

Japan Technology: IT Services: NC company results read-across (3) Cybersecurity: Techmatrix, Digital Arts

In this report, we consider the implications for our IT services sector coverage from visits we made to two Not Covered companies, security vendors **Techmatrix (network security/in-car software verification tools/medical cloud)** and **Digital Arts (network security/Web filtering software)**. **Techmatrix's** new consolidation of Medmain, which provides AI software and cloud services for pathological diagnosis support, resulted in its FY3/27 operating profit guidance being set below the target in the medium-term plan, and once the amortization of its intangible fixed assets is finalized, the company expects the consolidation to depress near-term earnings. While security in the information infrastructure business continues to perform well, other businesses continue to be a drag on earnings. For **Digital Arts**, the competitive environment for GIGA school software has intensified sharply, leading to a decline in market share, and its FY3/27 operating profit guidance is well below the target in the medium-term plan. While earnings continue to lag targets, the company is also seeing tailwinds such as expanding demand ahead of the security measures evaluation system that the Ministry of Economy, Trade and Industry (METI) plans to introduce.

In terms of read-across, security-related demand is robust overall, which is a tailwind for the domestic earnings of Trend Micro (Neutral), which is strong in this field. Additionally, increased investment spurred by the security measures evaluation system should also be a positive for the earnings of Otsuka (Sell), which handles related products. Below we outline our key takeaways from company commentary. (See earnings tables at [Exhibit 2/Exhibit 3/Exhibit 4](#).)

Techmatrix (3762.T) (network security/medical)

- (1) **Guidance:** FY3/27 operating profit guidance calls for ¥8.2 bn (+6% yoy), below the target in the medium-term plan (¥8.6 bn). This is largely due to the new consolidation of Medmain, which provides AI software and cloud services for pathological diagnosis support (planned for consolidation from 1Q, with Techmatrix expecting this to depress operating profits by -¥0.4 bn). By segment, the company looks for a +10% yoy increase in operating profits in the information infrastructure business (security), where demand is strong. The struggling application services business is guided to improve by +¥0.35 bn yoy and return to profitability. The medical systems business, which will be impacted by Medmain's consolidation, is forecast to see a -43% yoy decline in profits. The company assumes one-off factors will depress profits by just over ¥100 mn yoy

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on net, namely the drop-out of impacts from a sales booking omission (which boosted 4Q3/26 operating profits by +¥166 mn in information infrastructure) and a revision of retirement benefit expenses (-¥50 mn impact in 4Q3/26). Additionally, losses are guided to narrow by a few hundred million yen in the Ed Tech business (systems for schools and the education industry), but the company forecasts it will remain in the red for now (and turn an operating profit in the latter half of the next medium-term plan).

- **(2) Information infrastructure business:** 4Q3/26 operating profits rose by +48% yoy, and by +35% yoy on an underlying basis excluding the one-off factor of the sales booking omission. Growth has been driven by next-generation firewalls from US-based Palo Alto Networks, SOC (Security Operation Center) automation solutions, and mail security products from US-based Proofpoint (4Q order value rose +10% yoy; [Exhibit 1](#)). In addition, management noted the standalone recurring sales ratio (in FY3/26) was 88%, enhancing earnings stability. FY3/27 operating profit guidance is for ¥7.24 bn (solid growth of +10% yoy). As the company's main products are mostly cloud-based, it is less susceptible to the impact of rising memory prices and longer parts procurement lead times. Storage products, which could be affected, account for a minor portion of sales in this business (less than 3%), and management said there has been no impact so far.
- **(3) Medical systems business:** FY3/27 operating profit guidance is for ¥0.76 bn (-43%/-¥0.57 bn yoy). The main reasons for the anticipated decline are the impact of the new consolidation of Medmain (a profit drag of c.¥0.4 bn), a temporary decrease in sales due to the shift from on-premise to cloud systems, and an increase in development investment for cloud services. According to the company, (a) Medmain is in an upfront investment phase and will probably take about five years to turn a profit, and (b) as PPA has not been completed, the amortization expense for intangible fixed assets has not been finalized (it is not included in guidance, and will be a downside factor for targets once finalized).

