

TerraSky Co., Ltd.

3915

TSE Mothers

22-May-2017

FISCO Ltd. Analyst

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FISCO Ltd.

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

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Summary

Growing Continuously as the leading Cloud Integrator

1. Company and business overview

TerraSky Co., Ltd. <3915> (hereafter, also “the Company”) is the leading cloud integrator in the Japanese market for cloud computing. The Company operates two business segments, a Solution Business, which supports the development of optimal systems that use cloud computing and develops such systems, and a Product Business, which develops and supplies cloud computing services. The Solution Business provides 80% of the Company’s consolidated sales and 66% of its operating income before adjustments, while the Product Business accounts for 20% of consolidated sales and 34% of pre-adjusted operating income. Of total consolidated sales, 79% comes from services that facilitate the use of services from Salesforce.com, Inc. and 21% comes from services that facilitate the use of Amazon Web Services (AWS). Having provided integration services for the introduction of more than 2,500 cloud computing systems and possessing overwhelming number of top-quality certified engineers, the Company easily attracts business proposals from other companies. The Company has established a mutually reinforcing cycle through which it and its engineers acquire knowhow and recognition through many past projects, enabling them to gain new business. The demand for cloud computing in Japan is growing rapidly, and the Company holds a position of competitive superiority in the field of cloud integration, which has great growth potential.

2. FY2/17 financial results

In the fiscal year through February 2017, i.e., in FY2/17, the Company’s consolidated net sales grew 42.5% year on year (YoY) to ¥3,534mn, but its operating income decreased by 22.2% to ¥202mn. In the Solution Business, sales increased 47.6% YoY to ¥2,819mn, while operating income fell 9.5% to ¥407mn. In the Product Business, sales advanced 25.4% YoY to ¥714mn and operating income rose 6.6% to ¥208mn. As Salesforce.com increased its sales in Japan, the Company expanded its sales of products for Salesforce services, supporting the large sales increase in the Product Business and an upturn in the business’s operating income despite the costs of promoting a new product called mitoco and an increase in personnel costs in the business. In the Solution Business, sales jumped 47.6% YoY, reflecting an increase in the number of large orders received and an increase in the need to improve projects completed earlier. However, operating income in the Solution Business declined YoY because of several factors, including an increase in the number of engineers in the business, an increase in the amount of subcontracted work, and the prolongation of special development projects.

3. FY2/18 Company forecast

For FY2/18, the Company projects a 42.7% YoY increase in consolidated net sales to ¥5,044mn and a 6.4% rise in consolidated operating income to ¥215mn. Sales in the Solution Business are projected to grow 44.7% to ¥4,078mn, and sales in the Product Business are seen climbing by 35.3% to ¥966mn. However, operating income growth is seen to be limited by the costs of developing new products and of increasing the work force.

4. Company targets ordinary income of ¥1.0bn for FY2/20, but still in the investment phase of expansion

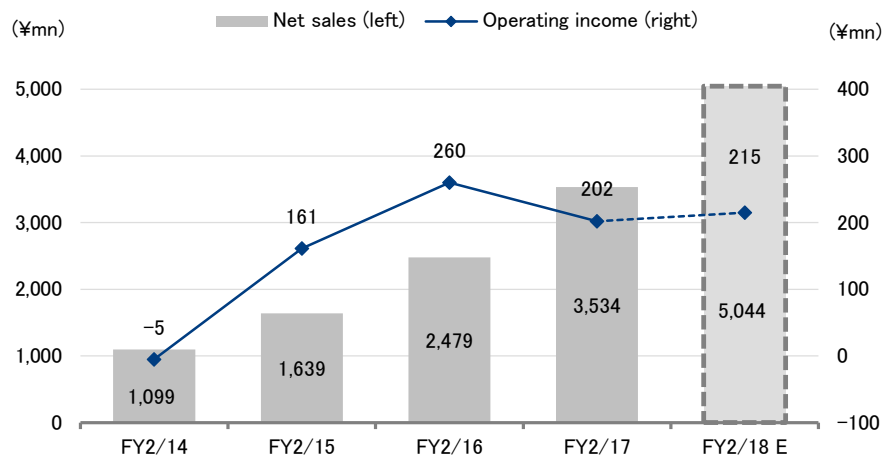
The Company’s medium-term plan of operations aims to earn a consolidated ordinary income of ¥1.0bn in FY2/20. While sales should continue to expand rapidly YoY through FY2/20, profits and profit margins are likely to grow modestly through FY2/20 because of heavy investments in personnel and new products. Profits and margins should expand more rapidly from FY2/21.

Summary

Key Points

- The leading cloud integrator in Japan's cloud computing market, TerraSky operates a Solution Business and a Product Business.
- Although consolidated net sales grew 42.5% YoY in FY2/17, operating income decreased 22.2% because of such factors as an increase in the number of engineers hired, an increase in subcontracted work, and the prolongation of special development projects. For FY2/18, the Company forecasts a 42.7% YoY increase in consolidated net sales and a 6.4% rise in consolidated operating income.
- For FY2/20, the Company aims to achieve an ordinary income of ¥1.0bn. Until then, profit growth will be modest because of heavy investments. Profit growth should accelerate from FY2/21.

Results trends



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

Company profile

A top-class cloud integrator in Japan

1. Company profile

TerraSky co. is Japan's top-class cloud integrator. Since its founding in 2006, the Company has specialized in cloud computing services, contributing significantly to the development of the cloud computing market in Japan. Salesforce and AWS hold the largest shares of the Japanese market for the cloud computing services in which TerraSky specializes. TerraSky has provided services for the implementation of more than 2,500 cloud computing contracts in Japan. Its customers span the ranges of size and industry. TerraSky has five consolidated subsidiaries, including TerraSky Inc., Sky365 Co. Ltd., BeeX Inc., Cloudia Japan Inc., and Kitalive Inc. An affiliate, Serverworks Co., Ltd., is accounted for by the equity method in its consolidated accounts.

Company profile

2. History

The Company was established as Head Inc. in 2006 to specialize in the development of cloud computing services. Company president Hideya Sato left IBM Japan, Ltd. to join the Japanese subsidiary of Salesforce.com, Inc. (CRM), which he helped to expand. In 2007, the Company changed its name to TerraSky Co., Ltd.

