
 Yoshihiko Inami, CEO	Vario Secure Inc. (4494)
	

Company Information

Exchange	2 nd section of Tokyo Stock Exchange
Industry	Information and Communications
CEO	Yoshihiko Inami
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Year-end	February
Homepage	https://www.variosecure.net/en/

Stock Information

Share Price	Number of shares issued		Total market cap	ROE (Act.)	Trading Unit
¥1,302	3,788,433 shares		¥4,932 million	13.4%	100 shares
DPS (Est.)	Dividend yield (Est.)	EPS (Est.)	PER (Est.)	BPS (Act.)	PBR (Act.)
¥40.44	3.1%	¥134.79	9.7x	¥1,048.52	1.2x

*The share price is the closing price on November 30. Numbers of shares issued, DPS and EPS are from the financial results for the second quarter of Fiscal Year ending February 2022. ROE and BPS from the financial results for the previous term.

Earnings Trends

Fiscal Year	Revenue	Operating Profit	Profit before tax	Profit	EPS	DPS
February 2020 Act.	2,513	789	723	498	133.70	0.00
February 2021 Act.	2,545	764	707	491	131.78	39.44
February 2022 Est.	2,649	782	732	507	134.79	40.44

* Unit: million-yen, yen. Estimates calculated by the company. IFRS applied.

This Bridge Report presents Vario Secure Inc. Inc.'s earnings results for the second quarter of Fiscal Year ending February 2022, etc.

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Key Points

- The company offers comprehensive network security services through which their customers can safely use the Internet, under the mission: “To ensure that all enterprises using the Internet can easily and securely carry out their business, we will offer the very best services to Japan and to the world.”
- Their specialties and strengths include (1) an original business model, which offers a one-step solution with the procurement of devices used for security services, the development of key software installed into those devices, installation and setting up of those devices, and monitoring and operation of the devices after installation, (2) a stable earnings model, which is based on a recurring revenue business, whose revenues increase year by year through an increase in the number of companies installing their products with a monthly charging system, and on a low cancellation rate, (3) a strong marketing channel covering the entire country with 31 partnered companies in OEM and 59 partnered companies in resale, and (4) a high share among small and medium sized enterprises, which appraises the ease of installation of their products.
- The revenue for the term ended February 2021 was 2,545 million yen, up 1.3% from the end of the previous term. Managed Security Services grew steadily. Operating profit was 764 million yen, down 3.1% from the end of the previous term. Travelling and entertainment expenses decreased because of the novel coronavirus, but in addition to the added expenses for preparation for listing on the stock exchange, they also incurred maintenance expenses for the integration of the security operations center and for preparations to adapt to online workstyles. Both revenue and profit were almost in line with their estimates.
- In the second quarter of the term ending February 2022, sales revenue increased 1.7% YoY to 1,283 million yen. While managed service performed as planned, integration service failed to reach the forecast as some projects took longer to set up on-site due to the prolonged restrictions under the state of emergency, despite the increase in revenue. Operating profit decreased 14.2% YoY to 363 million yen. While enhancing marketing and sales as planned, the company hired personnel to strengthen legal aspects and built a security operation center, which resulted in a decrease in profit, but was in line with the plan. The recruitment of engineers progressed as assumed.
- In September 2021, the company entered into a capital and business alliance agreement with HEROZ, Inc. (the first section of TSE: 4382). Both companies aim to create and promote new products and services and increase their corporate value by mutually providing and cooperating with each other's management resources such as Vario Secure's industrial domain knowledge and data and HEROZ's AI technology to create and maximize synergies. As part of the full-scale launch of the alliance system, Vario Secure and HEROZ started a Proof of Concept (POC) for the joint development of services to discuss the adoption of AI.
- Earnings forecasts aren't unchanged. Revenue is estimated to be 2,649 million yen, up 4.1% from the previous term and operating profit is projected to be 782 million yen, up 2.4% from the previous term. Expecting an increase in personnel recruitment to strengthen the marketing and sales department and strengthen the legal department following the listing on the stock exchange, an increase in advertisement expenses, and an augmentation of advisory fees, operating profit margin is projected to decrease 0.5 points from the end of the previous term, but an increase in profit is expected. The

company is aiming for a dividend payout ratio of 30.0% on the IFRS base. The dividend for the term ended February 2021 is 40.44 yen per share.

- The POC with HEROZ is currently underway, but from the current progress, we have a feeling that it can be commercialized more reliably than initially expected, and we are now very interested in it. In addition, as the news about ransomware and other cyber-security issues is becoming increasingly common, inquiries about the services (VDaP and EDR) are steadily increasing, not only for data backup, but also as a precaution against viruses and malware that cannot be detected by conventional anti-virus software. Accordingly, the business environment remains favorable. Although it is unlikely to see a significant increase in sales by 20% or 30% due to the accumulative nature of the recurring business, we expect to see an increase in sales through their initiatives centered on the development of new commercial channels.

1. Company Overview

[1-1 Corporate History]

In June 2001, Ambisys Inc. — the predecessor of the company — was founded with the business objectives to develop and operate information, communication, and security systems and provide consulting services on them. In May 2002, the company launched the managed security services using the integrated Internet security appliance equipment. In June 2003, the company name was changed to Vario Secure Networks Inc. As an independent Internet security service company, the company steadily expanded its businesses and was listed on the Nippon New Market “Hercules” at the Osaka Securities Exchange in June 2006.

In the ensuing period, the company’s growth slowed down with a higher churn rate from existing customers and the increase in service installation locations stagnating, as a result of the deterioration in corporate profits and the decline in private capital investments triggered by the bankruptcy of Lehman Brothers.

In order to make speedy management decisions and improve corporate value under a dynamic and flexible management system in the constantly changing network security market, the company realized that upfront investments were unavoidable, which might temporarily deteriorate profits. Under such a condition, the company took a decision to delist shares and concentrate on improving corporate value, and in December 2009 duly delisted the shares on Hercules.

