

TerraSky Co., Ltd.

3915

Tokyo Stock Exchange First Section

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Summary

Expecting sustained robust growth at a roughly 20% annual pace over the medium term, likely increase in public-sector results too

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 5,000 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 Inc. (BeeX) provides services including support for installing Amazon Web Services (AWS) and cloud migration support for SAP systems.

1. FY2/21 Results Overview

The Company reported FY2/21 consolidated results with ¥11,144mn in net sales (+19.8% YoY) and ¥779mn in operating income (+7.5%). These values set all-time highs and exceeded period-start targets (¥10,728mn in net sales, ¥520mn in operating income). At period-start timing, the Company expected weaker profits on a rise in sales because of increases in personnel costs and training costs related to aggressive hiring and ramp-up costs for the newly established subsidiary in Thailand. Upside drivers, meanwhile, were larger increase in cloud system deployments than expected and lower costs at the Thai subsidiary than budgeted as the novel coronavirus pandemic (COVID-19) in the country curtailed progress in business activities.

2. Outlook for Results of FY2/22

The outlook for the FY2/22 consolidated results is that net sales will increase 18.1% YoY to ¥13,159mn and operating income will decrease 31.2% to ¥536mn. In net sales, the Company expects continued double-digit increase on steady rise in Salesforce, AWS, and other cloud-system installation projects and expansion of contracts for mitoco groupware service, a product developed in-house. In profit, meanwhile, it projects a decline because of higher upfront investment costs aimed at future growth that factor in a rise in ramp-up costs for LiberSky Co., Ltd. founded in January 2021 and TerraSky Technologies Co., Ltd. founded in February 2021 and business activity costs at Quemix Inc., which conducts R&D related to quantum computers, and the Thai subsidiary. At TerraSky Technologies, in particular, it plans to hire about 100 people in the first fiscal year with the intent of building a business that hires and trains inexperienced people and dispatches them to the Company itself and its customers aimed at resolving the issue of chronic shortage in cloud-related human resources. It expects a loss in the initial year due to needing a number of months as the training period until personnel is ready for dispatching. Once business has ramped up, the Company hopes to reduce orders opportunity losses that occurred up to now because of human resource issues. It projects an increase of about 180 people versus the previous fiscal year-end to just under 800 group employees at end-FY2/22. Orders remain upbeat, and this means that the Company is likely to continue operating at full capacity in FY2/22.

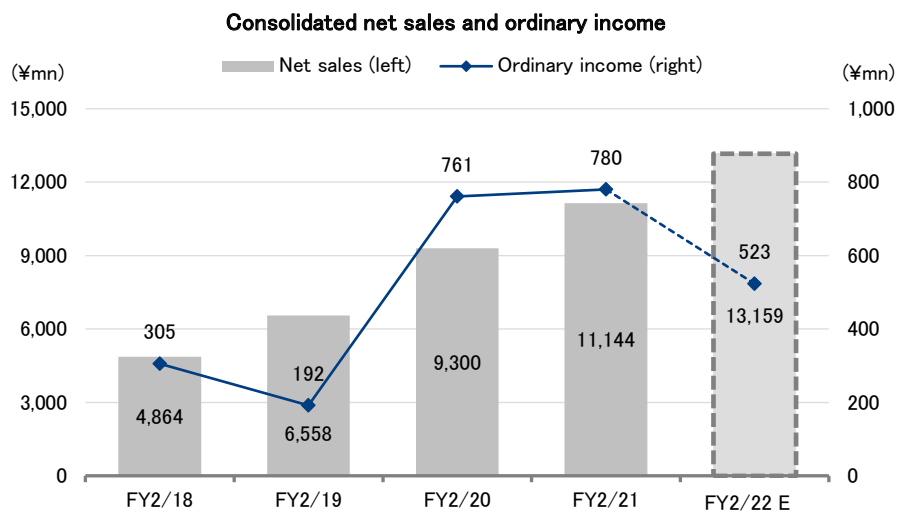
Summary

3. Growth strategy

The domestic public cloud services market should sustain a strong growth pace. Corporate efforts to accelerate management digital transformation initiatives with COVID-19 conditions as a catalyst are evident. The Company is strengthening development capabilities, including human resource training at TerraSky Technologies and aims to achieve sales growth that outpaces the industry average. While the Company mainly handled Salesforce and AWS deployments previously, it created subsidiary LiberSky to newly focus on projects related to Google Cloud Platform (GCP). GCP ranks third in the PaaS market after AWS and Microsoft Azure, but demand for BigQuery used in big data analysis and AI applications is growing thanks to its low cost and rapid processing performance. Working jointly with iFocus network Co., Ltd., an AI technology developer acquired as a subsidiary in February 2021, the Company wants to expand business in the GCP market too. It is focusing on the public sector as a new market opportunity as well. In 2020, it started assisting Salesforce deployments at regional government entities and tourism businesses in collaboration with Salesforce.com and JTB with goals of revitalizing tourism after COVID-19 settles down and supporting stimulation of local economies. While it still does not have many installations, the Company expects pick-up in deployments at local government entities and others and contributions to income from 2022.

