
- In FY 2024, the final year of the current medium-term management plan, the Company plans to achieve sales of Y19 billion (+Y2.8 billion compared to the Company's revised sales forecast for the current fiscal year) and an operating profit of Y1.71 billion (similarly, +Y290 million).
- We have not changed our medium-term outlook for the Company's financial performance, predicting that IT investments will continue to be solid in the next fiscal year onward too. We also have not changed our medium-term forecast of dividend starting next fiscal year (annual increase of +2 yen/share for ordinary dividend).
- However, the Company will most likely start to see the effects of the capital and business alliance with NRI starting in the next fiscal year, and we plan to review our medium-term financial forecast upon the announcement of this fiscal year's full-year results.
- In the long term, the alliance is expected to increase the Company's sales and profit. However, as previously mentioned, the Company plans to make full-scale investments to strengthen its production facilities and production system from FY 2024 to FY 2026. After these augmentations, employees and facilities will start full operation, but there will most likely be a time lag before their full effects start to be seen. Also, the increase in costs is expected to temporarily cause its profitability and profit growth potential to worsen. Investment in production facilities is planned to peak in FY 2024, which will be depreciated in FY 2025 from the beginning to the end of the fiscal year. Since FY 2025 is also when fiscal-year costs related to strengthening the production system will peak, costs are expected to increase (Figure 1 on page 1).
- Highly specialized IT engineers, such as those with expertise in DX, are competitively in demand across all

industries. Even if employment terms and compensation are improved, the Company may not be able to hire and retain the necessary number of employees.

- On the other hand, IT investments are expected to continuously increase as customers work on digitalization, building business models for a world coexisting with COVID-19, strengthening their competitive edge, solving employee shortages, and streamlining and speeding up their operations. In addition, the strengthened alliance with NRI should have a significant effect. The Company's growth potential therefore seems to be increasing even further.
- We believe that the Company will be able to continue to stably increase sales and profit at a rate of about 6-10% per year, on the condition that the economic environment normalizes, through business with NRI, expansion of business area, acquisition of new customers, and improvement of productivity through various measures.

◆ Stock price and characteristics: domestic-demand-oriented, stable growth stock that has been significantly outperforming the TOPIX over the long term. The effect of the alliance with NRI will be a key point going forward.

Performance

- Over the past approximately 14 years, the Company's stock has risen by about 5.8x due to its strong financial performance and has been significantly outperforming the TOPIX (+347%). It has also risen by 7.5% since the beginning of this year (outperformed the TOPIX by 2.5%) and rose by 3.5% after the announcement of the Q3 results (since the closing price on February 8, 2023) (outperformed the TOPIX by 3.4%). The stock price has been solid, offsetting the dilution of shares due to the third-party allotment (paid-in amount of 1,010 yen/share; dilution rate of approx. 8.6%) (Figure C on page 11).

Comparison of Valuation and Financial Performance

- The current average of all companies listed on the TSE Prime is as follows: forecasted P/E of 13.85 (based on company forecasts), P/B of 1.17 (based on the actual BPS), and forecasted dividend yield (simple average) of 2.38%. The Company's valuation is about average in terms of its dividend yield (2.3%) based on its ordinary dividend, but somewhat high for its P/E and P/B which are 16.57 and 1.87, respectively.
- Compared to its competitors listed on the TSE Prime Market (HIMACS and Toho System Science; see Figure 9), the Company's valuation is high and at a premium in terms of the major indicators.
- Its valuation and performance seem to reflect its long-term track record of steady profit growth and relatively low earnings volatility, as well as the anticipation of positive effects from the alliance with NRI.
- In comparison with NRI with whom it has formed an alliance, the Company's valuation is low in terms of each indicator. Going forward, its valuation may gradually rise closer to NRI's relatively high valuation along with business expansion.

