

TerraSky Co., Ltd.

3915

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<http://www.fisco.co.jp>

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Summary

No change in the trend of shifting to the Cloud, and results are forecast to achieve high growth in the medium term

TerraSky Co., Ltd. <3915> (hereafter, also “the Company”) is a cloud integration services company, providing support services for the installation of cloud-based systems and the development of related applications. The Company has a track record of more than 4,500 installations of cloud-based systems, most of which use the Salesforce platform. It sells products developed in-house, including cloud-system development support tools and the mitoco groupware service. In addition, the subsidiary BeeX Co. Ltd. (BeeX) provides services including support for installing Amazon Web Services (AWS) and cloud migration support for SAP systems.

1. FY2/20 Results Overview

In the FY2/20 consolidated results, net sales and profits increased significantly, with net sales rising 41.8% year-on-year (YoY) to ¥9,300mn and operating income growing 477.7% to ¥725mn. The backdrop to these strong results is a situation in which companies are more actively conducting measures for digital transformation, so an increasing number of them are installing cloud services, such as Salesforce and AWS. The main factors were that orders for cloud-systems development and installation support projects grew, and also that sales of DataSpider Cloud, which can smoothly integrate data on Salesforce and other cloud services with other systems, rapidly increased. Personnel costs grew due to the active recruitment of human resources, but this was absorbed by the effects of the higher sales, so the operating income margin also increased significantly, rising from 1.9% in the previous fiscal period to 7.8%.

2. Outlook for Results of FY2/21

The outlook for the FY2/21 consolidated results is that net sales will increase 15.4% YoY to ¥10,728mn and operating income will decrease 28.2% to ¥520mn. Although the impact of the novel coronavirus has not been incorporated into these forecasts, at FISCO we think that they are at achievable levels as long as the impact of the virus does not further worsen in the near future, and that if personnel recruitment proceeds smoothly, results may surpass them. This is because even though companies investment in IT has cooled, there has been no change to the trend of migrating to cloud systems to improve business efficiency. Moreover, as the Company's target customers are mainly large companies, it is considered that the risk is low that they will postpone their investment plans. Also, for cloud migration support for SAP systems, which is provided by the subsidiary BeeX, support for existing systems will end in 2027, so it continues to receive many inquiries. From these factors, even if the Company is negatively affected by the novel coronavirus, it considers that strengthening the personnel structure so it can respond to this demand to be more important. So, while the forecast is for profits to decline in FY2/21, this is mainly due to the increases in personnel costs and training costs because of the active recruitment of human resources, which is being positioned as upfront investment to realize high growth. On April 30, the Company upwardly revised its forecast for net income attributable to owners of parent, from the initial forecast of ¥222mn to ¥2,170mn (¥880mn in the previous fiscal period). This is because it expects to record extraordinary income of ¥2,806mn from a gain on the sale of some of the shares it holds.

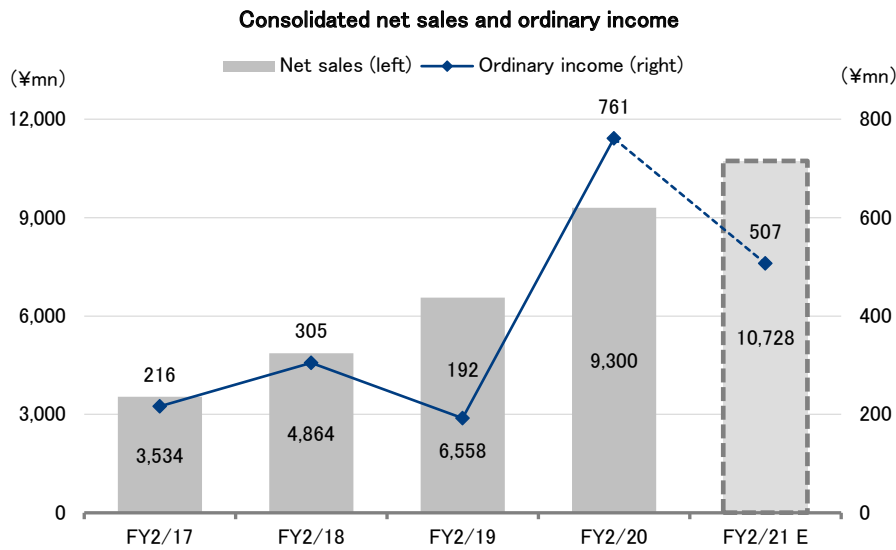
Summary

3. Growth Strategy

According to a market research company, the cloud service market in Japan is projected to achieve high growth of slightly less than an annual average of 20% up to 2024. In this market environment, the Company is aiming to utilize its Group's strengths, of advanced technological capabilities and a track record of many installations, to grow sales by 30% a year in the medium term through increasing sales of installation support for the main cloud systems, including Salesforce and AWS, and of the services it has developed itself. It has also started new businesses through the subsidiaries newly established in 2019, for developing algorithms using quantum computers, for investing in and training for cloud-related start-up companies, and also for cloud systems installation support for the Southeast Asia market. At the present time, these businesses are still in their investment phases, but they are expected to contribute to earnings in the future.

Key Points

- Expecting the cloud service market to enjoy continued strong growth of around 20% per year as companies energetically pursue digital transformation.
- For FY2/21, is forecasting higher sales but lower profits, as it will continue upfront investment, including to actively recruit human resources
- Benefiting from cloud first policies, is aiming for an annual sales growth rate of 30% by increasing sales of SI and its own services



Source: Prepared by FISCO from the Company's financial results

Company profile

Japan's top-class cloud integrator

1. Company profile

Since its founding in 2006, TerraSky has specialized in cloud computing services and, as the leading domestic cloud integration company, has been the driving force behind the growth of the cloud computing market in Japan. With more than 4,500 cloud system installations including Salesforce (as of February 2020), TerraSky has experience with a wide range of development projects for companies big and small and in all kinds of industries. As of February 2020, it has 6 consolidated subsidiaries in Japan and 2 overseas. Among them, BeeX, which provides AWS installation support and cloud migration support for SAP systems, has grown in business scale to be second only to the Company. At the end of February 2020, the number of consolidated employees had increased by 120 on the end of the previous fiscal period to 580 employees, and employee numbers continue to rise alongside the business growth.

Consolidated subsidiaries and business descriptions

Company	Ownership ratio	Business segment	Business description
Sky365 Co., Ltd.	60%	Solution Business	Supplied management service provider (MSP)* services specialized in cloud computing
BeeX Inc.	78%	Solution Business	AWS installation support, and support services for migration to cloud computing systems on SAP software platform
Kitalive Inc.	56%	Solution Business	Cloud system installation support centered in Hokkaido
Cuon.inc.	100%	Solution Business	Web system development
Quemix Inc.	100%	Solution Business	Quantum computer research and provision of solutions for companies
TerraSky (Thailand) Co., Ltd.	49%	Solution Business	Cloud systems installation support in Thailand
TerraSky Inc.	100%	Product Business	Sales and marketing in the North America region for products developed in-house
TerraSky Ventures Co., Ltd.	100%	Investment Business	Investment in, development of, and support for venture companies in the cloud-related domain

*MSP (Management Services Provider) services include services for the operations, monitoring, and maintenance of companies' servers and networks.
 Source: From the Company's results briefing materials

2. History

The Company was established in 2006 by current President and Representative Director Hideya Sato. President Sato left IBM Japan to join the Japanese subsidiary of Salesforce.com, Inc., helping it get off the ground in Japan. He anticipated that the use of cloud services would spread in the future as companies' information systems, and since its foundation, the Company has deployed a business specializing in cloud systems development and installation support, centered on Salesforce.