In 2008, the Company started marketing its SkyEditor screen development service and its SkyOnDemand data integration service. In 2012, the Company released the AppComponent service, which enable systems developers and vendors enhance the capabilities of the SkyVisualEditor screen development service and provide application programs. In 2013, the Company started selling its Cloud ERP Concierge Service, its Automigration for Notes package, which enables the automatic migration from Notes to Salesforce, and its Hybrid Cloud Solution service. In 2016, the Company entered a new field of business by launching sales of its mitoco socialware service.

In 2010, TerraSky concluded an equity investment and business development contract with NTT Software Corporation (now called NTT TechnoCross Corporation), and in 2013, it formed a similar agreement with Serverworks Co., Ltd., which is a primary vendor to AWS. In 2014, the Company concluded an equity investment agreement with Salesforce.com, Inc., of the US. In 2012, TerraSky Co. established subsidiary TerraSky Inc. in California, and through this subsidiary, it started selling its cloud computing services in North America. In 2015, TerraSky Co. listed its shares on the Mothers market of the Tokyo Stock Exchange. In 2016, the Company concluded equity investment and business development agreements with Ecomott Inc., which is engaged in the internet of things (IoT), and with Cloudia Japan Inc., which provides cloud integration services in Kyushu, Japan. Also in 2016, the Company established subsidiary BeeX, which provides cloud integration services for migrating from a simple cloud computing system to a cloud computing system based on SAP Inc.'s main ERP software. Finally, in 2016, the Company, with Win Consul Inc., established subsidiary Kitalive Inc., which also provides cloud integration services.

History

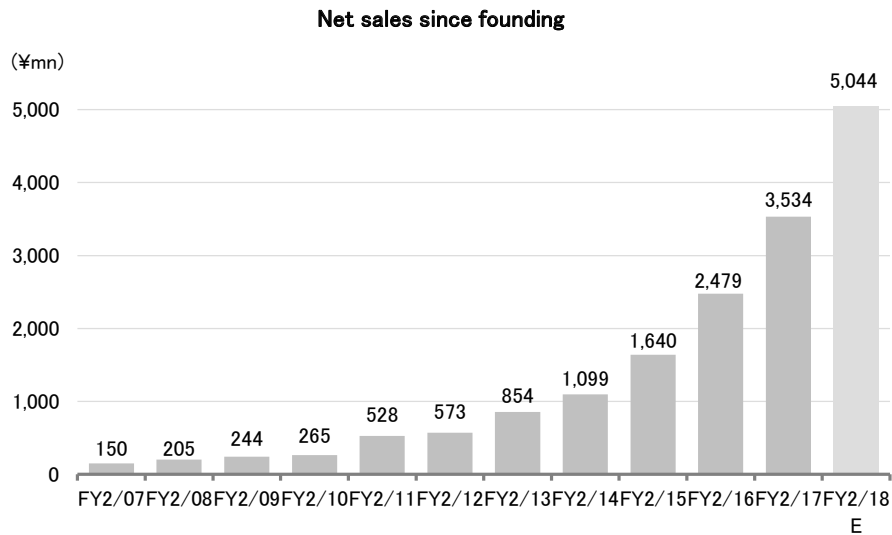
March 2006	Founded as Head Inc.
February 2007	Changed name to TerraSky Co., Ltd.
July 2008	Started selling SkyEditor screen development service
October 2008	Started selling SkyOnDemand data integration service
September 2010	Concluded an equity investment and business agreement with NTT Software Corporation
October 2010	Started selling SkyVisualEditor 2.0 screen development service
March 2011	Started selling SkyOnDemand 2.0 data integration service
August 2012	Established subsidiary TerraSky Inc. in California, US
November 2012	The Company released the AppComponent service, which enable systems developers and vendors enhance the capabilities of the SkyVisualEditor screen development service and provide application programs
May 2013	Started selling the Cloud ERP Concierge Service
June 2013	Started selling Automigration for Notes package, which enables the automatic migration from Notes to Salesforce
September 2013	Concluded an equity investment and business agreement with Serverworks Co., Ltd.
October 2013	Started selling the Hybrid Cloud Solution service
May 2014	Established subsidiary Sky 365 Co., Ltd. to engage in the new business of management service provider (MSP) specialized in cloud computing
October 2014	Concluded an equity investment agreement with Salesforce.com, Inc., of the US
April 2015	Listed shares on the Mothers market of the Tokyo Stock Exchange
January 2016	Concluded an equity investment and business agreement with Ecomott Inc.
March 2016	Established subsidiary BeeX Co., Ltd. to engage in ERP business using cloud computing
April 2016	Concluded an equity investment and business agreement with Cloudia Japan, Inc.
July 2016	Started selling the mitoco socialware service
August 2016	With Win Consul Inc., established subsidiary Kitalive Inc., which provides cloud integration services

Source: Prepared by FISCO from the Company's website, securities report and results briefing materials

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Company profile

In its first fiscal year, through February 2007, the Company reported sales of ¥150mn. Every year since then, its sales have increased, reaching ¥3,534mn in FY2/17. For FY2/18, the Company projects sales of ¥5,044mn, which would match the high rate of sales growth achieved in FY2/17.