[Figure 9] Comparison of Valuation and Financial Performance with Competitors

Item	Company Name	CUBE SYSTEM (CS: consolidated)	HIMACS (HM: consolidated)	Toho System Science (TS: non-consolidated)	Reference: Nomura Research Institute (NRI: consolidated)	All TSE Prime Stocks
Stock Information	Securities Code (P stands for the TSE Prime Market)	2335 P	4299 P	4333 P	4307 P	1,836 companies
	Stock Price (at 2/10/2023 closing)	1,119	1,452	1,030	2,964	1,022.46
	Market Cap (million yen)	17,624	18,024	14,282	1,812,051	716,445,300
Valuation	P/E (forecasted price-to-earnings ratio)	16.57	13.38	12.18	22.76	13.85
	P/B (price-to-book ratio)	1.87	1.69	1.48	4.58	1.17
	Dividend Yield (%)	4.47 (incl. commemorative dividend) or 2.32 (excl. commemorative dividend)	2.96	3.88	1.52	2.38 (simple average) or 2.52 (weighted average)
	EV/EBITDA	7.66	5.45	3.67	11.84	-
	P/S (price-to-sales ratio)	1.09	1.04	0.93	2.63	Reference Ratios: NRI/CS
Results for This Fiscal Year's First Nine Months	Sales (million yen)	11,972	13,025	11,377	516,059	43.1
	Operating Profit (million yen)	951	1,356	1,171	83,873	88.2
	YoY Sales Growth Rate (%)	-0.6	6.8	8.1	15.2	-
	YoY Operating Profit Growth Rate (%)	-15.3	16.2	10.7	3.1	-
	Operating Margin (%)	7.9	10.4	10.3	16.3	2.0
	This Q3's Progress with Sales Compared to Full-Year Forecast (%)	73.9	75.5	74.4	74.8	-
	Similarly, Progress with Operating Profit (%)	67.0	75.3	78.1	72.9	-
Full-Year Results for This Fiscal Year (company forecast)	Sales (million yen)	16,200	17,250	15,300	690,000	42.6
	Operating Profit (million yen)	1,420	1,800	1,500	115,000	81.0
	YoY Sales Growth Rate (%)	0.6	3.4	7.7	12.8	-
	YoY Operating Profit Growth Rate (%)	0.1	4.9	13	8.3	-
	Operating Margin (%)	8.8	10.4	9.8	16.7	1.9
Relationship with the NRI Group	NRI's Stake in Each Company (%)	1.51 (before allotment) ⇒ 20.18 (after allotment)	4.90	2.02	-	-
	Each Company's Stake in NRI (%)	0.01% (68,463 shares held)	No information on securities report	0.02% (119,790 shares held)	-	-
	Each Company's Sales (million yen) to NRI and Their Proportion to Total Sales (%) in the Previous Fiscal Year	8,285 million yen / 51.5%	6,248 million yen / 37.5%	3,800 million yen / 26.7%	-	-
	Number of Directors and Officers from NRI	3 (president, 1 internal director, and 1 external director)	0	0	-	-

(Note) Prepared by Alpha-Win Research Dept. based on each company's financial results summary.

Market cap = (shares outstanding) x (market share price [at 2/10/2023 closing])

The companies' planned EPS values for FY 2023 were used in all P/E calculations. Actual BPS values of Q3 FY 2023 were used in P/B calculations.

EV/EBITDA = (market cap + interest bearing debt - cash & deposits) / (operating profit + depreciation + intangible fixed asset amortization, etc.)

Interest bearing debt and cash & deposits are actual values of Q3 FY 2023. Operating profit, depreciation, and intangible fixed asset amortization, etc., are values forecasted for this fiscal year by each company or calculated for the full year based on Q3.

PS = market cap / sales [the companies' forecasts for FY 2023]

Relationship with the NRI Group: NRI's stake in each company (in terms of shares outstanding excluding treasury shares) is as of the end of December 2022 for CS and as of September 2022 for the other companies. All other figures are as of the end of March 2022.

Stock Price Outlook

- Factors that will likely affect the Company's stock price in the future include the following: the effect of the alliance with NRI (its impact on earnings in the next fiscal year and beyond); trends in IT investments by the end-user companies (the level of orders received and the order backlog); progress with increasing employees, which has been the Company's bottleneck (the number of mid-career and new-graduate employees that are newly hired and the total number of employees); and the measures to return profit to shareholders (level of dividend, share buybacks, and stock splits).
- We believe that if the Company continues to show a stable profit growth at a nearly double-digit annual rate as a domestic-demand-oriented, defensive, small-cap, and stable growth stock, then its stock price may rise over the medium to long term in line with P/E level corrections and the increase in EPS.

[2335 CUBE SYSTEM Sector: Information & Communication] Figure A												
FY		Sales (million yen)	YoY (%)	O.P. (million yen)	YoY (%)	R.P. (million yen)	YoY (%)	N.P. (million yen)	YoY (%)	EPS (Y)	BPS (Y)	Dividend (Y)
2020		14,708	2.7	959	4.1	976	1.7	525	-11.9	38.69	411.96	18.0
2021		14,788	0.5	1,174	22.5	1,295	32.7	844	60.7	62.11	476.52	20.0
2022		16,099	8.9	1,417	20.7	1,432	10.6	944	11.9	69.82	531.14	23.0
2023	Mid-Term Plan: Initial CE	17,200	-	1,340	-							
2023	Old CE	17,300	7.5	1,530	7.9	1,545	7.8	1,000	5.9	73.91	Not disclosed	50.0
2023	New CE	16,200	0.6	1,420	0.1	1,445	0.9	950	0.6	67.53	Not disclosed	50.0
2023	Initial E	17,200	6.8	1,520	7.3	1,535	7.2	1,000	5.9	74.08	585.46	50.0
2023	Old E	17,100	6.2	1,480	4.4	1,495	4.4	970	2.8	69.73	565.30	50.0
2023	New E	16,200	0.6	1,420	0.1	1,445	0.9	950	0.6	67.53	595.69	50.0
2024	Mid-Term Plan: Initial CE	18,500	7.6	1,480	10.4							
2024	Mid-Term Plan: Revised CE	19,000	9.8	1,710	11.8							
2024	E	18,700	15.4	1,700	19.7	1,715	18.7	1,100	15.8	72.55	618.24	28.0
2025	E	19,600	4.8	1,800	5.9	1,820	6.1	1,180	7.3	77.83	668.07	30.0
2022	Q1	3,987	18.2	378	56.5	390	57.1	262	59.0	19.4	487.51	0.0
2023	Q1	3,892	-2.4	272	-28.1	271	-30.5	173	-34.0	12.8	543.58	0.0
2022	Q2	4,073	9.8	368	18.7	362	2.0	239	1.7	16.8	509.03	8.0
2023	Q2	4,000	-1.8	326	-11.1	323	-10.8	215	-9.5	15.9	556.76	23.0
2022	Q3	3,981	13.5	376	56.7	381	19.4	254	29.6	18.8	531.14	8.0
2023	Q3	4,080	2.5	353	-6.1	359	-5.8	240	-5.4	17.5	597.49	23.0
2022	Q4	4,058	-3.3	295	-22.8	299	-19.8	189	-23.8	14.0	531.14	15.0
2023	Q4 CE	4,228	4.2	469	58.9	492	64.4	322	70.3	21.3		27.0
2022	Q3 YTD	12,041	13.7	1,122	41.7	1,133	22.9	755	26.6	55.8	531.14	8.0
2023	Q3 YTD	11,972	-0.6	951	-15.3	953	-15.8	628	-16.8	45.8	597.49	23.0