Company profile

In 2008 as the Product Business, the Company started providing SkyEditor*¹ (currently this service is called SkyVisualEditor) and SkyOnDemand*² as development support tools that contribute to the improved convenience of cloud systems. In 2016, it launched mitoco*³, which is a communications platform positioned as the next-generation version of groupware, and then in 2017, DataSpider Cloud*⁴, which is a cloud-based data-integration service, and the number of companies installing each of these services has steadily grown. Most recently, as an omni-channel call center service linking Salesforce with LINE <3938>, in 2018 the Company launched OMLINE-I for inbound response, while in 2019 the Company launched OMLINE-O for outbound response.

*1 SkyEditor, now called SkyVisualEditor, is a Salesforce screen development tool that allows companies to customize screens on Salesforce for easier use. By making it quick and easy for companies to develop desired screens, SkyVisualEditor outshines competing products to such an extent that is viewed as the de facto industry standard.

*2 SkyOnDemand in an on-demand integration service that allows internal corporate systems to link to the data on Salesforce, AWS, Microsoft Azure, or other public cloud services as well as link the data on other cloud-based data with each other. It is to end its service in September 2021.

*3 A communications platform developed for use on the Salesforce cloud platform. It can serve not only as an internal corporate communication tool (bulletin boards, talks, etc.), as well as workflow and document management along with a calendar function, but also makes it possible to connect with outside parties at partner companies. Connections with the IoT also allow it to be used to make reservations for intelligent conference rooms. It is also compatible with a mobile app.

*4 A product jointly developed with Appresso K.K. (absorbed via merger into Saison Information Systems Co., Ltd. <9640> in April 2019). This service enables non-programming coordination linkage between various cloud services and in-house databases and systems including applications.

Also, a feature of the Company is that it has expanded its business while actively progressing capital and business alliances. It entered-into capital and business alliances with NTT TechnoCross Corporation (formerly NTT Software Corporation) in 2010, and with Serverworks Co., Ltd. <4434>, which mainly provides AWS installation support and conducts resales, in 2013. After 2015 also, which is the year it was listed on the Tokyo Stock Exchange (TSE) Mothers market (its listing was changed to the TSE 1st Section in November 2018), it entered-into a series of capital and business alliances, with Ecomott Inc.<3987>, which conducts an IoT/mobile cloud solutions business, in 2016; with Cloudia Japan inc. (subsequently it made it a subsidiary and conducted an absorption merger in 2018), which conducted a cloud integration business in the Kyushu district, in 2016; with IGUAZU Corporation, which is a distributor of IBM <IBM> products, in 2017; and with Business Engineering Corp.<4828>, which provides installation support for ERP systems and other services, in 2018.

For the establishment of subsidiaries, in 2014 the Company established Sky365 Co., Ltd., which provides AWS monitoring and maintenance services, as a joint venture with Serverworks. Then in 2016, it established BeeX and also Kitalive Inc., which is based in Hokkaido and provides cloud systems installation support. More recently, in March 2019 it newly established TerraSky Ventures Co., Ltd., which invests in and provides training for venture companies, and in May, it acquired all of the shares of Cuon.inc., a web systems development company, and made it a subsidiary. Cuon is a company with slightly more than 20 employees, and it specializes in web systems development through Ruby on Rails*. Subsequently also, in June the Company newly established Quemix Inc., which conducts research into quantum computers and develops solutions, and then in December in Thailand, it established TerraSky (Thailand) Co., Ltd., which provides cloud systems development and installation support, and these subsidiaries are actively developing businesses. In March 2019, the Company transferred its AWS business to BeeX. BeeX provides cloud migration support for SAP systems, and this transfer was to concentrate AWS-related engineers within BeeX and also to facilitate business synergies.

* An open source Web application framework using the Ruby programming language developed by a Japanese person. This framework has recently become a trend, as it was designed to make development easy with less code than other frameworks.

Company profile

Company timeline

Date	Major events
March 2006	Founded as Head Inc.
July 2008	Began offering screen development tool SkyEditor (now known as SkyVisualEditor)
October 2008	Began offering cloud integration tool SkyOnDemand
September 2010	Entered into capital and business alliance with NTT TechnoCross Corporation (formerly NTT Software Corporation)
August 2012	Established US-based subsidiary TerraSky Inc. (now a consolidated subsidiary)
September 2013	Entered into capital and business alliance with Serverworks Co., Ltd., making it an equity-method affiliate
May 2014	Established subsidiary Sky 365 Co., Ltd. (now a consolidated subsidiary) in Sapporo, Hokkaido, as joint venture with Serverworks Co., Ltd
October 2014	Entered into capital alliance with US-based Salesforce Inc.
April 2015	Listed shares on the Mothers market of the Tokyo Stock Exchange
January 2016	Entered into capital and business alliance with Ecomott Inc.
March 2016	Established subsidiary BeeX Inc. (now a consolidated subsidiary) to provide cloud integration services for SAP software-based systems Entered into capital and business alliance with Cloudia Japan inc., making it a consolidated subsidiary
July 2016	Started selling the mitoco groupware service
August 2016	Opened TerraSky Lab Established subsidiary Kitalive Inc. (now a consolidated subsidiary) as joint venture with Win Consult, Inc. to provide cloud integration services
March 2017	Entered into capital and business alliance with Phone Appli Inc.
May 2017	Entered into capital and business alliance with IGUAZU Corporation
March 2018	Entered into capital and business alliance with Business Engineering
November 2018	Moved listing to TSE 1st Section
March 2019	Transferred AWS business to BeeX Co., Ltd. Established TerraSky Ventures Co., Ltd., a corporate venture capital firm
May 2019	Acquired all shares of Web system developer Cuon.inc., making it a consolidated subsidiary
June 2019	Established Quemix Inc. for the purpose of quantum computer research and provision of solutions to companies Established TSV Investment Limited Partnership No. 1 for the purpose of investing in start-up companies in the cloud-related field
August 2019	Started providing the OMLINE-O marketing solutions distributed via LINE from Salesforce
September 2019	Entered into a capital and business alliance with Japan System Techniques Co., Ltd.
December 2019	Established TerraSky (Thailand) Co., Ltd., in Thailand

Source: Prepared by FISCO from the Company's securities report and the financial results

Cloud service market and TerraSky's businesses

Company sees cloud service market continuing to grow at more than 20% per year as companies ramp up digital transformation initiatives

1. Cloud service market

The history of the development of corporate information systems shows that in the first half of the 1960s, companies started adopting mainframe computers. Since the 1980s, mainframe computers have been replaced by desktop office computers and minicomputers. From the late 1990s, the form of information systems started changing to distributed processing type client-server systems together with the spread of computers, and from the late 2000s there have been increasingly high-speed communication networks along with progress being made in Internet technology. Against this background, cloud computing services appeared, IT applications have entered an era in which usage is considered more important than ownership by companies.