After delisting, the company renewed its management structure amid several major shareholder reshuffles, and increased its internal cost awareness, while working to expand its businesses by strengthening the existing sales force and developing new sales agents, as well as continuously conducting R&D to improve the quality of security services. As a result, the company was able to increase corporate value, which was the purpose of delisting, by strengthening its sales structure, creating new businesses, and strengthening the service menu. The company name was changed to its current name, Vario Secure, Inc. in September 2016.

To realise a sustainable growth and corporate value enhancement, the company was convinced of the importance of securing the flexible and diverse financing methods and also that by relisting, the company could further improve social credibility, secure excellent human resources, improve employees’ motivation to work, and aim for appropriate stock price formation and liquidity, the company got listed on the Second Section of the Tokyo Stock Exchange in November 2020.

[1-2 Corporate Philosophy, etc.]

The company’s mission is **“to ensure that all enterprises using the Internet can easily and securely carry out their business, the company will offer the very best services to Japan and to the world.”**

Under this mission, as a company that provides Internet-related security services, it provides comprehensive network security services to assist with the safer use of the Internet by protecting the customers’ networks from attacks from the Internet, intrusions into internal networks, and various threats such as virus infections and data thefts.

[1-3 Market Environment]

◎ Growing demand for cybersecurity

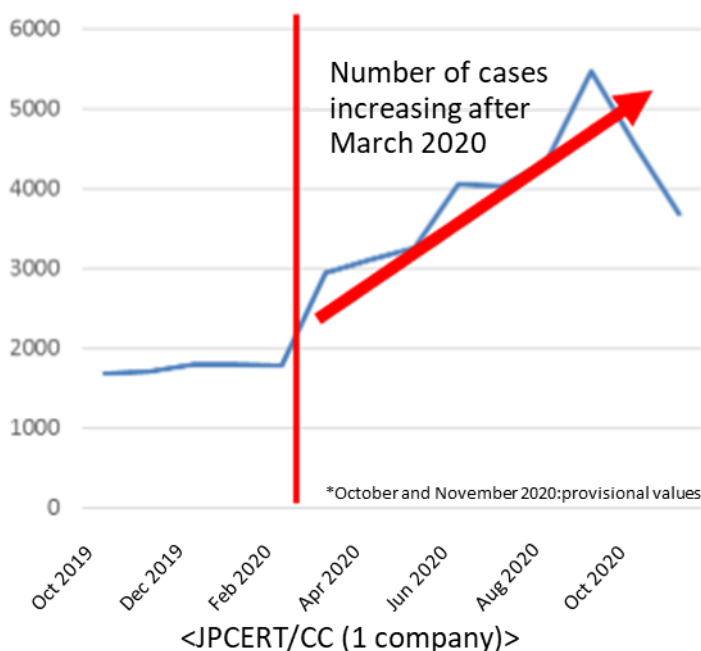
In December 2020, the Ministry of Economy, Trade and Industry (METI) issued a report urging business owners to strengthen cybersecurity efforts in response to the ever-increasing cyberattack entry points as well as the severities of the attacks.

This report identified the following current issues:

- In recent years, the attack entry points in the supply chain used by attackers have been constantly increasing. These include overseas bases of business partners including SMEs and companies expanding overseas, as well as gaps created by the increase in telework due to the spread of the novel coronavirus.
- In addition to demanding ransoms to recover encrypted data, ransomware that uses the so-called “double threats” — threatens to release the data that was stolen in advance before encrypting unless ransom is paid — are rapidly increasing in Japan. This is due to the establishment of an ecosystem which enables attackers to systematically provide ransomware as well as collecting ransoms systematically, allowing them to operate easily without having to be highly skilled.
- With the globalization of businesses, more and more systems that are closely linked with overseas bases are being built; however, as a result of linking the Japanese domestic systems to those of overseas without sufficient measures, the risk of intrusion is increased as this enabled the attackers to construct intrusion routes at overseas bases where security measures are insufficient.

As shown in the graph below, since March 2020 when the novel coronavirus began spreading, the number of consultations concerning those unexpected events that would quickly spiral out of control without immediate counteractions has been increasing.

**Number of incident-related consultations to JPCERT/CC
(per month)**



(From the Ministry of Economy, Trade and Industry’s “Warning to Managers Concerning the Recent Cyberattacks (Summary Edition)”

Based on these, the report urges corporate managers to act on the following responses and initiatives:

- The severity of damage caused by cyberattacks is increasingly more serious and the damages are also more complex: management needs to be involved even more than previously.
- Responding to the damages caused by ransomware attacks is an important issue directly related to corporate trust, and sweeping management leadership is required from proactive prevention to postvention.

Under these conditions, the security service market is seeing an increase in demand.

The security service market requires advanced security measures, but companies that find it difficult to operate and manage in-house security measures tend to outsource operations and monitoring to security vendors, leading to an increase in the service usage.

The market size is expected to expand from 223.7 billion yen in the fiscal 2019 to about 322.2 billion yen in the fiscal 2025, with an average annual growth rate of 6.3% (from the company’s securities report. Source: Fuji Chimera Research Institute, Inc. “2020 Network Security Business Survey Overview (Market Edition)” published on November 17, 2020).

◎ IT personnel shortage

The METI ran a trial calculation of the output gap in IT human resources due primarily to the expansion of IT investment by companies using AI. According to the report, if the productivity growth rate is 0.7%, the shortage in the number of IT workers in 2030 is estimated at 787,000 in the high-level scenario (3-9% growth in IT demand), 449,000 in the medium level scenario (2-5% of the same), and 164,000 in the low-level scenario (1%). Even if productivity were to rise to 2.4%, the high-level scenario still predicts a shortfall of 438,000 people.

Under these circumstances, it is difficult for companies to secure sufficient IT human resources within their companies, therefore a steady increase is expected for the demand for “managed service” that provide not only the functions but also combine the operation management as one when using IT systems.

* Gap in demand for IT personnel in 2030 (number of workers)

Productivity Growth Rate	Low-level scenario	Medium-level scenario	High-level scenario
0.7%	164,000	449,000	787,000
2.4%	-72,000	161,000	438,000

*Created by Investment Bridge based on the Ministry of Economy, Trade and Industry’s “Survey on Supply and Demand of IT Human Resource (Summary)” (April 2019).