(Note) CE: the Company's forecast/estimate. Old CE: the Company's previous forecast/estimate. New CE: the Company's current, revised forecast/estimate. "Mid-Term Plan: Initial CE" is the company forecast announced on June 11, 2021. "Mid-Term Plan: Revised CE" is the company forecast announced on May 11, 2022.

E: Alpha-Win Research Dept.'s forecast/estimate. Initial E: Alpha-Win Research Dept.'s initial forecast/estimate. Old E: Alpha-Win Research Dept.'s previous forecast/estimate. New E: Alpha-Win Research Dept.'s current forecast/estimate.

Q1: Apr-June. Q2: July-Sept. Q3: Oct-Dec. Q4: Jan-Mar. Q3 YTD: Apr-Dec.

[Stock Price and Valuation Indicators: 2335 CUBE SYSTEM] Figure B						
Item	2/10/2023	Item	P/E	P/B	Dividend Yield	Dividend Payout Ratio
Stock Price (Y)	1,119	Last FY (actual)	16.0	2.1	2.1%	32.2%
Shares Outstanding (thou.)	15,750	This FY (est.)	16.6	1.9	4.5%	74.0%
Market Capitalization (million yen)	17,624	Next FY (est.)	15.4	1.8	2.5%	38.6%
Dilutive Shares (thou.)	0	Equity Ratio at End of This FY's Q3	77.3%		Last FY's ROE	13.8%

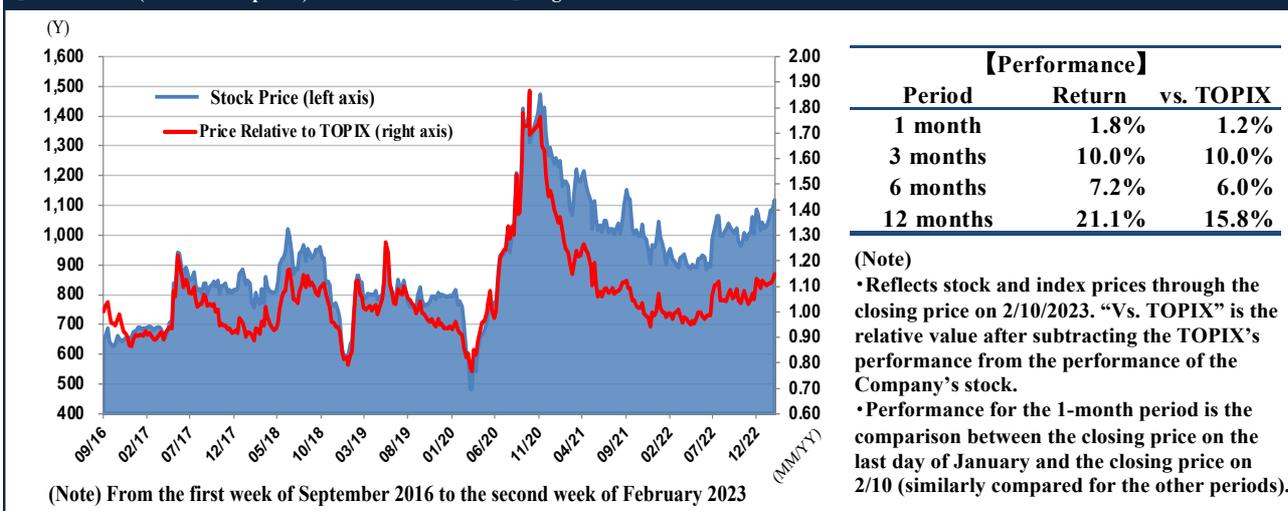
(Note) Estimates were made by Alpha-Win Research Dept. Shares outstanding are the total amount after the third-party allotment of new shares.

Short Report

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【 Stock Chart (end-of-week prices): 2335 CUBE SYSTEM 】 Figure C



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