Cloud service market and TerraSky's businesses

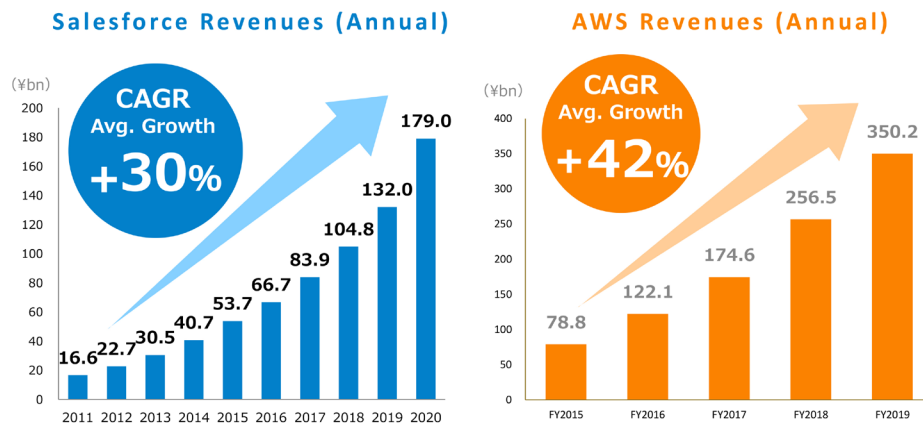
Cloud computing refers to services that can use a variety of IT resources on demand, including computing on the Internet from cloud services platforms like Salesforce and AWS, databases, storage, and applications. Previously, companies had to build, manage, and administer their own information systems, but using the Cloud eliminates the time and labor required for this, making it possible to increase business efficiency and keep down investment costs. It also reduces the time required to build information systems, so such installations have major advantages for companies. In particular, in the last few years, progress has been made in increasing the speed of communication networks, in strengthening the security measures of cloud-services businesses, and in expanding the lineup of services, so regardless of their scale, an increasing number of companies are migrating from their existing systems to the Cloud.

According to a market research company, the Japanese public cloud services market in 2019 grew by 22.9% on the previous year to be worth ¥877.8bn. In the 5 years up to 2024, it is projected to grow at an average annual rate of slightly less than 20%, to be worth more than ¥2tn in 2024, which is growth of approximately 2.4 times compared to 2019. The backdrop to this high growth is that there are many companies and government offices that have their own in-house computer systems, and in the future, these users will migrate to public cloud services.

Public cloud services are broadly split into three different types: SaaS*1, PaaS*2, and IaaS*3. Of these, PaaS and IaaS are used when companies create information systems. Salesforce, which is PaaS, and AWS, which is IaaS, are the companies with the highest global shares, and in the last few years their sales have rapidly grown. The average annual growth rate of Salesforce is 30% and of AWS is 42%, and an oligopoly of major companies, including Microsoft <MSFT> and Alphabet <GOOG>, is developing worldwide.

- *1 SaaS (Software as a Service) refers to online services that provide users access to software that had been available as a packaged product.
- *2 PaaS (Platform as a Service) refers to online services that provide a platform (hardware and operating system) that allows user to run applications.
- *3 IaaS (Infrastructure as a Service) refers to online services that provide the virtual servers, equipment, and all other network infrastructure needed to operate information systems

Salesforce and AWS Net Sales Trend



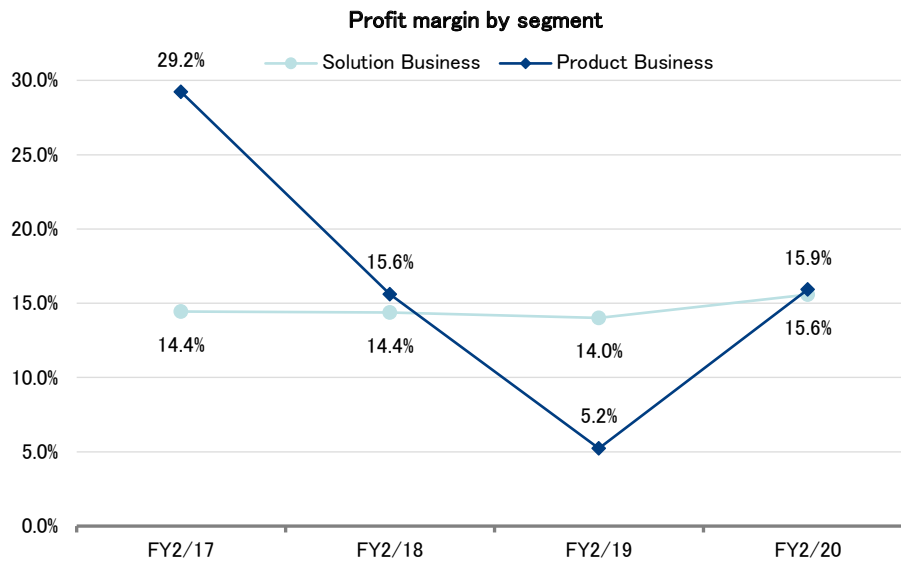
Source: From the Company's results briefing materials

The Solution segment accounts for over 80% of net sales

2. The Company's business

The Company has two business segments, the Solution Business and the Product Business. In the percentages of total results in FY2/20, the Solution Business provided 81.9% of net sales and 81.5% of segment profit, so it is the mainstay business. The segment profit margins of both businesses are around the 15% level, but the Product Business incurs a significant depreciation burden related to development, so the profit margins before depreciation are 16.7% for the Solution Business and 31.9% for the Product Business. In the Product Business, a high percentage of sales are recurring income-type sales, at 52.6%, and going forward, if the number of installing companies increases and the scale of sales grows, it is expected that its segment profit margin will further rise. Conversely, in the Solution Business, the percentage of sales from management and maintenance services, which are recurring income-type sales, is around 15%, mainly for cloud systems development and installation support, and its profit margin fluctuates depending on ordering trends for development and installation projects and the productivity of projects. In the last few years, this segment has had hardly any unprofitable projects and orders have also continued to be strong, so its profit margin has trended stably at around 15%.

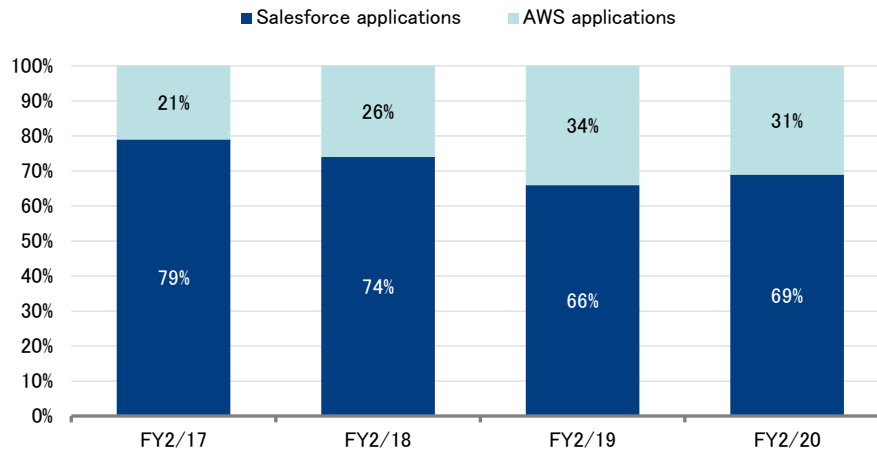
Looking at the breakdown of net sales by platform, in FY2/20, Salesforce-related provided 69% and AWS-related 31%, and the percentage provided by Salesforce-related rose by 3 percentage points (pp) compared to in the previous fiscal period. Also, looking at the sales growth rates, Salesforce-related increased 49.6% and AWS-related rose 30.4%, so there has been no change to the fact that both continue to achieve high growth.