Exhibit 1: Firewalls, mail security, and software quality assurance driving growth

Technatrix: Information infrastructure and application services businesses: Sales growth by product (yoy; cumulative basis)

Sales growth rate (y-y)	25/3				26/3			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
<Information Infrastructure Business>								
Load balancers	5%~10%	5%~10%	>10%	>10%	>10%	>10%	5%~10%	-5%~+5%
Next-Generation Firewall etc	>10%	>10%	>10%	>10%	>10%	5%~10%	>10%	>10%
Antivirus etc	-5%~+5%	-5%~+5%	-5%~+5%	-5%~+5%	>10%	>10%	>10%	>10%
Storage products	-5%~10%	>10%	>10%	5%~10%	>10%	<-10%	<-10%	<-10%
Security-related operation & monitoring	>10%	>10%	>10%	5%~10%	<-10%	<-10%	-5%~10%	-5%~+5%
Next-Generation Mail security	>10%	>10%	>10%	>10%	>10%	>10%	>10%	>10%
<Application Service Business>								
Business Solution field	>10%	>10%	-5%~+5%	-5%~+5%	-5%~10%	-5%~10%	-5%~+5%	5%~10%
Software Quality Assurance field	>10%	>10%	>10%	>10%	5%~10%	>10%	>10%	>10%
CRM field	>10%	>10%	>10%	>10%	5%~10%	5%~10%	5%~10%	-5%~+5%
EdTech field	>10%	>10%	>10%	>10%	5%~10%	>10%	>10%	>10%

Source: Company data, Data compiled by Goldman Sachs Global Investment Research

Digital Arts (2326.T) (network security)

- **(1) Results:** FY3/26 operating profits came to ¥4.79 bn (+5% yoy), substantially missing guidance (¥5.61 bn). The main reasons cited were a decline in share for GIGA

school projects amid intensified price competition with rivals, a reduction in the size of public sector projects due to changes in procurement policy (from multi-year to single-year contracts), and a delay in sales recognition due to an increasing cloud ratio. According to management, all of these factors are ongoing.

- (2) **Guidance:** FY3/27 operating profit guidance is for ¥5.4 bn (+13% yoy), which is well below the target in the medium-term plan (¥7.8 bn). The main reasons are the same as for the underperformance in FY3/26. On a yoy basis, although communication costs (AWS server fees) are expected to increase with the rising cloud ratio, the company expects double-digit % profit growth due to greater demand for GIGA school and school DX projects, a full-year contribution from the new Z-FILTER product, and operational efficiencies from AI.
- (3) **Public business:** Order value (contract value) for GIGA school projects is on an upward trend, but it missed company expectations in 4Q3/26. Until 3Q, the company had a dominant market share due to its technological lead, but in 4Q, several competitors launched an offensive with prices at about half of the company's, resulting in a decline in cumulative market share from 95% (at end-3Q) to 70% (at end-4Q). Management said the cumulative market share assumption for end-FY3/27 is 70%, which is higher than the level in the first GIGA school phase (53%), and the company will need to acquire new customers. Digital Arts thinks competitors' price offensive may continue, so it also plans to propose slightly lower-than-usual prices to some customers.
- (4) **Enterprise business:** 4Q3/26 sales grew by just +1% yoy, hampered by a decline in on-premise sales. FY3/27 sales guidance is for a +10% yoy increase, with growth expected for the new Z-FILTER product. Z-FILTER has many more functions than i-FILTER (firewall/antivirus, etc.), and while the monthly unit price is set at 3-4x the previous level, it is cheaper than products from foreign vendors and is competitive. Per the company, the contract value pipeline is c.¥1 bn, mainly from existing customers, of which it expects ¥0.9 bn to be booked in FY3/27. While not factored into plans, the company noted that corporate security investment is highly likely to expand ahead of the security measures evaluation system that METI plans to introduce, and that this could become a tailwind for a range of its products.