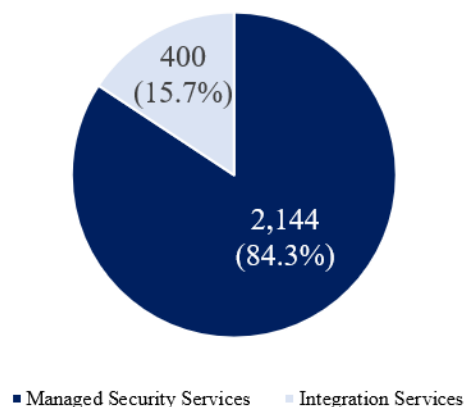
[1-4 Business Contents]

(1) Service category

The company provides two security services: Managed Security Services and Integration Services (segment: single segment of Internet security service business).

These services cover every step in the security framework: construction, identification, defense, detection, response, and recovery.

Service components(FY Feb. 2021, unit:million yen)



① Managed Security Services

In addition to the integrated Internet security service using VSR and the data backup service (VDaP), since the term ended February 2021, the company has been offering Vario EDR service that helps detect and respond to cyberattacks at lower operational costs, and Vario-NSS, which detects abnormal terminals and provides vulnerability management.

<Integrated Internet Security Service Using VSR>

Overview

This service provides comprehensive network security that protects corporate networks from the attacks from the Internet, intrusions into internal networks, and threats such as virus infections and data thefts, and enables customers to use the Internet safely.

The company’s integrated Internet security service uses VSR (Vario Secure Router) — a network security device developed by the company which integrates various security functions such as firewalls, IDS (intrusion detection system), and ADS (automatic defense system) into one unit — which is installed between the Internet and customers’ internal networks, and acts as a filter to remove threats such as attacks, intrusions, and viruses.

VSR is automatically managed and monitored by a proprietary operational monitoring system run by the company’s data center, and operational information statistics and various alerts are processed in real time without human interventions.

Statistics and alerts are provided in real time to user company administrators over the Internet via a reporting function called, the Control Panel. In addition, the company has established a 24/7 support center, and a maintenance network covering all 47 prefectures in Japan and an operation support system such as changing the equipment settings.

Since they are manufactured at several factories in Taiwan while the core software is developed in-house, it is more cost-effective than purchasing hardware and adding services, and this is one of the reasons contributing to VSR’s high operating income margin.



(Source: the company’s website)

Merits

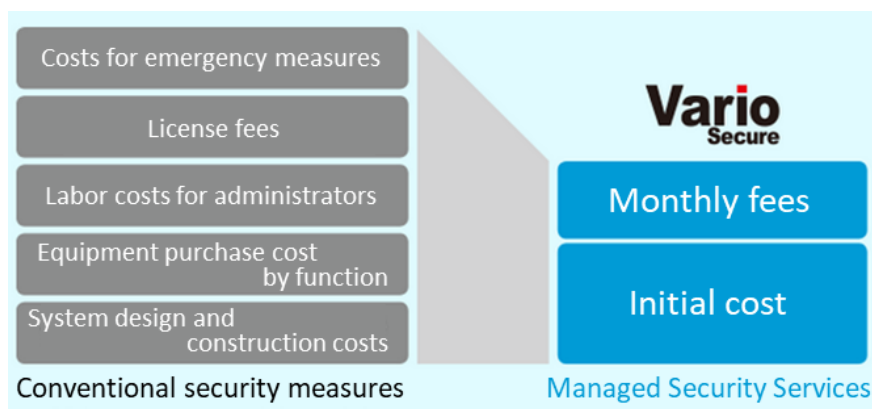
Previously, to introduce the security system such as above, it was necessary to install various security devices in-house and maintain them, making it more difficult for many companies to introduce sufficient network security measures because they required highly skilled engineers and high investments.

In addition, even after the introduction of the security system, monitoring, quick response to alerts, software updates, inquiries in the event of trouble, etc. required a great deal of effort and time, and the operational burden was extremely large.

In contrast, the company’s Managed Security Services, which provides the one-stop solution from initial introduction to operation and maintenance of VSR, a unique in-house product, provides significant benefits to customers in the following respects:

As VSR boasts 23 different security features per unit, it eliminates the need to purchase equipment and instead provides the security system via the rental equipment.
A monthly fee is set for each security feature, allowing customers to choose the options they need from a variety of security features.
By simply paying the initial cost incurred only at the start of the contract and monthly fees, it is possible to outsource most of the man-hours required for the operation of network security, such as using the control panel, changing settings, updating software, and local maintenance through monitoring and business trip support, reducing the burden of work.
In addition to inquiries from customers (end-users) to the company or distributors, the company actively detects and supports problems through remote monitoring. Operation and maintenance are remotely handled as much as possible by the company’s engineers, making it possible to respond more quickly compared to general on-site responses via call centers.
To deal with hardware failures, the company deploys inventory at warehouses of subcontractors throughout the country, and aims to replace the equipment within the target timeframe of four hours.

The ease of introduction and the clarity of the menu are highly evaluated by mid-tier enterprises and MSEs.



(Source: materials provided by the company)

Customers

Most of their customers are mid-sized and small businesses who would struggle to employ IT managers with expertise on their own. As of the end of February 2021, 2,917 companies use the services and are operating at 7,372 locations nationwide (number of VSR-installed locations). It has a high market share amongst the mid-tier enterprises and SMEs.

<Data Backup Service (VDaP)>

The company provides a backup service that combines VDaP, where backup data are stored on a device, and the storage in a data center. After temporarily backing up corporate digital data to VDaP, data are automatically transferred to the data center to further increase the fault resistance. In addition, since the latest and past data are kept as version-managed backup data, it is easy to select and recover the necessary digital data by providing an interface for the customers that are easy to use when recovering data. Utilizing its experiences in monitoring and operating services for integrated Internet security service using VSR, the company also provides the service that efficiently covers the whole country by utilizing the system for installing equipment and responding to failures.

<Vario EDR Service>

Vario EDR Service visualizes cyberattacks that try to penetrate through antivirus measures and avoid security incidents before they happen. It adopts highly accurate detection methods using AI and machine learning, and against the high-risk incidents, it would conduct automatic isolation of terminals and initiate investigations by security specialists.