Source: Prepared by FISCO from the Company's results briefing materials

Cloud service market and TerraSky's businesses

Sales mix by platform



Source: Prepared by FISCO from the Company's results briefing materials

(1) Solution Business

The Solution Business provides support services for the installation of cloud-based systems designed to meet the needs of client companies. Specifically, solution services cover everything from defining business requirements for front-end or backbone systems, to design, development, testing, operations, validation of effectiveness, and planning improvement policies and systemization planning. Salesforce is frequently developed as a front-end system and many companies enter-into its license-sales agreements with Salesforce.com, and the Company and its subsidiary Kitalive (whose main sales area is Hokkaido) provide installation support for this. Their cumulative number of cloud system installations, centered on Salesforce, is more than 4,500 installations, which is the leading number in Japan. Installations have been conducted by many companies regardless of their industry, business form, or size, including Mizuho Financial Group, Inc. <8411>, Odakyu Electric Railway Co., Ltd. <9007> Group, and KDDI Corporation <9433>. But as Salesforce is particularly strong in the CRM field, it is installed by a high percentage of large companies in the B-to-C area.

Also, the subsidiary BeeX provides cloud migration support for SAP systems and AWS development and installation support (and also for Microsoft Azure). In particular, against the backdrop of its advanced technological capabilities for SAP cloud migration support, it has a track record of supporting many migrations within Japan. In addition, Sky365 provides MSP services for cloud installation projects, including for Salesforce and AWS.

(2) Product Business

As a SaaS vendor, the Company develops and provides services specializing in the Cloud. Its main products include SkyVisualEditor, which is a Salesforce screen development tool; DataSpider Cloud, which realizes smooth data integration with other systems; mitoco, a communications platform; and OMLINE-I and OMLINE-O, which are contact center solutions. Of these, currently the mainstay services are two products, DataSpider Cloud and SkyVisualEditor. In Japan, customer needs are strong for customized specifications, such as for screens and logic tailored to the work, and for improving usability, and SkyVisualEditor has established a position as the de-facto product in its industry. There are also many cases in Japan of companies selecting DataSpider Cloud when they want to integrate their in-house, on-premises system with a cloud service, such as Salesforce. The US subsidiary's main role is for marketing functions and its impact on results is minimal.

We encourage readers to review our complete legal statement on "Disclaimer" page.

Has the largest number of Salesforce certified engineers in Japan and also the leading track record for SAP cloud migration support

3. Strengths

TerraSky has three main strengths. The first is that it has participated in the Cloud market since it was first established and therefore has expertise accumulated from its abundant experience. With a track record of more than 4,500 installations as of the end of February 2020, the Company has acquired substantial expertise not only in cloud integration, but also in project management and quality control that can meet the needs of a wide range of customer companies. In particular, it is one of only a limited number of companies that are capable of taking on large projects, which is a competitive advantage.

The Company's second strength is its overwhelming large number and quality of engineers who possess cloud expertise, as attested by its number of certified engineers. According to materials released by Salesforce.com, as of April 1, 2020, it has presented MVP awards to only 14 engineers in Japan, and of these, 3 work for TerraSky. There are only 12 certified technical architects, which is the highest technical certification in Japan and 5 of them work for the Company (the highest of any company in Japan). It also has the leading lineup of certified engineers in other development fields. As the number of certified engineers corresponds closely to a company's ability to receive orders for projects, it is not an exaggeration to say that TerraSky has more experience and more capacity to conduct development and installation support projects for Salesforce cloud systems than any other company in Japan. After engineers join the Company, they spend roughly six months attending classes and undergoing training to acquire technical certifications, and after acquiring practical skills, they are sent to job sites as part of a project team. It has positioned human resources development as a core competence to grow as a company, and it is the driving force behind its growth.

As BeeX has also been the pioneer in its industry for cloud migration support for SAP systems, it has the leading track record in this field as well. In order to migrate an SAP system to the Cloud, it is necessary to have not only the technological capabilities for the SAP system's infrastructure layer, but also to have advanced technologies for the cloud platform, such as AWS. But few companies possess both types of engineers, and this is another of the Company's strengths. In 2019, it was certified as an AWS Well-Architected Partner, and in February 2020, it acquired the AWS Managed Service Provider Program certification after being highly evaluated for its AWS migration skills, its high-quality management and maintenance services, and its track record of supporting many installations.

* As an APN (AWS Partner Network) partner certified as having high levels of skills and expertise to solve customers' AWS environment problems and that is able to seamlessly provide solutions on AWS, among the certified partners, other than the Company, only 9 companies are Premier Tier Consulting Partners.

The Company's third strength is that it covers multiple cloud platforms, including Salesforce, AWS, and Microsoft Azure. Many large companies use multiple platforms, including on-premises types, and the Company's technological capabilities and expertise enable it to respond to diverse customer needs, which is leading to its high growth.

4. Business risks

In terms of business risks, the Company must hire and retain enough engineers to respond to robust demand. The Company's hiring is centered on mid-career hires, not only at the headquarters but also at regional offices, but hiring is not keeping up with the increase in demand, and if the Company is not able to meet its hiring and retention goals, its sales growth could fall short of its forecasts. There is also the risk of the Company taking on unprofitable projects. The department in charge of project management shares information and carefully monitors progress, and as a result there has only been approximately one unprofitable project per year since FY2/17, which is a very low number.

Results trends

In FY2/20, sales and profits grew and exceeded the Company forecasts due to the increase in installations of cloud systems

1. FY2/20 results

In the FY2/20 consolidated results, net sales increased 41.8% YoY to ¥9,300mn, operating income rose 477.7% to ¥725mn, ordinary income grew 294.8% to ¥761mn, and net income attributable to owners of parent increased 464.2% to ¥880mn. So, the results were higher sales and profits that exceeded both the initial Company forecasts and the revised forecasts announced in October 2019.

FY2/20 consolidated results

	FY2/19		Initial forecasts		Revised forecasts*		FY2/20		Compared to revised forecasts
	Results	% of sales	Results	% of sales	Results	% of sales	YoY		
Net sales	6,558	-	8,634	8,960	9,300	-	41.8%	3.8%	
Cost of sales	4,690	71.5%	-	-	6,404	68.9%	36.5%	-	
SG&A expenses	1,742	26.6%	-	-	2,170	23.3%	24.6%	-	
Operating income	125	1.9%	246	498	725	7.8%	477.7%	45.7%	
Ordinary income	192	2.9%	250	548	761	8.2%	294.8%	39.0%	
Extraordinary income (loss)	40	-	-	-	558	-	-	-	
Net income attributable to owners of parent	156	2.4%	434	711	880	9.5%	464.2%	23.9%	

*The revised forecasts were announced in October 2019

Source: Prepared by FISCO from the Company's financial results

An increasing number of companies are considering installing cloud systems as part of their measures for digital transformation, and therefore sales in both the Solution Business and the Product Business increased significantly by more than 40% YoY. In costs, personnel costs and recruitment costs rose alongside the increase in the number of personnel, while other costs, including depreciation costs (up ¥29mn) and amortization of goodwill (up ¥23mn) also grew. However, these increases were absorbed by the effects of the higher sales, so the operating income margin rose from 1.9% in the previous fiscal period to 7.8%.