Exhibit 2: Techmatrix (3762.T): Earnings by segment

(mn yen)					CoE	26/3			
Techmatrix (3762)	24/3	25/3	26/3	27/3E	Q1	Q2	Q3	Q4	
Order	68,446	82,866	89,009		20,544	23,098	21,261	24,106	
yoy	15.1%	21.1%	7.4%		-5.2%	7.5%	20.9%	8.9%	
Order Backlog	68,566	88,155	105,431		92,836	98,420	102,073	105,431	
yoy	30.8%	28.6%	19.6%		21.4%	21.7%	21.3%	19.6%	
Sales	53,303	64,882	71,734	81,800	15,863	17,514	17,608	20,748	
yoy	16.0%	21.7%	10.6%	14.0%	15.3%	2.6%	10.8%	14.3%	
Gross Profit	18,203	20,555	22,575		4,931	5,562	5,562	6,521	
yoy	11.2%	12.9%	9.8%		14.8%	5.3%	7.0%	12.9%	
% of sales	34.1%	31.7%	31.7%		31.1%	31.8%	31.6%	31.4%	
SGA	12,310	13,561	14,829		3,659	3,667	3,652	3,851	
yoy	10.2%	10.2%	9.4%		14.6%	9.4%	6.6%	7.3%	
% of sales	23.1%	20.9%	20.7%		23.1%	20.9%	20.7%	18.6%	
Other sales	24	38	35		3	9	15	8	
Other costs	67	363	21		0	3	2	15	
Operating Profits	5,850	6,668	7,760	8,200	1,274	1,901	1,922	2,663	
yoy	14.7%	14.0%	16.4%	5.7%	14.4%	-0.5%	8.1%	42.6%	
% of sales	11.0%	10.3%	10.8%	10.0%	8.0%	10.9%	10.9%	12.8%	
<Sales and OP by Segments>									
I Information Infrastructure Business									
Order	47,652	60,482	64,134		14,878	16,928	16,024	16,304	
yoy	17.3%	26.9%	6.0%		-8.6%	3.6%	22.5%	10.3%	
Order Backlog	49,861	66,366	78,880		69,746	73,943	77,153	78,880	
yoy	34.0%	33.1%	18.9%		23.4%	22.4%	21.0%	18.9%	
External Sales	35,006	45,586	51,620	59,500	11,498	12,731	12,814	14,577	
yoy	19.5%	30.2%	13.2%	15.3%	19.7%	2.3%	12.6%	19.9%	
% of sales	65.7%	70.3%	72.0%	72.7%	72.5%	72.7%	72.8%	70.3%	
Operating Profits	3,973	5,274	6,580	7,240	1,257	1,670	1,715	1,938	
yoy	28.6%	32.7%	24.8%	10.0%	33.6%	3.2%	21.9%	48.2%	
% of sales	11.3%	11.5%	12.7%	12.2%	10.9%	13.1%	13.3%	13.2%	
II Application Service Business									
Order	9,074	9,924	10,938		2,789	2,487	2,146	3,516	
yoy	16.3%	9.4%	10.2%		5.6%	14.1%	15.5%	8.4%	
Order Backlog	5,327	6,071	7,125		6,558	6,631	6,347	7,125	
yoy	19.5%	14.0%	17.4%		11.8%	15.1%	16.8%	17.4%	
External Sales	8,205	9,177	9,884	11,130	2,302	2,414	2,430	2,738	
yoy	12.4%	11.8%	7.7%	12.6%	9.5%	5.7%	11.2%	5.0%	
% of sales	15.4%	14.1%	13.8%	13.6%	14.5%	13.8%	13.8%	13.2%	
Operating Profits	317	142	-148	200	-45	-9	-53	-42	
yoy	22.4x	-55.4%	N.M.	N.M.	N.M.	N.M.	N.M.	N.M.	
% of sales	3.7%	1.5%	-1.5%	1.8%	-1.9%	-0.3%	-2.1%	-1.5%	
III Medical Systems Business									
Order	11,719	12,459	13,936		2,876	3,685	3,090	4,285	
yoy	6.3%	6.3%	11.9%		5.0%	23.7%	17.0%	4.5%	
Order Backlog	13,377	15,717	19,425		16,531	17,846	18,572	19,425	
yoy	24.6%	17.5%	23.6%		17.5%	21.5%	23.8%	23.6%	
External Sales	10,092	10,119	10,229	11,170	2,062	2,370	2,364	3,433	
yoy	8.0%	0.3%	1.1%	9.2%	0.4%	0.6%	1.7%	1.4%	
% of sales	18.9%	15.6%	14.3%	13.7%	13.0%	13.5%	13.4%	16.5%	
Operating Profits	1,560	1,253	1,329	760	63	239	260	767	
yoy	-21.8%	-19.7%	6.1%	-42.8%	-42.7%	22.5%	7.6%	8.5%	
% of sales	15.5%	12.4%	8.8%	9.6%	3.0%	10.1%	11.0%	22.3%	