<Vario-NSS>

As the shortage of IT personnel in companies becomes more serious, the company will support the efficient operation of internal systems and promote the concept of "Information System as a Service." Vario-NSS automatically scans terminals connected to the corporate network by simply installing a dedicated terminal in the network for asset management, visualizes terminal information, and understands vulnerability response. This enables it to respond to terminals with security risks early and monitor unauthorized terminals, reducing the burden and risk on the IT asset management which tends to rely on personal operations. Through continuous updates, it can not only manage Windows terminals, but also centrally manage Red Hat Linux terminals which are widely used for internal servers, etc. reducing the burden on personnel in the information systems departments at customer companies.

② Integration Services

This consists of sales of Vario Communicate Router (VCR), an integrated security device (UTM) for small and medium-sized enterprises, and Network Integration Services (IS) for procurement and construction of network equipment.

<Sales of integrated security equipment VCR for small and medium-sized enterprises>

The company sells VCR, a security appliance device, in response to the growing security awareness among smaller businesses and clinics with fewer than 50 employees, due to regulatory changes such as revisions of the Basic Act on Cybersecurity among others.

Unlike Managed Security Services, UTM products are imported as their own brands from overseas manufacturers and sold to end-users through distributors specializing in small and medium-sized enterprises.

Throughout the warranty period, the manufacturers provide support on sold equipment and hardware failures, through the company's and/or distributors' support desk.

<Network Integration Services (IS)>

Their engineers cover the whole areas of designing, procuring, and building the network according to the needs of end-users, and are working to expand the business into the wider corporate network areas.

As with the VCR sales, the manufacturers provide support on sold equipment and hardware failures, through the company's and/or distributors' support desk.

(2) Revenue model

Managed Security Services provide one-stop service from the introduction of network security to management, operation, and maintenance, and is a stacked recurring business model that collects initial costs and fixed monthly costs from users.

There is a one-time charge for the Integration Services, associated with the sale of VCRs and the procurement and construction of network equipment.

(3) Sales channels

Sales are mainly indirect sales through distributors.

The company has signed contracts with distributors such as telecommunications carriers, Internet service providers, data center operators, etc., who are looking to provide added value to customers by attaching Vario Secure services, and has built a sales network covering the whole country. The company has established a system that can continuously create opportunities.

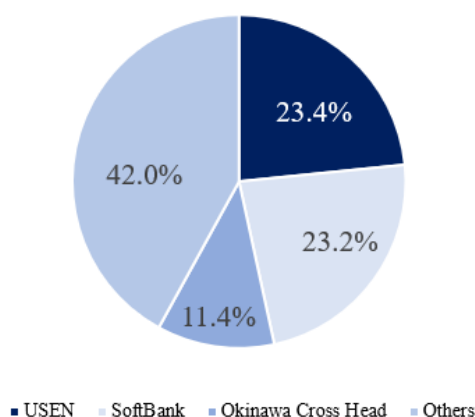
The company's distributors are divided into the original equipment manufacturers (OEM partners) and the reselling partners.

An OEM partner is a partner that provides security services under the distributor's own brand and enters contracts directly with the customers (end users). As of the first half of FY February 2022, the company has signed agreements with 31 companies with 2,661 end user companies.

A reselling partner is a partner that develops customers (end users) and engages in sales activities as an agent of Vario Secure, through which Vario Secure remains as the contracting entity with customers. As of the first half of FY February 2022, the company has signed agreements with 59 companies with 108 end user companies.

In addition to the above, to promote sales activities, Vario Secure as a security expert provides sales representatives who directly explain technical aspects to customers on behalf of distributors, and provides one-stop support from introduction to installation of services.

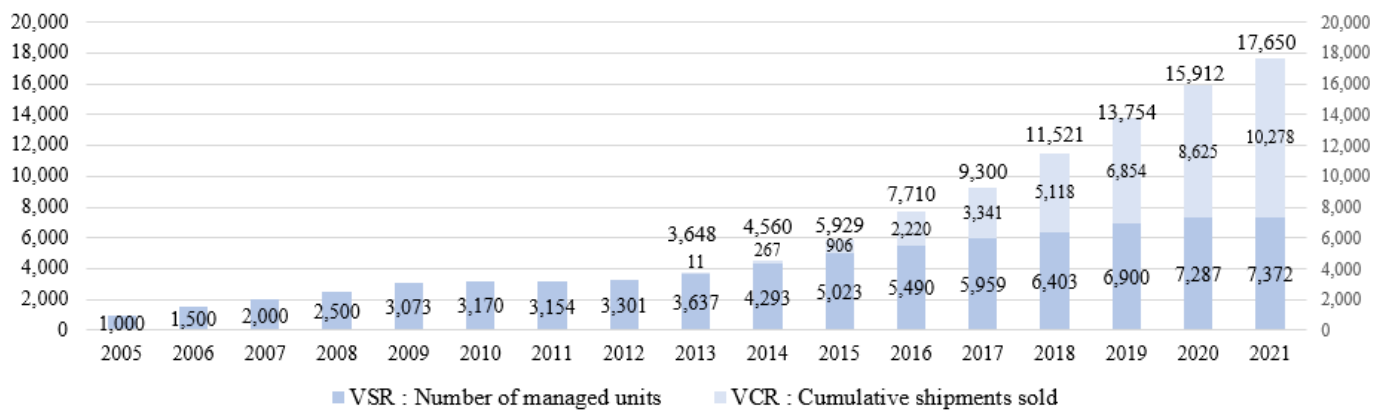
Revenue composition by major partners (FY Feb. 2021)



(4) Numbers of VSR and VCR installations

As of the end of February 2021, there were 7,372 VSR managed units and the VCR cumulative shipments were 10,278 units. It is installed in all 47 prefectures nationwide.

VSR and VCR Installation Trends



[1-5 Characteristics and Strengths]

(1) Unique business model

The company provides one-stop service for (1) procurement of equipment used in security services, (2) development of core software to be installed on equipment, (3) installation/setting of equipment, and (4) monitoring and operation after installation of equipment. There is no need for end-users to individually consider equipment selection and operation services, and they can quickly start using the service. In addition, since the service is provided as one-stop, the company can easily investigate the cause of a problem and respond.