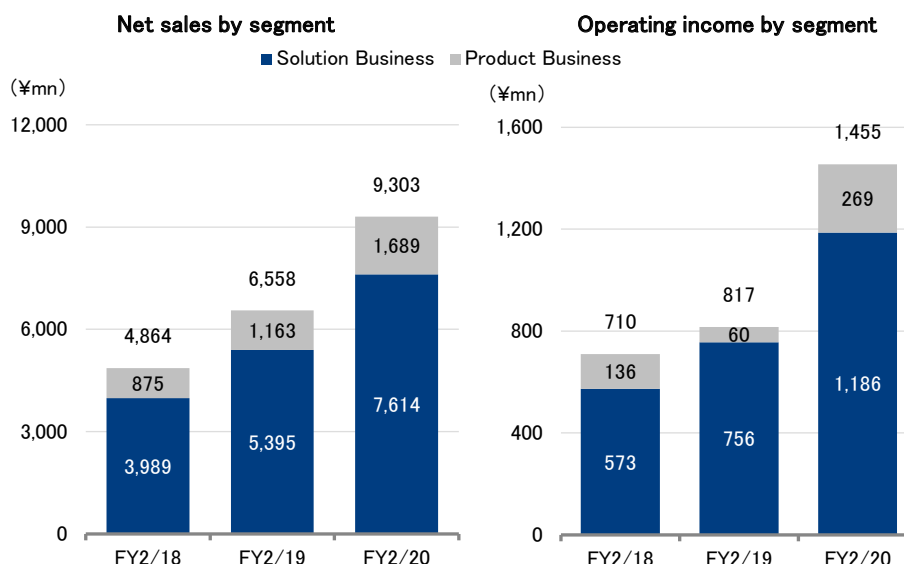
Non-operating income and expenditure worsened ¥31mn YoY, but this was because, following the listing of Serverworks, which was an equity-method affiliate, the Company sold one part of its shares in Serverworks and it ceased to be an equity-method affiliate, so it no longer recorded equity-method investment income (¥71mn in the previous fiscal period). Conversely, it recorded a gain on the sale of shares and a change in equity of ¥558mn as extraordinary income, which was the main reason why net income attributable to owners of parent increased significantly.

Results trends

(1) Results by business segment

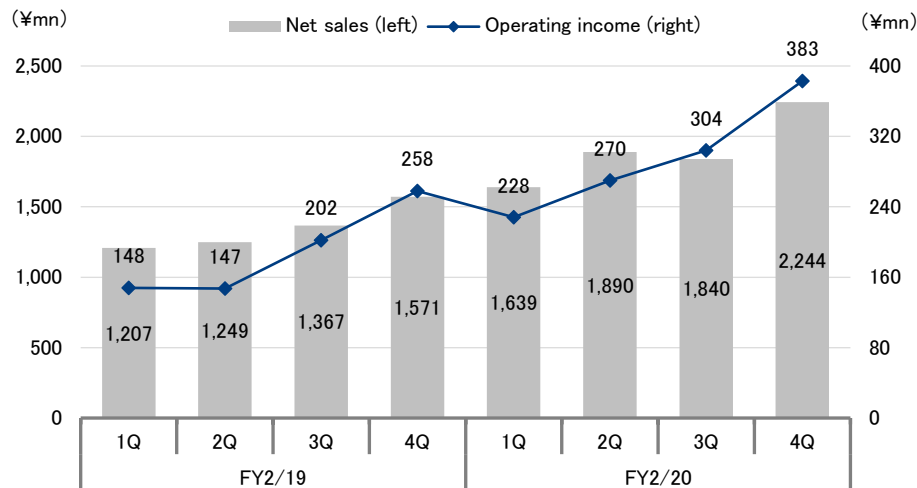
In the Solution Business in FY2/20, sales and profits increased greatly, with net sales rising 41.1% YoY to ¥7,614mn and segment profit (operating income) growing 56.9% to ¥1,186mn. Salesforce installations continued to increase, mainly for large companies, while in BeeX as well, orders for AWS installation support and cloud migration support for SAP systems were strong. In addition, installations of the OMLINE series of CRM solutions integrating Salesforce and LINE contributed to the higher sales. On a quarterly basis, results trended upward and continued their high growth in the 4Q (December 2019 to February 2020), with net sales increasing 42.8% YoY and segment profit growing 48.4%, and a situation continued in which the increase in capacity was unable to keep up with demand. The cumulative number of installation projects increased to more than 4,500 (compared to more than 3,500 projects at the end of the previous period).

In the Product Business, net sales increased 45.3% YoY to ¥1,689mn and segment profit grew 342.4% to ¥269mn, while the profit margin also rose considerably, from 5.2% in the previous period to 15.9%. As a data-integration foundation for integrating on-premises data, such as in mission-critical systems, with a cloud system, there were a series of large-scale orders for DataSpider Cloud, including from Toyota Motor Corporation <7203> and from TAKARA STANDARD CO., LTD.<7981>. In addition, the number of companies concluding contracts for mitoco, a strategic product that is a tool for “workstyle reforms,” steadily grew. Looking at net sales by type, recurring-type income, such as monthly usage fees, grew 24.9% YoY to ¥889mn due to the increase in the number of installing companies, while flow-type income, which includes development fees recorded at the time of an installation, also increased significantly, up 77.4% to ¥800mn, following a series of large-scale orders, and these increases were the main reasons for the higher profit margin. On a quarterly basis, in the 4Q net sales increased 2.9% YoY, so it appears the pace of growth slowed. But this was because flow-type income declined compared to in the same period in the previous fiscal year, and recurring-type income steadily grew. Sales of mitoco grew by double digits, but its sales scale is still small and it remains in the upfront investment stage and its development, including to enhance functions, is continuing.

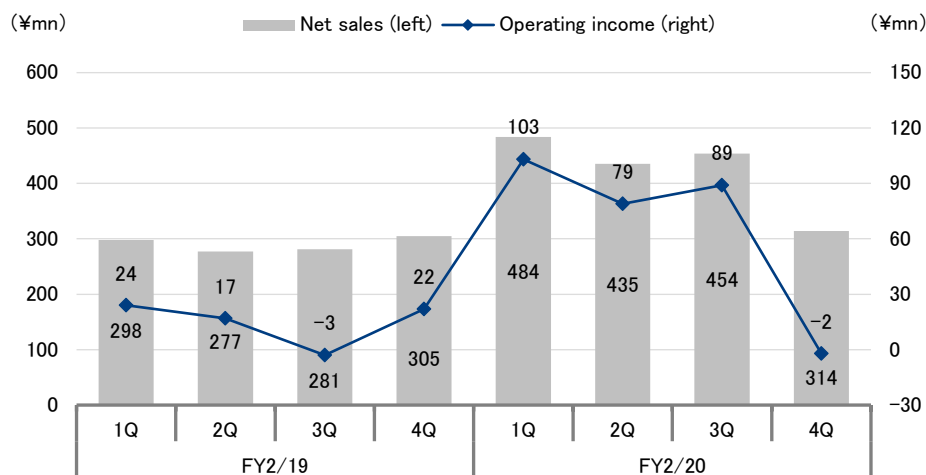


Source: Prepared by FISCO from the Company's results briefing materials

Results trends

Solution Business' quarterly results


Source: Prepared by FISCO from the Company's financial results

Product Business 's quarterly results


Source: Prepared by FISCO from the Company's financial results

(2) Trends by company

For the Company's results on a standalone basis, net sales increased 13.9% YoY to ¥5,864mn and operating income was ¥517mn (operating income of ¥2mn in the previous fiscal period). The sales-increase rate appears low because it transferred the ASW business to BeeX, but on an existing-businesses basis, it seems that sales and profits increased significantly. Results were also strong in BeeX, Kitalive, and Sky365, as they benefited from the expansion of the cloud market. The results of Cuon, which was made a subsidiary in May 2019, were added only for a nine-month period, so its impact on the consolidated results was minimal (it recorded amortization of goodwill of ¥23mn).