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

Japan's cloud computing market and Company's businesses

Leading market development as a specialist in cloud computing services

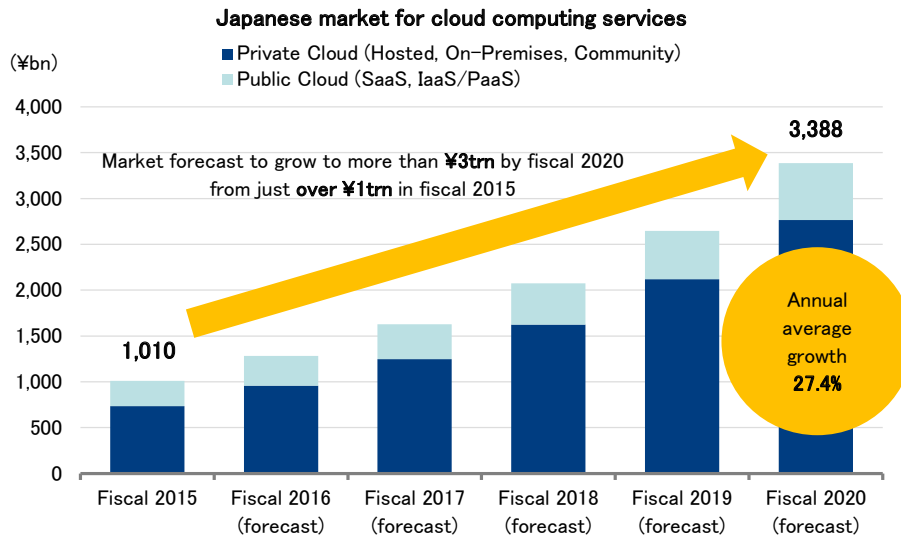
1. Japan's cloud computing market

In the first half of the 1960's, Japanese companies adopted mainframe computers. Since the 1980's, mainframe computers have been replaced by desktop office computers and minicomputers. In the 1990's, the computer industry emphasized client servers. Between 2005 and 2010, cloud computing appeared in Japan, prompting a paradigm shift in Japan's IT industry dominated by companies and platforms such as Salesforce, Amazon Web Services, Google, and Microsoft Azure. With the spread of cloud computing, IT applications have entered an era in which usage is more important than ownership.

Japan's cloud computing market and Company's businesses

The cloud is a platform that allows the offering of software and data through a network as a service, rather than as components of a computer system. A user of the cloud for computing does not need to buy hardware, software, and data, and the construction and maintenance of a cloud computing system requires less time and effort than the construction and maintenance of an on-premises computer system. Thus, the use of cloud computing lowers costs and improves work efficiency. Cloud computing can be used by companies of any size and in any industry, requires no initial investment, and can be implemented in a short period of time. These large advantages over client server systems have motivated Japanese companies to adopt cloud computing.

According to MM Research Institute, Ltd., the Japanese market for cloud computing services was valued at ¥1.0108trn in the government's fiscal 2015, which ran through March 2016. This institute forecasts that this market will grow to ¥3.3882trn by fiscal 2020, or to 3.4 times the size of the market in fiscal 2015, for average annual growth of 27.4%. As many Japanese companies still use client server systems, there appears to be ample room for TerraSky co. to expand its business.



Source: Prepared by FISCO from MM Research Institute, Ltd. news release

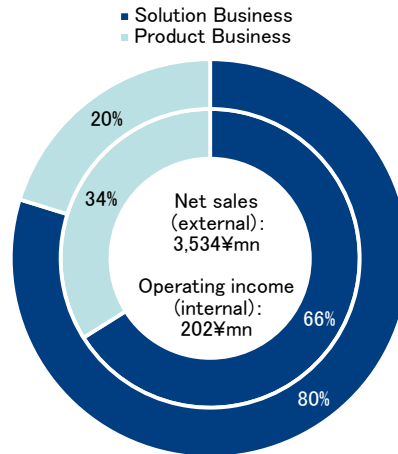
2. Company's business segments

The Company's two business segments are the Solution Business and the Product Business. In FY2/17, the Solution Business provided 80% of the Company's consolidated sales and 66% of its operating income, while the Product Business accounted for 20% of consolidated sales and 34% of pre-adjusted operating income.

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Japan's cloud computing market and Company's businesses

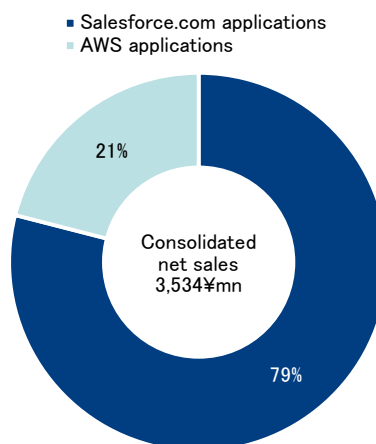
Breakdown by business of consolidated net sales and operating income in FY2/17



Note: Operating income ratios are based on the income before adjustments
 Source: Prepared by FISCO from the Company's financial results

In FY2/17, 79% of the Company's total consolidated sales were made to facilitate the use of services provided by Salesforce.com, Inc. and 21% were made to facilitate the use of Amazon Web Services (AWS). Salesforce.com applications thus remained the leading sales driver in FY2/17, but they were less dominant than they had been in FY2/16, when they accounted for 96% of total sales, while AWS applications accounted for only 4%. The Company's sales for Salesforce.com applications grew YoY in FY2/17, but not by as large a rate as its sales for AWS applications.

Breakdown by consolidated net sales in FY2/17 by cloud service application



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

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Japan's cloud computing market and Company's businesses

(1) Solution Business

The Solution Business supports the development of optimal systems using the cloud that satisfy a customer company's needs. The business also develops such systems. Its three main services are cloud integration, cloud consulting, and cloud ERP. To facilitate the introduction or implementation of the front office systems Salesforce and AWS, the Solution Business undertakes a wide range of services, from defining requirements to design, development, testing, operation, validation of effectiveness, planning improvement policies, and systemization planning. TerraSky Co. has licensed Salesforce products from Salesforce.com, Inc.

The Solution Business of TerraSky Co. serves mainly large corporate customers. Consolidated subsidiary Cloudia Japan offers consulting services for the introduction of Salesforce products to companies in Kyushu, while consolidated subsidiary Kitalive provides similar services to companies in Hokkaido. Equity-accounted affiliate Serverworks provides cloud integration services for the introduction of cloud systems, mainly AWS. Consolidated subsidiary Sky365, which is owned 61.5% by TerraSky Co. and 38.5% by Serverworks, provides MSP services for the cloud. Although many large Japanese companies have introduced cloud services, many small and medium-sized companies have not. Thus, Cloudia Japan and Kitalive should be able to introduce cloud services to smaller companies and companies in rural areas of Japan.