Key Points

- Reached all-time highs again in FY2/21 on COVID-19-driven acceleration of cloud shift
- Conservatively guides for lower profit on increased sales in FY2/22 due to factoring in upfront investment costs at subsidiaries
- Intends to sustain roughly 20% annual sales growth and broaden Salesforce deployments to local government entities with goals of revitalizing tourism and promoting regional DX



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

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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 5,000 cloud system installations including Salesforce (as of May 2021), TerraSky has experience with a wide range of development projects for companies big and small and in all kinds of industries. As of February 2021, it has 9 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 2021, the number of consolidated employees had increased by 83 on the end of the previous fiscal period to 605 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.	57.1%	Solution Business	Supplied management service provider (MSP)* services specialized in cloud computing
BeeX Inc.	78.3%	Solution Business	AWS installation support, and support services for migration to cloud computing systems on SAP software platform
Kitalive Inc.	58.2%	Solution Business	Cloud system installation support centered in Hokkaido
Cuon.inc.	100.0%	Solution Business	Web system development
Quemix Inc.	75.7%	Solution Business	Quantum computer research and provision of solutions for companies
TerraSky (Thailand) Co., Ltd.	49.0%	Solution Business	Cloud systems installation support in Thailand
TerraSky Technologies Co., Ltd.	100.0%	Solution Business	Dispatching and recruiting human resources specializing in cloud services
LiberSky Co., Ltd.	81.0%	Solution Business	Building GCP-based data analysis foundations, implementing cloud zero-trust network integration, etc.
TerraSky Inc.	100.0%	Product Business	Sales and marketing in the North America region for products developed in-house
iFocus network Co., Ltd.	52.0%	Product Business	AI platform development and installation assistance
TerraSky Ventures Co., Ltd.	100.0%	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. As an omni-channel call center service linking Salesforce with LINE Corporation, 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.

The Company engaged in numerous capital and business alliances in the growth process for its business. Arrangements implemented thus far are NTT TechnoCross Corporation (former NTT Software Corporation) in 2010, Serverworks Co., Ltd. <4434>, which mainly handles AWS deployment assistance and resale, in 2013, Ecomott Inc. <3987>, which handles IoT/mobile cloud solutions, and Cloudia Japan inc. (absorbed in 2018 after acquisition as a subsidiary), which handles cloud integration in the Kyushu area, in 2016, IGUAZA Corporation, a distributor of IBM <IBM> products, in 2017, Business Engineering Corporation <4828>, which provides assistance in deployment of ERP systems, in 2018, and Japan System Techniques Co., Ltd. <4323>, an independent system developer, in 2019.

In subsidiary initiatives, the Company established Sky365 Co., Ltd., which provides AWS monitoring and maintenance services, as a joint venture with Serverworks in 2014, BeeX and Kitalive Inc., which assists in cloud system deployments mainly in Hokkaido, in 2016, and TerraSky Ventures Co., Ltd., which invests in and cultivates venture companies, Cuon inc. (acquired as a subsidiary via stock purchases), a Web system developer, and TerraSky (Thailand) Co., Ltd., which handles cloud system development and deployment assistance in Thailand, in 2019. The Company continued aggressive business initiatives in 2021 with the founding of LiberSky, which builds data analysis foundations on Google's cloud platform, in January and the formation of TerraSky Technologies, which dispatches and introduces cloud human resources, and an investment in and acquisition as a subsidiary of iFocus network, which handles AI platform development and deployment assistance, in February.

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
April 2016	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
January 2021	Established LiberSky Co., Ltd.
February 2021	Established TerraSky Technologies Co., Ltd. Invested in iFocus network Co., Ltd. to acquire it as a subsidiary

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

Cloud service market and TerraSky's businesses

Expects the cloud services market to sustain strong growth in the 20% range on acceleration of corporate DX investments spurred by COVID-19

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.

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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, while companies transitioning existing systems to cloud service had been increasing in recent years, regardless of their size, with support from faster communication network speeds and enhanced security measures at cloud service providers and progress in broadening services, the shift to cloud service, including ERP systems, accelerated amid pick-up in initiatives with management DX triggered by COVID-19.