Results trends

Quemix is a subsidiary at the research and development stage, and it is developing algorithms for analyzing big data and other data using quantum computers. Specifically, it has started joint research on algorithms with a university on the themes of finance-related and chemical-related (drug discovery and material science). The competition to develop algorithms using quantum computers is fierce both in Japan and overseas, and Quemix's strategy is to develop algorithms and create a library to acquire earnings in the form of patent-usage fees.

TerraSky Ventures composed the TSV Investment Limited Partnership No. 1 fund in June 2019, through which it has invested in two cloud-related early-stage companies. NTT Communications Corporation and Japan Asia Investment Co., Ltd., <8518> have also invested in this fund, and the plan is to continue to invest in start-up companies.

In the Thai subsidiary that was newly established in December 2019, the plan is to locally recruit and train around 10 engineers. Its impact on the FY2/20 results was minimal, while the current situation is that it has effectively stopped operating after the Thai government declared a state of emergency due to the spread of the novel coronavirus. In the future when work activities are normalized, the aim is to increase sales by providing Salesforce installation support together with solutions, including for OMLINE. It is thought that it will be able to easily acquire customers in Thailand, where the penetration rate of LINE is high and where there are many Japanese companies operating locally.

Net assets grew significantly due to the increase in latent gains from the listing of Serverworks, in addition to the higher earnings

2. Financial position and management indicators

At the end of FY2/20, total assets had increased significantly, up ¥9,815mn on the end of the previous fiscal period to ¥15,445mn. Looking at the main change factors, in current assets, cash and deposits increased ¥1,501mn alongside the higher earnings, while trade receivables rose ¥457mn. In non-current assets, investment securities increased ¥7,431mn due to the conversion to market value following the listing of Serverworks, while goodwill rose ¥156mn on Cuon being made a subsidiary.

Total liabilities were up ¥3,446mn on the end of the previous fiscal period to ¥5,889mn. Looking at the main change factors, interest-bearing debt decreased ¥45mn, but income taxes payable and advances received increased ¥474mn and ¥231mn, respectively. Also, deferred tax liabilities rose ¥2,289mn following the increase in latent gains for Serverworks' shares. Net assets were up ¥6,343mn on the end of the previous fiscal period to ¥9,556mn. Retained earnings increased ¥730mn, while the valuation difference on available-for-sale securities rose ¥5,292mn due to a change in the market valuation in conjunction with Serverworks' stock market listing. Controlling shareholders' equity also grew ¥265mn because of the increases in earnings at the subsidiaries, mainly BeeX.

For the key management indicators, alongside the increase in net assets, the equity ratio rose from 52.5% at the end of the previous period to 58.5%, while the interest-bearing debt ratio declined sharply, from 29.4% to 9.1%. In addition, net cash (cash and deposits – interest-bearing debt) increased ¥1,547mn on the end of the previous fiscal period to ¥2,580mn, and in such ways, the Company is making major progress in strengthening its financial base. For the profitability indicators as well, due to the effects of the higher sales, the operating income margin increased 5.9% YoY, while ROA and ROE rose 3.1% and 7.6% respectively, and these indicators are once again rising after bottoming-out in the previous period.

Results trends

Consolidated balance sheet

	(¥mn)				
	FY2/17	FY2/18	FY2/19	FY2/20	Change
Current assets	1,772	2,320	3,581	5,670	2,089
(Cash and deposits)	814	1,089	1,900	3,402	1,501
Non-current assets	777	1,495	2,048	9,774	7,726
Total assets	2,552	3,817	5,630	15,445	9,815
Total liabilities	1,314	2,155	2,417	5,889	3,471
(Interest-bearing debt)	723	1,049	868	822	-45
Net assets	1,238	1,661	3,212	9,556	6,343
Management indicators					
(Stability)					
Equity ratio	45.0%	38.5%	52.5%	58.5%	6.0pt
Interest-bearing debt ratio	63.0%	71.4%	29.4%	9.1%	-20.3pt
Net cash	90	39	1,032	2,580	1,547
(Profitability)					
ROA	10.1%	9.6%	4.1%	7.2%	3.1pt
ROE	12.2%	13.1%	7.1%	14.7%	7.6pt
Operating income margin to net sales	5.7%	5.5%	1.9%	7.8%	5.9pt

Source: Prepared by FISCO from the Company's financial results

Outlook

The forecasts for FY2/21 are for higher sales but lower profits, as the upfront investment, including to actively recruit human resources, will continue

1. Forecasts for FY2/21

The forecasts for the FY2/21 consolidated results are for net sales to increase 15.4% YoY to ¥10,728mn, operating income to decline 28.2% to ¥520mn, ordinary income to fall 33.3% to ¥507mn, and net income attributable to owners of parent to increase 146.3% to ¥2,170mn. On April 30, the Company announced that it had upwardly revised the net income forecast from the initial forecast of ¥222mn. This is mainly because it expects to record a gain on the sale of investment securities of ¥2,806mn through selling one quarter of its holding of Serverworks shares*. It has cash on hand of more than ¥5bn, but it plans to allocate this to investment in order to continue to realize high growth. For M&A, its policy is to proactively investigate proposals for which synergies can be expected.

* It holds 506,000 Serverworks shares, so when calculated based on the closing price on May 1 (¥14,820), the latent gains are more than ¥7bn.

Outlook

Forecast for FY2/21 consolidated results

	FY2/20		FY2/21 E		YoY
	Results	% of sales	Forecast	% of sales	
Net sales	9,300	-	10,728	-	15.4%
Operating income	725	7.8%	520	4.8%	-28.2%
Ordinary income	761	8.2%	507	4.7%	-33.3%
Extraordinary income (loss)	558	-	2,806	-	402.0%
Net income attributable to owners of parent*	880	9.5%	2,170	20.2%	146.3%
Earnings per share* (¥)	70.35	-	171.85	-	144.3%

*The upwardly-revised value announced on April 30, 2020.