Furthermore, BeeX is promoting the migration from simple cloud systems to the cloud system based on the many ERP systems operated globally by SAP Inc. Thus, SAP's cloud services may become the next main target of TerraSky's services, following the cloud services of Salesforce and AWS. In December 2016, TerraSky co. became the only Japanese company certified as a Gold Partner for the cloud enterprise application GLOVIA OM developed by Fujitsu Ltd. <6702>. Agencies affiliated with TerraSky are now selling GLOVIA OM, thereby expanding the involvement of TerraSky in cloud ERP services. Since the GLOVIA OM application is used mainly by smaller companies, while SAP's ERP services are used mainly by larger companies, there should be little competitive overlap between the services.

Group companies and descriptions of their businesses

Company	Ownership ratio	Consolidated subsidiary or equity accounted affiliate	Business segment	Business description
TerraSky co., Ltd.	-	-	Solution Business	<ul style="list-style-type: none"> Supply and maintenance of cloud integration services for Salesforce products. Provision of cloud consulting service to support the planning of IT systems that enable the maximum use of cloud services, mainly from Salesforce and AWS. Introduction, integration, and maintenance of RP systems into the cloud platform.
	-	-	Product Business	<ul style="list-style-type: none"> Development, sale and maintenance of cloud services
TerraSky Inc.	100%	Consolidated subsidiary	Product business	<ul style="list-style-type: none"> Sell TerraSky cloud services in North America
Sky365 Co., Ltd.	61.5% (38.5% owned by Serverworks)	Consolidated subsidiary	Solution Business	<ul style="list-style-type: none"> Managed service provider (MSP) specialized in cloud computing
Cloudia Japan Inc.	67%	Consolidated subsidiary	Solution Business	<ul style="list-style-type: none"> Offers consulting services for the introduction of Salesforce products to companies in Kyushu
Kitalive Inc.	70%	Consolidated subsidiary	Solution Business	<ul style="list-style-type: none"> Offers consulting services for the introduction of Salesforce products to companies in Hokkaido
BeeX Inc.	67%	Consolidated subsidiary	Solution Business	<ul style="list-style-type: none"> Provides cloud integration services for migrating from a simple cloud computing system to a cloud computing system based on SAP Inc.'s main ERP software
Serverworks Co., Ltd.	34%	Equity accounted affiliate	Solution Business	<ul style="list-style-type: none"> Offers cloud integration services to install and maintain cloud systems, mainly for AWS

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

Japan's cloud computing market and Company's businesses

TerraSky has implemented more than 2,500 Salesforce applications for companies of all sizes, in many industries, and with a wide range of capabilities. Among its clients are the Mizuho Financial Group, Inc. <8411>, Odakyu Electric Railway Co. Ltd. <9007> Group, and the World Wildlife Federation.

In FY2/17, the Solution Business generated net sales of ¥2,819mn and operating income before adjustments of ¥407mn for a segment operating income margin of 14.4%.

(2) Product Business

TerraSky is developing and marketing cloud services as a vendor of software as a service (SaaS), i.e., software provided through the internet. These services include the screen development services SkyVisual Editor and SuPICE, the data integration services SkyOnDemand and DataSpiderCloud, the socialware service mitoco, and the IAS service for insurance agencies. Many companies in Japan use these services to adjust aspects of their IT systems, such as screens and logic. In particular, the SkyVisualEditor service and the SkyOnDemand service have become de facto standards in Japan's IT industry.

TerraSky had previously developed products for engineers in charge of developing and maintaining systems, but in July 2016, the Company released its first socialware (groupware) service, mitoco. The Japanese government is promoting a revolution in work styles, and Japanese companies are also introducing flexible work styles, such as working at home. Groupware is a corporate communication tool that is expected to become more important in coming years. The mitoco socialware service differs from competing services now used by many companies in that it is based on the cloud. Current socialware services use database engines that were designed a long time ago when today's cloud environment was not foreseen. Thus, it is difficult to use these socialware services on smartphones. To operate as originally intended, these services put great stress on computer systems. The mitoco service was developed for use on the cloud, and its simple operating system makes it easy to select desired functions. As a platform for linking with the applications of other companies, it is very expandable. For these reasons, the mitoco service is easy to use, not only for managers of computer systems, but also for general company employees. In cooperation with Ecomott Inc., a maker of IT devices, TerraSky has developed a sensor that enables the mitoco service to detect the usage of conference rooms and an IoT option service for functions such as managing vehicles. Sometimes, conference rooms are reserved but are not in use during the reserved time. The conference room sensor automatically sends a message to the person who has reserved the unused room, and if that person does not respond soon, the sensor can automatically cancel the reservation, allowing others to use the room. Similarly, the vehicle management service promotes the efficient use of vehicles by matching reservations with actual use. The drive recorder incorporated in this service allows vehicle managers to monitor the operation of vehicles, any mechanical problems they may encounter. The mitoco service has already been adopted by SOMPO Systems Inc., Tokio Marine & Nichido Fire Insurance Co., Ltd., Nikkei Inc., and other companies, and the Company anticipates an increase in orders for the service. The name mitoco was derived from the English-language expression, "More in today's company".

The Product Business is conducted by TerraSky Co. and TerraSky Inc. NTT Software, with which TerraSky holds an equity investment and business alliance, is a general sales agent for the sale of the SkyOnDemand service in Japan, but TerraSky Inc. handles all product sales in North America.

In FY2/17, the Product Business generated sales of ¥714mn and operating income of ¥208mn for a high segment operating income margin of 29.2%.