Support is available 24/7, allowing end-users to quickly receive support for inquiries and troubles. The company aims to reach customers within four hours if it deems that equipment needs replacing, and in the term ended February 2021, it almost achieved the target at 99%.

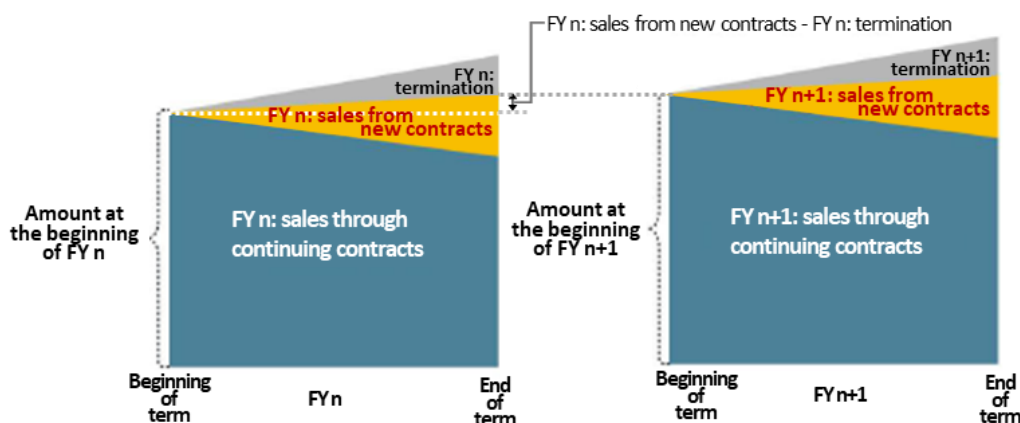
(2) Stable revenue model

As mentioned above, Managed Security Services are recurring business in which profits accumulate year by year due to the increase in the number of companies introduced by monthly billing, and as of the end of February 2021, Managed Security Services were provided at approximately 7,300 locations (number of VSR-installed locations) in all 47 prefectures nationwide.

In the term ended February 2021, Managed Security Services accounted for 84.3% of the company’s total sales revenue. With a low churn rate of 0.81% (in the term ended February 2021), a stable earnings model has been built, and it is possible to forecast revenues at a relatively early stage in the fiscal year.

[Recurring Revenue Model]

Note: The amount at the beginning of FY n+1 moves above the amount at the beginning of FY n if the FY n sales from new contracts exceed that in the FY n termination, and down if it falls below the amount at the beginning of FY n.



(Source: material provided by the company)

(3) Strong sales channels

As mentioned above, it has built strong sales channels with 31 OEM partners and 59 reselling partners, covering the whole country.

It is an important asset for efficient sales for the company, which mainly targets small and medium-sized enterprises.

In addition, since there are many OEM partners in the telecommunication industry and the company's services are incorporated as an option in the menu of the operating company, it is easy for users to select and introduce when the Internet connections are newly installed or altered, leading to a high order rate.

(4) High market share

With its easy implementation of high-level security services as well as the operation and management, the company is the market leader in all following categories by employee number: 300 to 999, 100 to 299, and 0-99 in the Firewall/UTM* operational monitoring service market.

* Firewall/UTM operational monitoring service market: Sales Amount and Market Share by Employee Size (FY2019)

	0–99 employees	100–299 employees	300–999 employees
No. 1	Vario Secure 31.2%	Vario Secure 24.7%	Vario Secure 23.2%
No. 2	Company A 15.8%	Company A 14.2%	Company A 9.8%
No. 3	Company B 13.5%	Company B 9.4%	Company B 8.9%

* Created by Investment Bridge based on the company's financial results briefing materials (source: ITR "ITR Market View: Gateway Security-Based SOC Service Market 2020")

* UTM: Unified Threat Management. A network security measure operated by combining multiple security functions into one.

2. Second Quarter of Fiscal Year February 2022 Earnings Results

(1) Overview of business results

	2Q of FY 2/21	Ratio to sales	2Q of FY 2/22	Ratio to sales	YoY
Revenue	1,262	100.0%	1,283	100.0%	+1.7%
Gross profit	799	63.3%	792	61.8%	-0.8%
SG&A and others	375	29.8%	429	33.5%	+14.2%
Operating profit	423	33.5%	363	28.3%	-14.2%
Profit before tax	394	31.2%	337	26.3%	-14.5%
Profit	273	21.7%	233	18.2%	-14.6%

*Unit: million yen

Increase in revenue and decrease in profit. Profit was almost in line with estimates.

Sales revenue increased 1.7% YoY to 1,283 million yen. While managed service performed as planned, integration service failed to reach the forecast as some projects took longer to set up on-site due to the prolonged restrictions under the state of emergency, despite the increase in revenue. Operating profit decreased 14.2% YoY to 363 million yen. While enhancing marketing and sales as planned, the company hired personnel to strengthen legal aspects and built a security operation center, which resulted in a decrease in profit, but was in line with the plan. The recruitment of engineers progressed as assumed.

(2) Major index trends

◎ Recurring revenue

Sales were firm, due to an increase in the number of remote VPNs that provide secure connections for telecommuting, and an increase of upgrades to higher-end models as companies increased their lines to support telework.