Source: Prepared by FISCO from the Company's financial results

Net sales by business segment

	FY2/17	FY2/18	FY2/19	FY2/20	FY2/21 E	Growth rate
Solution Business	2,819	3,989	5,395	7,614	9,021	18.5%
Product Business	714	875	1,163	1,689	1,707	1.1%
(Recurring-type income)	-	606	712	889	1,158	30.3%
(Flow-type income)	-	269	451	800	549	-31.4%
Total	3,534	4,864	6,558	9,303	10,728	15.3%

Source: Prepared by FISCO from the Company's results briefing materials

The outlook for net sales is that installations of cloud systems, such as Salesforce and AWS, will continue to grow for a double-digit increase in sales. The reasons why the growth rate is expected to slow down are that the forecasts were created assuming that the recruitment of engineers will not be increased significantly, and also that, in the Product Business, the forecast is conservative for flow-type income, which grew sharply in the previous fiscal period. By business, net sales are forecast to increase 18.5% to ¥9,021mn in the Solution Business and 1.1% to ¥1,707mn in the Product Business. Breaking down the changes in the Product Business, recurring-type income will increase 30.3% to ¥1,158mn, but flow-type income will decrease 31.4% to ¥549mn.

In costs, personnel costs, training costs, and related costs will increase in conjunction with the strengthening of the personnel structure. Upfront-investment costs will also increase for new businesses and for overseas subsidiaries, and therefore profits will decrease. Continuing on from the previous fiscal period, the Company plans to significantly increase personnel recruitment. In the last few years, the boom conditions in the IT industry have continued and it has been unable to progress the recruitment of engineers as expected. But in order to strengthen its recruitment capabilities, from March 2020 the Company will further increase salaries for existing employees and also review the conditions for recruiting mid-career hires, so it is expected to be able to progress recruitment more than in the past. Also, due to the impact of the novel coronavirus, it is possible that the demand-supply environment will improve. Although the future of the market environment remains unclear, for the Company, which is targeting high growth in the medium term, FY2/21 can be viewed as an excellent opportunity to strengthen the personnel structure. If it can progress recruitment as planned, net sales may exceed the Company's forecast, although it will depend on the ordering conditions.

Outlook

As it is difficult to predict at the present time the impact that the spread of the novel coronavirus will have on results, it has not been incorporated into the current results forecasts. But on looking at the most recent conditions, as there was a backlog of orders in the current 1Q, it seems that it will have no effect on results. However, it may affect sales discussions in the future, should elements such as the government's state of emergency and the requirements for self-restraint continue intermittently. That said, at FISCO we think that because many of the large companies that are the Company's main targets have a solid financial foundation, the probability is low that they will postpone their investment projects related to workstyle reforms and digital transformation.

The subsidiary BeeX is receiving many inquiries for projects for cloud migration support for SAP systems, and there is no change to the situation of the ongoing labor shortage. This is occurring against the backdrop of the end of maintenance and support for SAP existing systems (SAP R/3) in 2027. In Japan, approximately 4,000 companies have installed SAP systems, and these companies must either migrate their existing system to the successor system (SAP S/4 HANA) or change to an ERP other than SAP by 2027. However, it seems that currently only around 10% of these companies have completed this migration. The SAP successor system is compliant both with on-premises and on the Cloud, so it is not the case that all systems will be migrated to the Cloud. But there is no doubt that the percentage of systems on the Cloud will increase above the current level, so at FISCO we anticipate that the busy conditions will continue for BeeX, which has the leading track record in Japan for cloud migration support. In May 2020, BeeX relocated its head office in conjunction with the strengthening of its personnel structure and business expansion, having been previously based in the same building as the Company. Elsewhere, business activities in the Thai subsidiary have currently been suspended due to the Thai government's declaration of a state of emergency. But should this result in a decrease in upfront investment costs (including human-resources recruitment and training costs), it may have a slightly positive effect on profits.

FY2/21 is the final fiscal year of the three-year medium-term management plan, and the plan's numerical management targets for this year are net sales of ¥10bn and operating income of ¥1bn. The net sales target appears achievable, and although the operating income target deviates from the forecast, there has been no change to the Company's policy of working to achieve this target. It is considered that the extent to which the results can exceed the lower limit of the forecast values will change depending on the recruitment situation and the impact of the novel coronavirus in the near future.

Benefiting from cloud first policies, is aiming for an annual sales growth rate of 30% by increasing sales of Salesforce-integration solutions

2. Growth strategy

In the future, it is anticipated that companies' information systems will shift from the on-premises type, in which companies hold every aspect in-house from hardware through to software, to the cloud-services type, of using the platforms of major cloud-services businesses. Therefore, it is forecast that in the next five years, the cloud service market will continue to grow at an annual rate of slightly less than 20%. The Company is aiming to exceed the industry average and achieve an average annual growth rate of 30% by increasing sales from both businesses, of the Solution Business, which migrates on-premises systems to the Cloud, and of the various types of cloud-related, in-house developed products, which since its foundation have been the core business.

Outlook

In order to realize high growth, in the future also the Company will continue to actively recruit and train development engineers, including for Salesforce and AWS, while its policy is to work to develop and increase sales of appealing solutions and services that will improve work efficiency in the installing companies. Looking from a medium- to long-term perspective as well, it is progressing preparations toward developing new businesses and entering-into the Asia market.

(1) Enhancing solutions

One of the current main solutions is the OMLINE series of CRM solutions. OMLINE-I, which the Company started providing in 2018, integrates Salesforce Service Cloud (below, Service Cloud)* and LINE official accounts, and it is a service to centrally manage inquiries from various channels, including via LINE and by telephone and email. Inquiries via LINE are responded to automatically using chatbots, while they can also be answered directly by an operator or through a LINE call. This not only improves customer satisfaction, such as by reducing waiting times, it also has the advantage of leading to improved work efficiency for the operators. Solutions for inbound demand include LINE Pay Corporation's LINE Pay customer support center and the So-net contact center, which is an Internet-connection service operated by Sony Network Communications Inc. Overseas as well, a help support system in LINE Taiwan began operating from June 2019, so installations have started to spread both in Japan and overseas. The fees consist of the initial installation fee of ¥500,000 and the basic monthly usage fee of ¥150,000 (up to 5 users, an additional ¥5,000 per user is added for the sixth and subsequent users).

| * A customer service support system provided by Salesforce.com |

Also, OMLINE-O, which the Company started providing in August 2019, is a service that can integrate Salesforce and LINE official accounts and centrally manage on Salesforce marketing initiatives and customer services, from sending messages through to managing users, using LINE. By linking LINE users to Salesforce's customer information, it is able to send the optimal LINE message for each customer attribute. Through using this service, users can create various measures, including effective customer-attraction measures, promotions for new products, and measures to improve branding. It also makes it possible to improve customer satisfaction. Salesforce is strong for B-to-C companies, such as in the retail and service industries, so the Company's service, which integrates it with LINE, is attracting a lot of attention. The fees plan depends on elements such as the number of messages sent by the company, but there are three fixed monthly fees of ¥30,000, ¥150,000, and ¥500,000, with each plan also having pay-as-you-go fees according to the number of additional messages sent.

There are several other similar Salesforce integration services, but the Company's service, which benefits from its strength in Salesforce development technological capabilities, seems to be superior in terms of functions and convenience. In January 2020, it announced that it had entered into a business alliance with transcosmos inc.<9715>, a major contact center management company. The aims of this alliance are to create a collaborative structure for Salesforce installation and construction support, and at the same time, to progress measures to propose and install OMLINE-I into transcosmos' customer companies as an optimal solution. Improving the name awareness of OMLINE is an issue, but the number of companies installing it is expected to further increase through this alliance. The Company is aiming for the OMLINE series to start contributing to profits by the third year from the launch of the service.