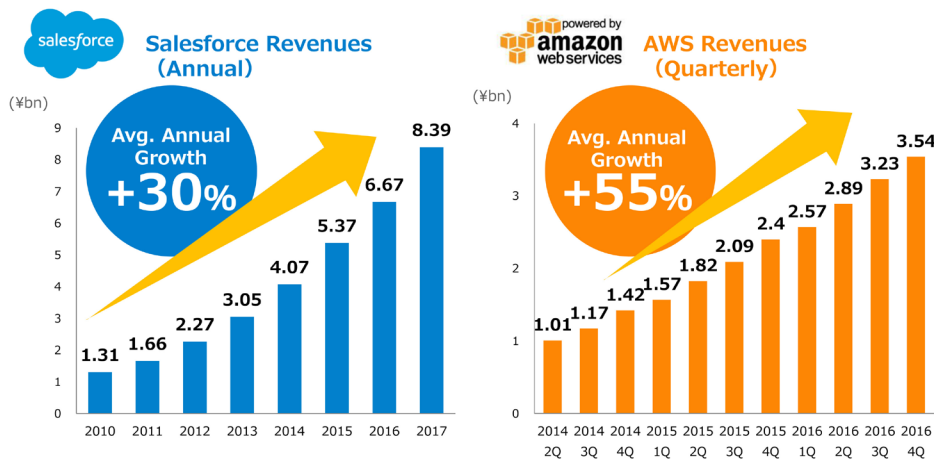
3. Strengths

TerraSky co. has three main strengths. The first is vast experience. As of March 2017, the Company had implemented more than 2,500 cloud computing services for companies of varying size, capability, and industry. With this much experience, the Company has acquired substantial knowhow in cloud integration, including knowledge of project management and product quality control. It is one of a few Japanese companies that can undertake large cloud integration projects, and it appears to be the most competitive of this small group. For the past 11 years, the magazine Nikkei Computer has ranked companies providing cloud services in Japan. For the past six years, TerraSky Co. has been selected as one of the leading suppliers of assistance for the implementation of cloud services in the public sector.

The second strength of TerraSky co. is the number and quality of its engineers, which are unmatched in Japan's cloud integration industry. The number of certifications or awards won by the Company's engineers attests to their high quality. Salesforce.com has presented MVP awards to only five engineers in Japan, and two of those five work for TerraSky co. There are only nine certified technical architects in Japan, and three of them work for TerraSky. The Company employs the largest number of Certified Advanced Platform Developers, Platform Application Builders, Advanced Administrators, Platform Developers, SalesCloud Consultants, and ServiceCloud Consultants in Japan. It also employs many engineers who are certified by AWS, including Certified Solutions Architect Professionals, DevOps Engineer Professionals, Developers, and SysOps Administrators. The Company encourages its engineers to improve their technical skills, pays competitive salaries, and controls working hours. Thus, it attracts high-quality engineers, and its engineer retention rate is high, compared with the average retention rate in the industry.

TerraSky's third strength is its ability to serve more than one platform. Salesforce has the greatest need for cloud integration services, so it is TerraSky's top priority service, while AWS is the second. One reason that companies buy the cloud service provided by Salesforce and AWS is that these companies have enough engineers to provide the services in greatest demand. These companies hold top shares of the global markets for platforms as a service (PaaS) and infrastructure as a service (IaaS), and in recent years, the sales of Salesforce have grown at an average annual rate of 30%, while the sales of AWS have risen at an average annual rate of 55%. These sales growth rates indicate that TerraSky's orders from these companies are likely to grow by similar rates.

Salesforce and AWS Revenue Trend



Source: From the Company's results briefing materials

Japan's cloud computing market and Company's businesses

FISCO believes that the Company's greatest strength is the cyclical reinforcement of the three strengths cited above. In other words, by completing many projects, the Company and its engineers gained substantial knowhow and valuable experience, which extended the Company's superiority in the Japanese market for cloud services, making it easy to acquire new projects.

4. Business risks

The Company will have to hire and retain enough engineers to expand its business. Although there is a labor shortage in Japan and hiring is very competitive, it appears that the Company can obtain personnel more easily as it grows in scale and its reputation spreads. Regardless of whether it can hire as many engineers as it wants, hiring appears to be getting easier for the Company than it used to be. The Company is trying to improve its working environment and to build a workplace where ambitious technicians can continue to pursue attractive projects aggressively. A long-term business risk is that the Company may react to the next great paradigm shift in Japan's rapidly changing IT industry too slowly. It is President Sato's top priority to insure that the Company remains alert to potential paradigm shifts.

■ Medium-term Plan

Targeting a consolidated ordinary income of ¥1.0bn in FY2/20

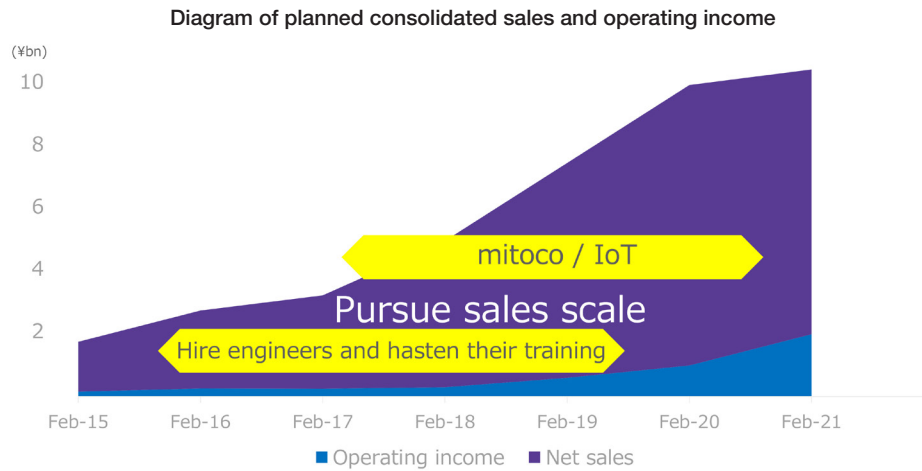
The Company's medium-term plan addresses management issues that appeared in the second year after listing its shares. It calls for investing heavily in human resources and in developing services in artificial intelligence, the internet of things, and enterprise resource planning on the cloud platform to better serve Japan's rapidly growing market for cloud services. As a result of implementing this strategy, the Company intends to earn a consolidated ordinary income of ¥1.0bn in FY2/20.

However, the plan has two phases. In the first phase, from FY2/17 through FY2/19, the Company will invest significantly while maintaining rapid sales growth. In the second phase, from FY2/20 through FY2/22, profit growth will be given greater emphasis. In the first phase, while selling more products, AI products and IoT products, mainly for Salesforce, the Company will hire and train more engineers, develop new products, expedite M&A, and plant the seeds to cope with future competition. In the second phase, the Company plans to take advantage of its number one position in Japan's cloud integration industry to improve its profits and profitability. The Company may also start paying dividends in FY2/20 if it achieves its profit forecasts.