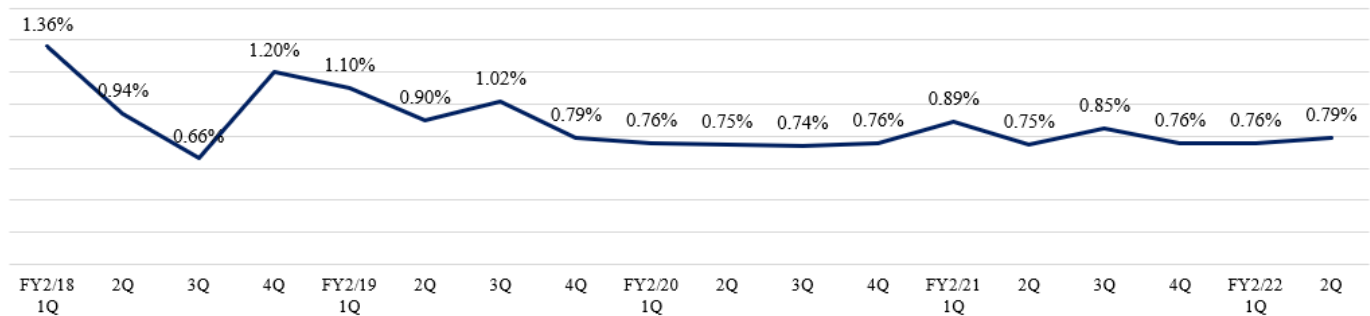
	2Q of FY 2/21	2Q of FY 2/22	YoY
Managed security service	1,072	1,084	+1.1%
Integration service	190	199	+4.6%

*Unit: million yen

◎ Churn rate

The churn rate remained low.

Churn Rate Trend



*Churn Rate (Monetary Base) = Quarterly cancellation amount / (initial monthly sales revenue in each fiscal year × 3 months)

(3) Initiatives in the first half

The following three issues were recognized and addressed.

① Developing new business channels

*Development of system integrators and network integrators

*Introduction of projects to agencies

*High-touch sales (a sales style in which a company directly attends to customers without using an agent)

*Approach to specific industries (medical care, education, and public services)

Situation in the first half

The new EDR service has made progress in generating deals (a high probability of closing a deal).

Progress was made in approaching specific industries (medical care, education, and public services) by finding OEM partners in Kyushu.

The introduction of VSR to a medical system company became a project.

However, due to the impact of the novel coronavirus, the company was not able to fully conduct in-depth sales activities, thus it will continue to be proactive in the second half onward.

② Improvement of service recognition

*Improvement in service recognition among end users

*Popularization of the name of the service

Situation in the first half

Webinars: Amid the need for companies to adopt telework, a total of four webinars focused on security risks and cyber-attack countermeasures were held between March and August.

Strengthening PR activities: The company co-sponsored and participated in the BCN Conference Spring 2021 to introduce security issues common to small and medium-sized companies and solutions that specialize in cyber-attack countermeasures and reduce the cost/operation burden on companies.

These activities resulted in a 2.5-fold increase in organic search traffic.

The company would like to further increase the number of webinars, and will continue to work on this as well.

③ Enrichment of contents

*Proactive provision of video content

*Overhaul of the website

BRIDGE REPORT

Situation in the first half

Post-event webinars and video guidance on service use cases were launched to deepen the understanding of the service for a wide range of customers. As a result, the average time spent on the site increased 2.6 times.

The company concluded that it was able to achieve some positive effects.

(4) Financial position and cash flows**◎ Main Balance Sheet**

	End of February 2021	End of August 2021	Increase/decrease		End of February 2021	End of August 2021	Increase/decrease
Current Assets	1,319	1,188	-131	Current Liabilities	992	2,576	+1,583
Cash and Cash Equivalents	593	414	-179	ST Interest Bearing Liabilities	369	1,972	+1,602
Trade and Other Receivables	461	464	+2	Trade and Other Payables	108	120	+12
Non-current Assets	5,896	5,871	-25	Noncurrent Liabilities	2,274	434	-1,839
Tangible Assets	293	252	-41	LT Interest Bearing Liabilities	1,889	65	-267
Goodwill	5,054	5,054	0	Total Liabilities	3,266	3,010	-256
Intangible Assets	173	204	+31	Total Equity	3,949	4,049	+100
Total Assets	7,216	7,060	-156	Retained Earnings	1,999	2,084	+84
				Total Liabilities and Net Assets	7,216	7,060	-156
				Balance of Interest-bearing Liabilities	2,259	2,038	-221

*Unit: million yen. Borrowings include lease liabilities.

Balance of interest-bearing liabilities decreased by 221 million yen from the end of the previous term. Net D/E ratio decreased 1.1% from the end of the previous term to 38.5%. Equity ratio increased by 2.7 points to 57.4% due to decrease in liabilities and increase in retained earnings.

Repayment of interest-bearing liabilities and financial soundness improvement are progressing as planned.

In addition, the allowance for doubtful accounts has been set at zero for this term again.

◎ Cash Flows

	2Q of FY 2/21	2Q of FY 2/22	Increase/decrease
Operating Cash Flow	217	243	+26
Investing Cash Flow	-57	-53	+3
Free Cash Flow	159	189	+30
Financing Cash Flow	-235	-369	-134
Balance of Cash and Equivalents	556	414	-142

*Unit: million yen

The surpluses of operating CF and free CF increased.

The cash position fell below from the end of the previous term.

(5) Topics

① Capital and business alliance agreement with HEROZ, Inc.

In September 2021, the company entered into a capital and business alliance agreement with HEROZ, Inc. (the first section of TSE: 4382).

(Background and purpose of the alliance)

With the concept of "Surprise to the Mind," HEROZ provides services that utilize artificial intelligence to make people's lives more convenient and enjoyable. For individuals, the company develops applications such as brain games on smartphones and tablets, and for businesses, it provides AI services such as machine learning in various fields.

By forming a technical expert group combining Vario Secure's domain knowledge of rare security personnel and HEROZ's AI personnel, the company decided to enter into a capital and business alliance agreement based on the judgment that the two companies will be able to create new services on a continuous basis and aim for further growth and improvement of corporate value.

(Details of the alliance)

*Business alliance

The company aims to create and maximize synergies, create and expand sales of new products and services, and increase the corporate value of both companies by mutually providing and cooperating with each other's management resources such as Vario Secure's industrial domain knowledge and data and HEROZ's AI technology.

*Capital alliance

HEROZ acquired 1,224,000 shares (approximately 32% of all the outstanding shares) of Vario Secure on September 13, 2021 from shareholders including i-Sigma Business Support Fund No. 2, a major shareholder of Vario Secure.

*Nomination of candidates for directors

Under the alliance, if the number of Vario Secure shares held by HEROZ is 20% or more in terms of voting rights, HEROZ may nominate one candidate for the board of directors of Vario Secure, and Vario Secure agreed to submit a proposal to the general meeting of shareholders for the election of the candidate for director nominated by HEROZ upon the request of the latter.