Market scale for public cloud service in Japan should continue to steadily expand. Many companies and ministries and agencies have their own computer systems, and ongoing transition by these users to public cloud service is the driver of robust growth. In particular, standard support for SAP's ERP system "SAP ERP 6.0" used widely by large companies ends in 2027, and this requires transition to the next-generation ERP product "SAP S/4HANA" by then. Since many cases are likely to involve replacement to the cloud usage format and integrators have limited human resources to handle cloud transitions for SAP ERP systems, industry outlooks generally expect busy conditions to last through at least 2027.

Public cloud service comes under three categories depending on the service format – SaaS*1, PaaS*2, and IaaS*3. AWS holds top shares in PaaS and IaaS and is followed by Microsoft Azure and Google Cloud Platform (GCP). These three companies dominate the market globally. In SaaS, meanwhile, participant vendors differ by the application, and Salesforce is the global leader in sales assistance and customer management. Annual average growth rates indicate Salesforce at 29% and AWS at 41%. Top cloud vendors, including Microsoft <MSFT> and Alphabet <GOOG>, are continuing high growth.

*1 SaaS (Software as a Service): This format delivers software provided in a package product as a service over the Internet. Leading services include Salesforce's Sales Cloud, Microsoft's Office 365, and Google's G Suite.
 *2 PaaS (Platform as a Service) refers to online services that provide a platform (server and operating system) that allows user to run applications. Leading services include AWS, Microsoft Azure, and Google App Engine.
 *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. Leading services include Amazon Elastic Compute Cloud (EC2) and Google Compute Engine.

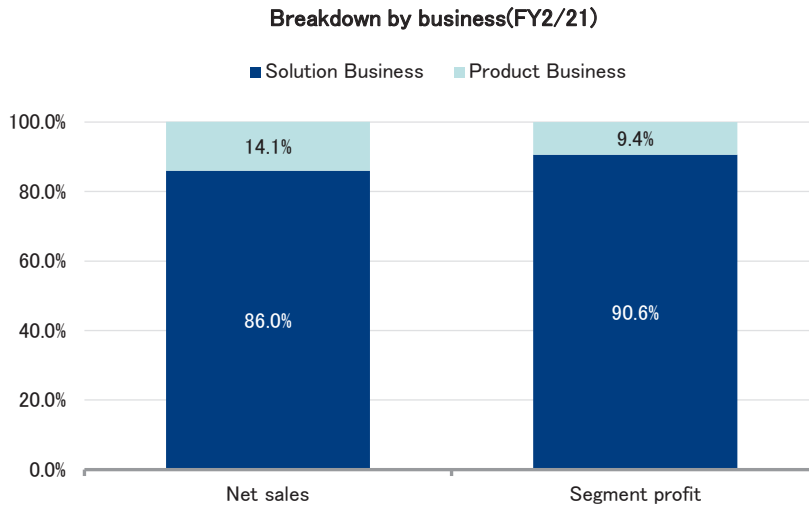
Cloud integration and other solution business contributes over 80% of sales

2. The Company's business

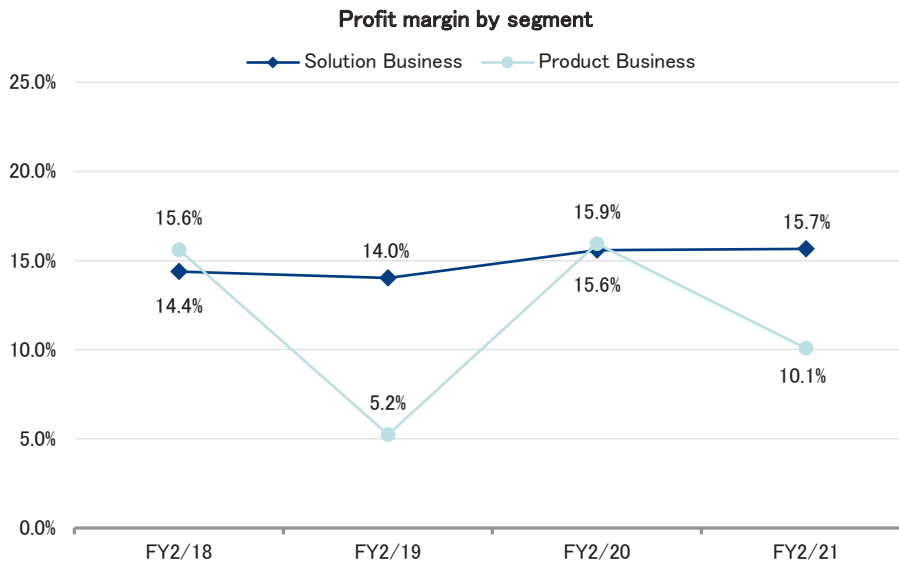
The Company operates in two business segments – Solution Business and Product Business. Solution Business is the main business at 86.0% of sales and 90.6% of segment profit in FY2/21. In segment profit margin, while Solution Business is at a relatively stable level of about 15%, Product Business fluctuates substantially depending on the period with a range of 5% to 15% because of its smaller scale at this point and larger impact by sales changes on profit margin. However, profitability is likely to stabilize in this segment too with the prospect of increase in the share of recurring income, a stable income base, in sales composition. The ratio of depreciation costs to sales is still high, though decline this ratio as sales expand should ultimately lift segment profit margin above the Solution Business level.