In order to achieve its targets, the Company is aware that it must do four things: raise project profitability, increase the sales weighting of the Product Business, ensure an adequate supply of engineers, and generate synergy among the companies in its group.

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Medium-term Plan



Results trends

Phase of investment priority

1. FY2/17 results

In FY2/17, the Company's consolidated net sales climbed 42.5% YoY to ¥3,534mn, while its operating income declined 22.2% to ¥202mn, its ordinary income decreased 10.9% to ¥216mn, and its net income attributable to owners of the parent fell 14.7% to ¥128mn. In the Solution Business, sales growth reflected brisk orders for the construction of cloud systems, and the aggregate number of cloud services, such as Salesforce, implemented by the Company exceeded 2,000. In addition, sales growth was led by an increase in the number of users of the Company's products. The initial consolidation of CloudiaJapan Inc. and two other subsidiaries also contributed to sales growth. Several factors contributed to the declines in profits. Advertising and promotion costs increased as a result of marketing the new mitoco socialware service. The number of man-hours of labor and the outsourcing cost increased as some special development projects took longer to complete than had been scheduled. The Company sped up the hiring of employees, mainly engineers, and some of its consolidated subsidiaries suffered losses. However, only one of the Company's projects suffered a loss, of ¥5.0mn, in FY2/17, down from 21 loss-making projects with losses totaling ¥18.0mn in FY2/15. This decline resulted from improved project management, including more detailed information about project proposals and assistance to financially struggling projects. The Company's operating income margin dropped to 5.7% in FY2/17 from 10.5% in FY2/16, but this was due to the increased investment by the Company and was within the range of management's expectations. The Company's ROE was 12.2% in FY2/17, and its ratio of ordinary income to total assets was 10.1%.

Results trends

Simplified consolidated statements of income

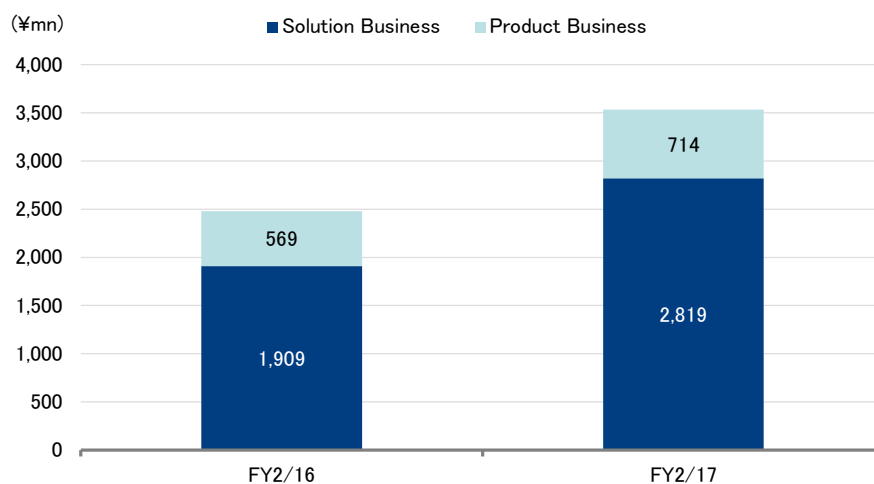
	(¥mn)			
	FY2/14	FY2/15	FY2/16	FY2/17
Net sales	1,099	1,639	2,479	3,534
YoY	28.7%	49.1%	51.2%	42.5%
Cost of sales	678	892	1,414	2,211
YoY	-	31.4%	58.6%	56.3%
Gross profit	420	747	1,064	1,323
YoY	-	77.7%	42.4%	24.3%
SG&A expenses	426	586	804	1,120
YoY	-	37.5%	37.2%	39.3%
Operating income	-5	161	260	202
YoY	-	-	61.5%	-22.2%
Ordinary income	-6	154	243	216
YoY	-	-	57.4%	-10.9%
Net income attributable to owners of parent	-23	72	150	128
YoY	-	-	108.2%	-14.7%
Profitability				
Gross profit margin	38.2%	45.6%	42.9%	37.4%
Operating income margin to net sales	-0.5%	9.8%	10.5%	5.7%
Ordinary income margin to net sales	-0.5%	9.4%	9.8%	6.1%
Net income margin	-2.1%	4.4%	6.1%	3.6%
ROE	-	19.4%	21.7%	12.2%
ROA (ordinary income to total assets)	-	18.0%	17.0%	10.1%

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

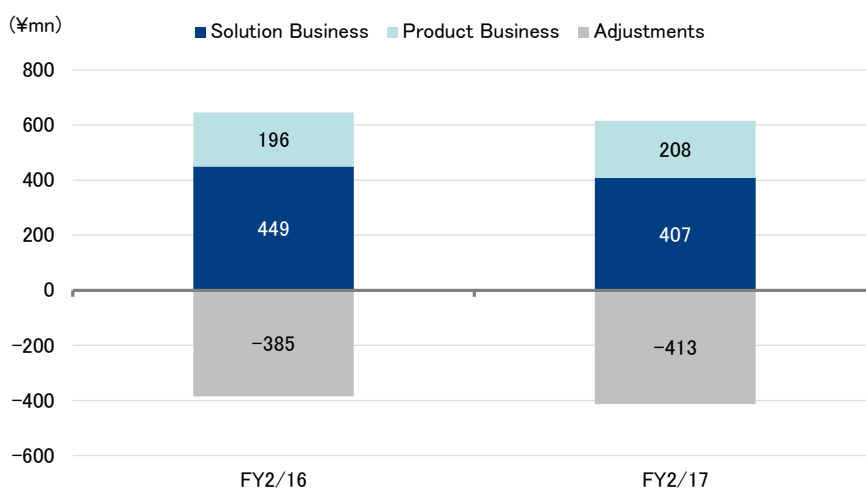
(1) Business segments

In the Solution Business, sales grew 47.6% YoY to ¥2,819mn, but segment profit (operating income before adjustments) weakened by 9.5% to ¥407mn. The business received more orders for large projects, i.e., projects worth more than ¥10mn each, than it had in FY2/16, and it improved more previously installed systems and services, leading to the sales rise. Segment profit declined because the business hired more engineers, and its outsourcing costs increased. Furthermore, the business aggressively pursued some projects linked to large systems and some that required new technology, and these projects took longer to develop than originally planned. In the Product Business, sales grew 25.4% YoY to ¥714mn, and segment profit increased 6.6% to ¥208mn. An expansion of the Japanese market for Salesforce products supported the sales increase. Segment profit increased at a smaller rate than sales because advertising and promotion costs grew as a result of marketing the new mitoco socialware service and because the business hired more personnel.