Following the completion of HEROZ's acquisition of 1,224,000 shares of Vario Secure (approximately 32% of the total number of shares issued), Vario Secure nominated Keiichi Iguchi, Director and CTO of HEROZ, as a candidate for a new director (external), and he was appointed at the extraordinary shareholders' meeting of Vario Secure held in November 2021.

In addition, Eriko Fukushima, Director of Vario Secure, resigned from her position due to her resignation at the conclusion of the said extraordinary general meeting of shareholders.

(Future initiatives)

As part of the full-scale launch of the alliance system, Vario Secure and HEROZ started a Proof of Concept (POC) for the joint development of services to discuss the adoption of AI.

The POC will analyze the chronological traffic data collected from the 7,372 VSRs in operation across Japan (as of the end of February 2021) by using the prediction engine of HEROZ's proprietary AI technology, HEROZ Kishin, and test traffic prediction. Then, it will be possible to check for security incident risks and early detection of equipment incompetence.

Through the alliance with HEROZ, the company aims to provide new added value to end users of managed services. The company plans to announce specific services, products, etc. in due course.

② Launch of a new lineup of Vario Data Protect

The company has started offering a new lineup of Vario Data Protect, a one-stop solution for storing, managing, and recovering important data.

In response to user needs, the price has been revised to be more acceptable, and the functions have been enhanced.

As the second half of the year begins, the company is receiving inquiries for large-scale projects to prepare for ransomware and other

cyber-attacks.

③ USEN ICT Solutions started to handle EDR for endpoint security

By adding the endpoint security service to the existing gateway security service, the company has started to provide a safer and more secure network environment. End users are highly interested in the service, and the company will strengthen sales promotion together with distributors.

④ Application for selection of the new market segment Standard Market

In July 2021, the company received the "Primary Evaluation Results Regarding Compliance with the Listing Maintenance Standards for the New Market Category" from Tokyo Stock Exchange and confirmed that it complies with the listing maintenance standards for the new market category Standard Market.

Based on the results, the company decided to select the Standard Market in October 2021.

The company will now proceed with the prescribed procedures related to the application for the selection of a new market segment in accordance with the schedule set by the TSE.

3. Fiscal Year February 2022 Earnings Forecasts

◎Earnings forecasts

	FY 2/21	Ratio to sales	FY 2/22 Est.	Ratio to sales	YoY	Progress Rate
Revenue	2,545	100.0%	2,649	100.0%	+4.1%	48.5%
Gross profit	1,560	61.3%	1,657	62.6%	+6.2%	47.8%
Operating profit	764	30.0%	782	29.5%	+2.4%	46.4%
Profit before tax	707	27.8%	732	27.6%	+3.4%	46.1%
Profit	491	19.3%	507	19.2%	+3.3%	46.1%

*Unit: million yen

Earnings forecasts aren't unchanged. Increase in revenue and profit estimated.

Earnings forecasts aren't unchanged. Revenue is estimated to be 2,649 million yen, up 4.1% from the previous term and operating profit is projected to be 782 million yen, up 2.4% from the previous term.

Expecting an increase in personnel recruitment to strengthen the marketing and sales department and strengthen the legal department following the listing on the stock exchange, an increase in advertisement expenses, and an augmentation of advisory fees, operating profit margin is projected to decrease 0.5 points from the end of the previous term, but an increase in profit is expected.

The company is aiming for a dividend payout ratio of 30.0% on the IFRS base. The dividend for the term ended February 2021 is 39.44 yen per share. The estimated payout ratio is 29.9% on the IFRS base, with that on the standard Japanese base being 53.4%.

As for the global semiconductor supply shortage, the company has been working on a solution since around May.

The company holds close meetings with its suppliers in Taiwan, check on the situation as needed and is responding flexibly, by securing parts by paying in advance and so on. In addition, by speeding up the cycle of collection and refurbishing of equipment when cancellations are made, a system is being established so that it will not take long before new installations are made.

In addition, the company has already verified the operation of older hardware models with recent software, and is preparing to ship them the customer has given approval.

This means that it is thanks to these measures that the semiconductor supply shortage has not had a major impact on them.

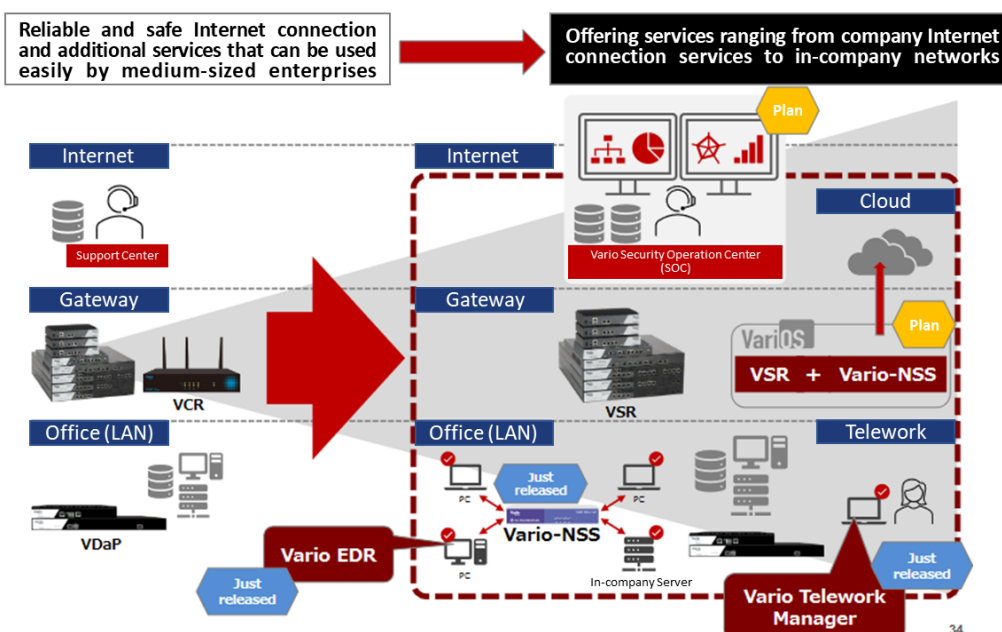
4. Growth Strategy

(This is a repost of the previous report.)