Cloud service market and TerraSky's businesses

In Solution Business, meanwhile, the Company mainly handles cloud system development and deployment assistance, and the recurring sales ratio (operating and maintenance service sales) is roughly 15%. Profit margin fluctuates with the orders trend in development and deployment projects and project productivity. In the past few years, profit margin has been stable at about 15% on the almost complete absence of unprofitable projects and continuation of a high utilization rate with upbeat orders.



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

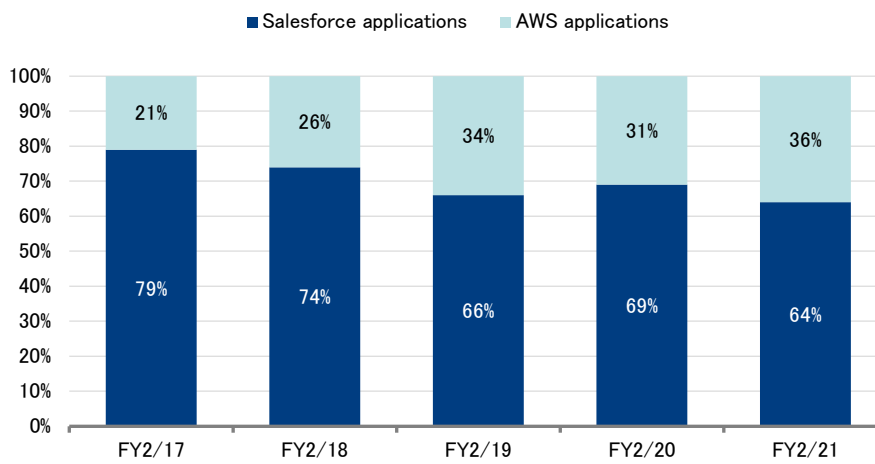


Source: Prepared by FISCO from the Company's results briefing materials

Cloud service market and TerraSky's businesses

Sales breakdown by platform in FY2/21 was Salesforce at 64% and AWS at 36%. Compared to the previous fiscal year, Salesforce sales dropped by 5ppt as a share of overall sales. Sales growth rates in FY2/21 were Salesforce at +11.1% and AWS at +39.2%, demonstrating modestly slower momentum in Salesforce-related business. The main setback was a hefty decline in sales from a major Salesforce deployment project in FY2/20 under the Product Business in FY2/21. Since Product Business sales share was down 5.7ppt YoY, composition did not change much just in terms of Solution Business.

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 5,000 installations, which is the leading number in Japan. Installations have been conducted by many companies regardless of their industry, business form, or size, including TOYOTA MOTOR CORPORATION <7203>, Hitachi, Ltd. <6501>, 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-scale projects by sales, service and marketing divisions of large companies.

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. Sky365 delivers MSP service related to Salesforce, AWS, and other cloud deployment projects, and Cuon develops Web systems.

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(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, groupware provided on Salesforce; and OMLINE-I and OMLINE-O, which are contact center solutions. Of these, currently the mainstay services are two products, DataSpider Cloud and SkyVisualEditor, which accounted for more than 70% of sales in FY2/21. 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.

With increase in companies shifting to telework due to COVID-19 since 2020, the number of companies deploying "mitoco" as an internal communication tool has climbed, and "mitoco" growth should continue. In the sales volume ranking for 2020 on AppExchange, the marketplace for business applications supplied by Salesforce, "mitoco" ranks third in the small business category and fourth in the large company category.

Has the largest number of Salesforce certified engineers in Japan and also one of the best track records 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 5,000 installations as of the end of May 2021, 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 June 1, 2021, it has presented MVP awards to only 15 engineers in Japan, and of these, 3 work for TerraSky. There are only 15 certified technical architects, which is the highest technical certification in Japan and 6 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.