Results trends

Net sales by segment


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

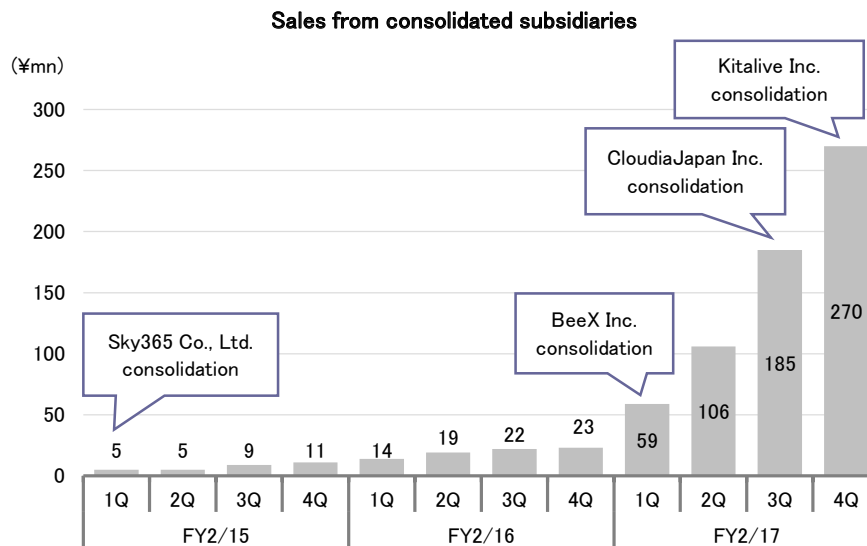
Operating income by segment


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

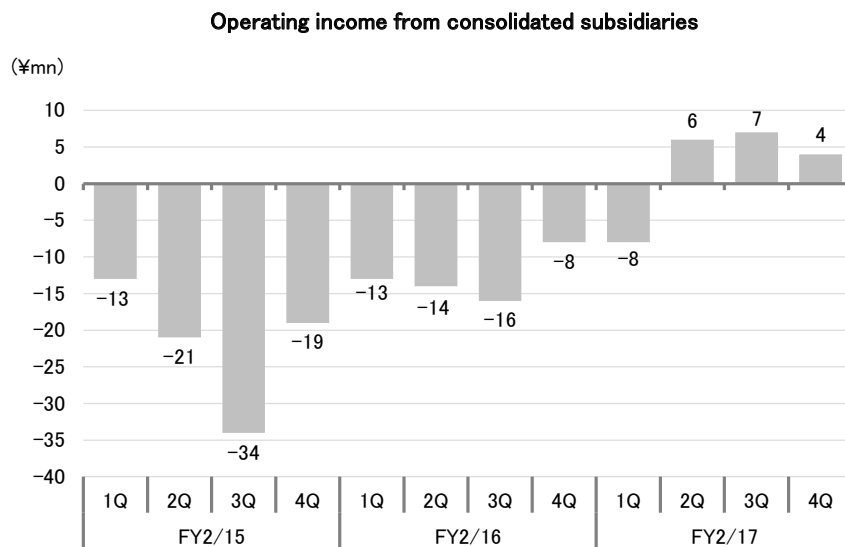
(2) Consolidated subsidiaries

FY2/17 marked a turnaround in the contributions of consolidated subsidiaries to sales and profits. In the final quarter of FY2/16, two consolidated subsidiaries contributed total sales of ¥23mn. With the consolidation of BeeX Inc. in the first quarter of FY2/17, total sales from consolidated subsidiaries rose to ¥59mn in the first quarter and 106mn in the second quarter. With the consolidation of CloudiaJapan Inc. in the third quarter of FY2/17, sales from all consolidated subsidiaries reached ¥185mn that quarter. The consolidation of Kitalive Inc. in the fourth quarter helped total sales from consolidated subsidiaries reach ¥270mn that quarter. Consolidated subsidiaries suffered an operating loss of ¥8mn in the first quarter of FY2/17, but in the following three quarters, they reported aggregate operating income of ¥6mn, ¥7mn, and ¥4mn, respectively.

Results trends



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



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

Results trends

(3) Financial position and cash flows

At the end of FY2/17, the Company's assets totaled ¥2,552mn, which was ¥791mn more than the total a year earlier. Current assets increased by ¥437mn YoY in FY2/17, and non-current assets grew by ¥352mn. Among current assets, cash and deposits increased, as did trade notes and accounts receivable. Goodwill increased by ¥73mn, and other intangible assets expanded by ¥242mn YoY in FY2/17, led by a ¥178mn increase in software accompanying the development of the mitoco socialware service. Investments and other assets grew by ¥106mn due mainly to a rise in guarantee deposits for new facilities. Total liabilities increased by ¥515mn YoY in FY2/17 to ¥1,314mn, as current liabilities declined by ¥4mn and non-current liabilities grew by ¥519mn. Interest-bearing debt increased by ¥523mn YoY to ¥723mn, reflecting a large increase in long-term debt, which more than offset a small decrease in short-term debt. Net assets increased by ¥276mn to ¥1,238mn, due to the inclusion of FY2/17's net income attributable to owners of parent to retained earnings and to the sale by Serverworks of some of its shareholdings in TerraSky Co. The Company issued ¥2mn of subscription rights to shares, and non-controlling interests increased to ¥86mn accompanying M&A activity during FY2/17. The equity ratio decreased by 8.8 percentage points in FY2/17 to 45.0%, but this was still higher than the average equity ratio for listed Japanese companies, of 30.0%, indicating financial strength.