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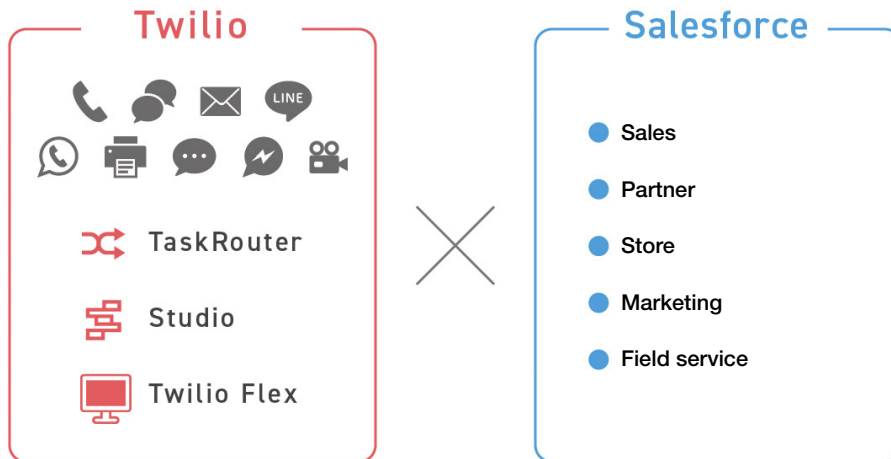
Outlook

Also, as new solutions for contact centers, in August 2019 the Company concluded a gold SI partner agreement with Twilio Inc. (<TWLO>) of the US and started proposing solutions for Salesforce construction support that incorporates Twilio’s services. Twilio provides communication platform services for contact centers that enable the use of various communication methods via API, including telephone, text messages, FAX, e-mail, chat, and video calls, and currently 160,000 companies around the world use its services. Its features include that it is able to flexibly construct a solution tailored to customer needs for the various functions required by contact centers and that it can centrally manage customer information on Salesforce through integration with Salesforce. Since 2013, KDDI Web Communications Inc., had held the exclusive sales rights as a gold SI partner, but in response to the increase in demand in the Japanese market, Twilio is increasing sales through newly establishing 7 SI partner companies*, including the Company.

* As its gold SI partners, it has concluded agreements with the Company and also NTT Communications Corporation, NTT DATA Smart Sourcing Corporation, Serverworks Co., Ltd., Pound 4 Technology Inc., and Classmethod, Inc., and as a registered SI partner, with UL Systems, Inc.

For the Company, this partnership will enable it to respond to diverse customer needs by enhancing its lineup for contact centers. Due to the impact of the novel coronavirus, the Company switched to an all-company teleworking system on April 1, and alongside this, it constructed a home-based call center system using Twilio for in-house use and started operating it on April 6. Its online seminars, which are held using the same method, are also attracting a lot of attention, such as having 150 participants. This platform is able to construct a system easily in a short period of time and to apply completely pay-as-you go fees and volume discount to the fee plans. This has the advantage of enabling use at the optimum price according to usage conditions, so demand is expected to increase in the future. In terms of earnings, the Company records one part of the usage fees as sales.

Image of the CRM integration platform through integrating Twilio and Salesforce



Source: Reprinted from the Company's website

Outlook

(2) Expanding the product lineup

For mitoco also, which is a communications platform that the Company is focusing on as a product developed in-house, it is working to increase its sales as a tool to realize “workstyle reforms,” while also aiming to improve its convenience and functions, such as improving its UI and strengthening the calendar function. In January 2020, it started integrating it with CloudSign, which is the electronic contract service of Bengo4.com, Inc. <6027>. Through this, the users of both services can improve work efficiency by consolidating into mitoco the in-company work previously divided into each system. For example, all the tasks, such as sales activities, schedule management, contract work and workflow applications to obtain in-company approval, and task management, can be realized with mitoco as the platform. Due to the impact of the spread of the novel coronavirus, a movement to reconsider the “seal (stamp) culture” is growing in Japan, and the number of companies installing CloudSign is expected to further increase from the current number of around 65,000 companies. If companies installing CloudSign also install Salesforce, they can aim to further improve work efficiency by using mitoco as well. So, we shall be paying attention to this partnership as an initiative to increase the number of companies installing mitoco.

At the end of March, the Company announced that it would provide mitoco free of charge for three months from the first day of the service for companies conducting teleworking due to the spread of the novel coronavirus (application period, up to May 29), and it would appear that it has received dozens of inquiries in total.

The number of installing companies is steadily increasing, but as the monthly fee per single ID is inexpensive, at ¥700 to ¥800, and also as the Company is currently investing in development costs, including to continuously enhance its functions, it does not yet contribute to profits. But the aim is for it to become profitable on a standalone basis in FY2/21.

(3) Initiatives for new businesses

As initiatives with an eye to growth in the medium- to long-term, the Company established three subsidiaries in 2019. TerraSky Ventures is investing in and developing cloud-related start-ups and early-stage companies in the B-to-B area. Quemix is aiming to generate earnings through creating IP and services by developing algorithms using quantum computers, including for big data analysis. TerraSky (Thailand) intends to increase sales in the Southeast Asia market for Salesforce installation support and for the Company’s own products.

Each of these subsidiaries is still in its upfront investment stages, so for the time being they are not expected to contribute to profits. Quemix has currently recruited several excellent researchers and is progressing joint development, including with a university, so it is forecast to continue to record a loss, mainly due to personnel costs. The aim is for it to become profitable through acquiring patent income by developing algorithms with high user value and creating a library, and by providing combination optimized* support.

* A solution to find the best approach from among a large number of combinations. For example, scheduling such as for work shifts and allocation of production facilities, placements of shelving that are highly efficient for picking and track-usage methods with high loading efficiency in distribution sites, route optimization methods to eliminate congestion by dispersing movement paths, optimization methods by combining different raw materials, etc.

For the Thai subsidiary, the local company is progressing the recruitment and training of engineers locally for Salesforce installation and construction support, and the aims are for it to achieve net sales of ¥200mn in 2022 and to be profitable on a single-year basis in 2023. The training is conducted through the training curriculum developed in Japan and OJT (on-the-job training). The Company decided to enter-into and establish a base in Thailand, as it is achieving high economic growth and is politically stable, and also as the penetration rate of LINE is high and demand is expected for the in-house developed OMLINE series, so it judged that it would be easy to acquire customers in this country. If it can achieve results in Thailand, it is considered that it will deploy its business in neighboring countries as well, including Vietnam and Indonesia.

■ Shareholder return policy

Dividends are an issue that it will consider in the near future as it still is in an investment phase, but it does provide shareholder benefits

Since it was listed, the Company has continued to not pay a dividend. This is because it is currently in an investment phase in order to realize high growth, and it considers that maximizing enterprise value through earnings growth will lead to returns to shareholders in the future. However, looking to the future, it has indicated its intention to comprehensively judge aspects such as its financial position and management performance and based on this, to stably pay a dividend at the stage when it has the financial capacity to do so. However, it has established a shareholder benefits program, and shareholders as of the end of February of each year all receive a QUO card worth ¥1,000.

■ Information security policy

As an information security measure, the TerraSky Group has established a basic information security policy, and provides management personnel regular training on information security. In addition, it has been certified as meeting the ISO27001 information security management standards, and is constantly striving to strengthen its information management structure.



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