The company, which has created a business foundation by offering reliable and safe Internet connection and additional services that can be used easily by medium-sized enterprises, will now move beyond Internet services and herald a concept of “Information System as a Service,” offering services by expanding their reach to in-company network infrastructure as a whole, and work towards its implementation.

In addition, the company will improve the overall strength of its services by focusing on the following three points. The company will work towards increasing its earnings and securing profit by combining specialized devices with the cloud and offering network services to companies.

Theme	Aim	Methods
User Interface Integration	Expansion of Cross-Selling	Integrating the User Interface with the aim of increasing convenience and promoting mutual usage <ul style="list-style-type: none"> Control Panel of the integrated Internet security service (VSR) Control Panel of the data backup service (VDaP) Dashboard of Vario-NSS (in-company network administration) Dashboard of VarioTelework Manager
Strengthening/Linkage of the Key Software	Expansion of the Channel	Performance Boost and System Linkage of Key Software <ul style="list-style-type: none"> Integration of the exclusive software for integrated Internet security service and the exclusive software for Vario-NSS (in-company network service) Promoting cloud compatibility for the new key software Linkage with the network service of other companies
Optimization/Automation of the Security Operation Center	Cost Reduction	Realization of a Security Operation Center Which Meets the Needs of the New Normal <ul style="list-style-type: none"> Integration of the support for services offered Implementation of the cloud migration for the center using the cloud environment Digitization of the voice data, automation of the process from setting finalization till confirmation of operation



(Taken from the reference material of the company)

5. Conclusions

The POC with HEROZ is currently underway, but from the current progress, we have a feeling that it can be commercialized more reliably than initially expected, and we are now very interested in it. In addition, as the news about ransomware and other cyber-security issues is becoming increasingly common, inquiries about the services (VDaP and EDR) are steadily increasing, not only for data backup, but also as a precaution against viruses and malware that cannot be detected by conventional anti-virus software. Accordingly, the business environment remains favorable. Although it is unlikely to see a significant increase in sales by 20% or 30% due to the accumulative nature of the recurring business, we expect to see an increase in sales through their initiatives centered on the development of new commercial channels.

<Reference: Regarding Corporate Governance>

◎ Organization type and the composition of directors and auditors

Organization type	Company with company auditor(s)
Directors	7 directors, including 2 outside ones
Auditors	3 auditors, including 3 outside ones

◎ Corporate Governance Report

Last update date: November 11, 2021

<Basic Policy>

Our company's mission is "to ensure that all enterprises using the Internet can easily and securely carry out their business, we will offer the very best services to Japan and to the world," and have conducted our business to meet the expectations of our various stakeholders. Business management based on corporate governance, which forms the core of our business, is the most important administrative category and through a highly transparent, optimized management with a strengthened monitoring system, we are aggressively taking initiatives to improve our corporate value.

<Reasons for Non-compliance with the Principles of the Corporate Governance Code (Excerpts)>

Principle	Disclosed Content
<Supplementary Principle 4-1 ② Information Disclosure Related to the Medium-Term Management Plan>	The company formulates its target amounts based on a medium to long term point of view, but does not publicly announce those amounts. As the scale of the company is still small, it refrains from disclosing for any quick changes in strategy can be possible. The company will disclose the information once it reaches a certain scale.
Principle 5-2. Formulation and Public Announcement of Management Strategy and Plan	The company formulates management strategies and earning plans, which it shares with its board members. Regarding earning capacity and capital efficiency, as the scale of the company is still small, it refrains from disclosing for any quick changes in strategy can be possible. The company will disclose the information once it reaches a certain scale.

<Disclosure Based on the Principles of the Corporate Governance Code (Excerpts)>

Principle	Disclosed Content
<Principle 1-4. Strategically Held Shares>	The company does not possess any strategically held shares. Further, the company will not hold any such shares, unless the alliance with invested companies would contribute to the improvement of the medium or long-term corporate value and is considered to contribute to the benefits of shareholders based on objective discussions, such as the comparison between the benefits and risk of ownership and the

	company's capital cost.
<Principle 3-1. Information Disclosure Enhancement>	<p>In addition to the timely and appropriate legal disclosure of information, the company also publishes the following policies:</p> <p>(i) Management Philosophy, Strategy, and Plan The company's corporate ethos is described on its website: https://www.variosecure.net/company/mission/</p> <p>(ii) Basic Policies and Way of Thinking Regarding Corporate Governance Kindly refer to "I.1. Basic Way of Thinking" of this report for details on the company's basic policies and way of thinking regarding corporate governance.</p> <p>(iii) The Board of Directors' Policies and Procedures for Determining the Compensation for Management Staff and Directors The Board of Directors consults a discretionary compensation committee regarding the compensation system and policies for Directors, the calculation method for determining the exact compensation amount, and individual compensation amounts. The Board of Directors has decided that the Representative Director will make the final decision on the individual compensation amounts reported by the discretionary compensation committee, within the compensation amount limit approved in the Stockholders' General Meeting through a resolution.</p> <p>(iv) Policies and Procedures for the Selection and Removal of a Management Staff Member by the Board of Directors and the Nomination of a Candidate for a Director Regarding the selection and removal of a Director, the Board of Directors will hold a final resolution based on the comprehensive decision on each employee's character as a manager as well as their experience, results, and expertise as a manager.</p> <p>(v) Explanation Regarding the Individual Nomination and Appointment During the Appointment or Removal of a Management Staff or the Nomination of a Candidate for the Board of Directors The reasoning behind each individual nomination is recorded in the regular General Meeting of Stockholders held every term, or in an extraordinary General Meeting of Stockholders.</p>
<Principle 5-1. Policies Regarding Constructive Dialogue with Stockholders>	<p>The company uses its IR Department as a medium to promote dialogue with stockholders every day instead of only during Stockholders' General Meetings and offers information through its website and through phone calls. Further, the company has a system where the opinions of investors and stockholders obtained through these dialogues are reported to the Management Staff every time.</p>

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