Simplified consolidated balance sheet

	(¥mn)			
	FY2/14	FY2/15	FY2/16	FY2/17
Current assets	426	827	1,334	1,772
Cash and deposits	192	450	692	814
Notes and accounts receivable - trade	197	309	514	707
Inventories	9	31	35	55
Non-current assets	194	267	425	777
Property, plant and equipment	9	10	34	38
Intangible assets	72	67	152	394
Goodwill	-	-	-	73
Investments and other assets	113	189	238	344
Total assets	620	1,096	1,761	2,552
Current liabilities	276	619	768	763
Notes and accounts payable - trade	20	66	128	143
Short-term loans payable and other short-term borrowings	122	209	200	177
Non-current liabilities	39	6	31	550
Long-term loans payable and other long-term borrowings	39	5	-	546
Total liabilities	316	625	799	1,314
Interest-bearing debt	161	214	200	723
Subscription rights to shares	-	-	-	2
Non-controlling interests	-	32	14	86
Total net assets	304	470	962	1,238
Equity ratio	51.7%	40.0%	53.8%	45.0%

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

The balance of cash and cash equivalents at the end of FY2/17 came to ¥813mn, which was ¥121mn more than the balance at the end of FY2/16. Operating cash flow was negative by ¥92mn as a result of several factors. Income before income taxes was ¥216mn and depreciation reached ¥95mn, but notes and accounts receivable - trade increased by ¥187mn, income taxes paid amounted to ¥141mn, and prepaid expenses grew by ¥103mn. Investment cash flow was negative by ¥320mn, mainly because ¥250mn for purchase of intangible assets accompanying investment in software development. Financial cash flow was positive by ¥530mn as the Company gained ¥800mn from proceeds from long-term loans payable, more than offsetting a ¥200mn decrease in short-term loans payable and ¥90mn repayments of long-term loans payable.

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Results trends

Simplified consolidated cash flow statement

	(¥mn)				
	FY2/13	FY2/14	FY2/15	FY2/16	FY2/17
Cash flows from operating activities (a)	61	-29	216	119	-92
Cash flows from investing activities (b)	-42	-139	-125	-215	-320
Cash flows from financing activities (c)	86	180	156	340	530
Free cash flow (a) + (b)	18	-168	91	-95	-413
Cash and cash equivalents at end of period	177	192	450	692	813

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

2. Company forecast for FY2/18

For FY2/18, the Company projects a 42.7% YoY rise in consolidated net sales to ¥5,044mn, a 6.4% increase in operating income to ¥215mn, a 16.8% upturn in ordinary income to ¥253mn, and a 17.6% improvement in net income attributable to owners of parent to ¥150mn. Management expects sales in the Solution Business to grow 44.7% YoY to ¥4,078mn and sales in the Product Business to advance 35.3% to ¥966mn. Solution Business sales are seen increasing by a smaller rate in FY2/18 than they did in FY2/17 because sales were boosted in FY2/17 by the initial consolidation of three subsidiaries, whereas the company does not plan any initial consolidations of subsidiaries for FY2/18. The Company expects the mitoco socialware service launched in FY2/17 to contribute substantially to sales growth in the Product Business in FY2/18. Sales generated by consolidated subsidiaries in FY2/18 are projected to more than double their sales in FY2/17, and these subsidiaries are expected to contribute an aggregate ordinary income of several tens of million yen. The Company intends to expand its workforce to 463 persons in FY2/18 from 319 in FY2/17.

Company forecast for FY2/18

	FY2/17		FY2/18		
	Results	% of sales	forecast	% of sales	YoY
Net sales	3,534	-	5,044	-	42.7%
Solution Business	2,819	79.8%	4,078	80.8%	44.7%
Product Business	714	20.2%	966	19.2%	35.3%
Operating income	202	5.7%	215	4.3%	6.4%
Ordinary income	216	6.1%	253	5.0%	16.8%
Net income attributable to owners of parent	128	3.6%	150	3.0%	17.6%

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

Share supply-demand balance

Individual shareholders hold more than 60% of shares outstanding

At the end of February 2016, financial institutions held 0.42% of all of TerraSky's outstanding shares, operators of financial instruments businesses held 6.51%, other Japanese companies held 21.21%, non-Japanese companies held 9.69%, and individuals and other shareholders held 62.14%. At the end of August 2016, Company president Hideya Sato was the top shareholder, with 45.46%. Business partner NTT Software was second, with 12.53%, and equity-accounted affiliate Serverworks was third, with 8.48%.

Although the Company has outstanding rights for the subscription to new shares, FISCO calculates that the maximum possible dilution of EPS from the exercise of these rights would be 5.0%.

Ownership ratio by shareholder type (as of February 29, 2016)

	Governments and local public bodies	Financial institutions	Financial instruments business operators	Other companies	Overseas corporations	Individual investors and others	Total
Ownership ratio	-	0.42	6.51	21.21	9.69	62.14	100.00

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

Major shareholders (as of August 31, 2016)

Ranking	Name	No. of shares held (shares)	Ratio of total shares issued (%)
1	Hideya Sato	1,286,600	45.46
2	NTT Software Co., Ltd.	354,600	12.53
3	Serverworks co., Ltd.	240,000	8.48
4	MSCO CUSTOMER SECURITIES (Standing proxy: Morgan Stanley MUFG Securities, Co., Ltd.)	88,282	3.11
5	UBS AG LONDON A/C IPB SEGREGATED CLIENT ACCOUNT (Standing proxy: Citibank Japan Ltd.)	70,398	2.48
6	BNY GCM CLIENT ACCOUNT J PRD ACISG (FE-AC) (Standing proxy: The Bank of Tokyo-Mitsubishi UFJ, Ltd.)	56,974	2.01
7	Tatsuo Dai	55,000	1.94
8	CHASE MANHATTAN BANK GTS CLIENTS ACCOUNT ESCROW (Standing proxy: Mizuho Bank, Ltd., Settlement & Clearing Services Division)	43,900	1.55
9	BNY FOR GCM RE GASBU (Standing proxy: The Bank of Tokyo-Mitsubishi UFJ, Ltd.)	40,426	1.42
10	GOLDMAN, SACHS & CO. REG (Standing proxy: Goldman Sachs Japan Co. Ltd.)	29,387	1.03
Total		2,265,567	80.0

Source: Prepared by FISCO from quarterly securities reports



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