Operating profits by business include internal transactions

Source: Company data, Data compiled by Goldman Sachs Global Investment Research

Exhibit 3: Digital Arts (2326.T): Earnings by segment

(mn yen)				CoE	26/3			
Digital Arts (2326)	24/3	25/3	26/3	27/3E	Q1	Q2	Q3	Q4
Contracts	10,838	10,570	16,604	13,500	2,306	4,323	4,246	5,729
yoy	6.4%	-2.5%	57.1%	-18.7%	15.7%	71.3%	81.3%	54.3%
yoy excl. effects of DAC deconsolidation		22.3%	-					
License Products and Others	7,479	5,373	5,192		927	1,313	1,451	1,501
yoy	10.1%	-28.2%	-3.4%		-14.6%	-10.1%	17.7%	-5.8%
Cloud Service Products	3,359	5,197	11,412		1,379	3,009	2,795	4,229
yoy	-1.1%	54.7%	119.6%		52.2%	183.1%	152.0%	99.6%
Order Backlog	5,651	6,243	12,006		6,279	7,903	9,286	12,006
yoy	-10.6%	10.5%	92.3%		16.1%	48.1%	77.1%	92.3%
Sales	11,512	9,982	10,835	12,000	2,270	2,722	2,843	3,000
yoy	10.3%	-13.3%	8.5%	10.8%	1.6%	4.5%	16.7%	10.8%
yoy excl. effects of DAC deconsolidation		7.1%	-	-				
Gross Profit	6,928	7,033	7,500	8,176	1,531	1,902	1,964	2,103
yoy	2.3%	1.5%	6.6%	9.0%	1.5%	3.0%	16.2%	5.8%
% of sales	60.2%	70.5%	69.2%	68.1%	67.4%	69.9%	69.1%	70.1%
SGA	2,500	2,474	2,708	2,776	735	676	643	654
yoy	6.1%	-1.0%	9.5%	2.5%	9.9%	6.8%	7.5%	13.9%
% of sales	21.7%	24.8%	25.0%	23.1%	32.4%	24.8%	22.6%	21.8%
Operating Profits	4,427	4,558	4,791	5,400	795	1,226	1,321	1,449
yoy	0.3%	3.0%	5.1%	12.7%	-5.1%	1.0%	20.9%	2.5%
% of sales	38.5%	45.7%	44.2%	45.0%	35.0%	45.0%	46.5%	48.3%
<Sales and OP by Segments>								
Enterprise								
Contracts	6,659	5,016	5,564		1,044	1,252	1,500	1,768
yoy	22.1%	-24.7%	10.9%		5.0%	3.6%	28.9%	7.2%
yoy excl. effects of DAC deconsolidation		15.0%	-					
Sales	6,456	4,783	5,176	5,691	1,169	1,263	1,362	1,382
yoy	21.4%	-25.9%	8.2%	9.9%	8.8%	5.3%	19.8%	0.7%
yoy excl. effects of DAC deconsolidation		12.3%	-	-				
% of sales	56.1%	47.9%	47.8%	47.4%	51.5%	46.4%	47.9%	46.1%
Public								
Contracts	3,760	5,146	10,639		1,160	2,966	2,649	3,864
yoy	-12.6%	36.9%	106.7%		29.6%	144.1%	146.6%	96.9%
Sales	4,637	4,788	5,256	5,905	999	1,354	1,381	1,522
yoy	-1.0%	3.3%	9.8%	12.3%	-6.3%	4.6%	15.7%	23.4%
% of sales	40.3%	48.0%	48.5%	49.2%	44.0%	49.7%	48.6%	50.7%
Consumer								
Contracts	418	408	400		101	104	99	96
yoy	-3.5%	-2.4%	-2.0%		-1.0%	4.0%	-4.8%	-5.9%
Sales	418	409	402	402	101	106	98	97
yoy	-3.5%	-2.2%	-1.7%	0.0%	8.6%	-2.8%	-6.7%	-4.9%
% of sales	3.6%	4.1%	3.7%	3.4%	4.4%	3.9%	3.4%	3.2%

Consulting subsidiary DAC was eliminated from the scope of consolidation from 1Q3/25, impacting contract value and sales, but with a minor impact on profits.

Source: Company data, Data compiled by Goldman Sachs Global Investment Research



Exhibit 4: IT services sector earnings outlook

Disclosure Appendix

Reg AC

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