Cloud service market and TerraSky's businesses

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. The Company received certification as an AWS "Well-Architected Partner" in 2019, and AWS announced its certification as a "100 APN Certification Distinction" in October 2020 on surpassing 100 employees with certification qualifications in the AWS Partner Network, an AWS global partner program.

* 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.

The Company's third strength is that it covers multiple cloud platforms, including Salesforce, AWS, Microsoft Azure, and GCP. 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

As business risk, the Company faces a challenge in training and recruiting enough engineers to accommodate vibrant demand. Industry companies are striving to bolster personnel for cloud human resources, though continue to encounter chronic shortages. The Company is hiring mainly mid-career resources at not only the headquarters but also at regional sites. However, it still trails growing demand. The Company hence founded a subsidiary in February 2021 to train cloud human resources and dispatch and introduce them to itself and customers. The subsidiary obtained a license for human resource recruitment and dispatching business and started advertising in May 2021 and began training in June 2021. The education program mainly aims to facilitate passage of Salesforce's certification test and trains people to a level that handles front-line activities in roughly half a year. Training should proceed smoothly because the Company uses its education program for new university graduates and other beginners. The Company aims to bolster personnel capabilities by utilizing this subsidiary as a supplier of human resources.

In risk of incurring unprofitable projects, the Company has a very low level of problematic projects at about one a year since FY2/17 thanks to sharing information and rigorously managing progress via the project management division, and this success is helping to stabilize profitability.

Results trends

Set all-time highs in FY2/21 results with tailwind from accelerated shift to cloud services with COVID-19 as a catalyst

1. FY2/21 results

The Company reported FY2/21 consolidated results with ¥11,144mn in net sales (+19.8% YoY), ¥779mn in operating income (+7.5%), ¥780mn in ordinary income (+2.5%), and ¥2,459mn in net profit attributable to owners of the parent (+179.2). These values set all-time highs in a second straight fiscal year and also exceeded initial forecasts and revised forecasts in October 2020.

Results trends

FY2/21 consolidated results

	FY2/20		FY2/21		FY2/21		YoY	Compared to revised forecasts
	Results	% of sales	Initial forecasts	Revised forecasts*	Results	% of sales		
Net sales	9,300	-	10,728	11,038	11,144	-	19.8%	1.0%
Cost of sales	6,404	68.9%	-	-	7,851	70.4%	22.6%	-
SG&A expenses	2,170	23.3%	-	-	2,513	22.6%	15.8%	-
Operating income	725	7.8%	520	682	779	7.0%	7.5%	14.2%
Ordinary income	761	8.2%	507	666	780	7.0%	2.5%	17.1%
Extraordinary income (loss)	558	-	-	-	2,803	-	-	-
Net income attributable to owners of parent	880	9.5%	2,170	2,211	2,459	22.1%	179.2%	11.2%

* The revised forecasts were announced in October 2020

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

Amid changes in social formats driven by COVID-19, companies are accelerating initiatives with defensive DX (raising productivity through improved business efficiency) and offensive DX (sales expansion via online sales, EC utilization, and other initiatives). Sustained robust growth in mainstay Solution Business sales at +25.8% YoY, including projects for the transition from on-premises to cloud systems, led the Company's overall growth. Product Business, meanwhile, slipped 7.1% in sales due to peaking out of a major project that had substantial growth in FY2/20 and only attained 7.5% operating margin because of a rise in the cost of sales ratio from 68.9% to 70.4% on upturn in depreciation costs and a 15.8% YoY increase in SG&A expenses primarily in personnel costs and R&D expenses. Higher R&D expenses mainly reflected algorithm development using a quantum computer at Quemix. The steep increase in net income attributable to owners of parent occurred as a result of booking ¥2,806mn in sales income from investment securities as extraordinary income on the sales of some shares held for the purpose of bolstering finances through effective utilization of Company assets.

Sales and profits exceeded targets in the initial forecasts and revised forecasts disclosed in October 2020 with sales upside on stronger Solution Business sales than planned from larger increase in Salesforce deployment and construction projects and SAP-system cloud transition projects than expected and earnings upside from sales increase effect and almost no ramp-up costs at the Thai subsidiary in contrast to the period-start budget. Due to issuance of Thailand's state of emergency order in response to COVID-19, the Japanese manager was unable to arrive in the country and business activities halted. The Company is currently just holding training for a few Thai engineers in Japan and is waiting until COVID-19 settles down for full-fledged implementation of business activities.

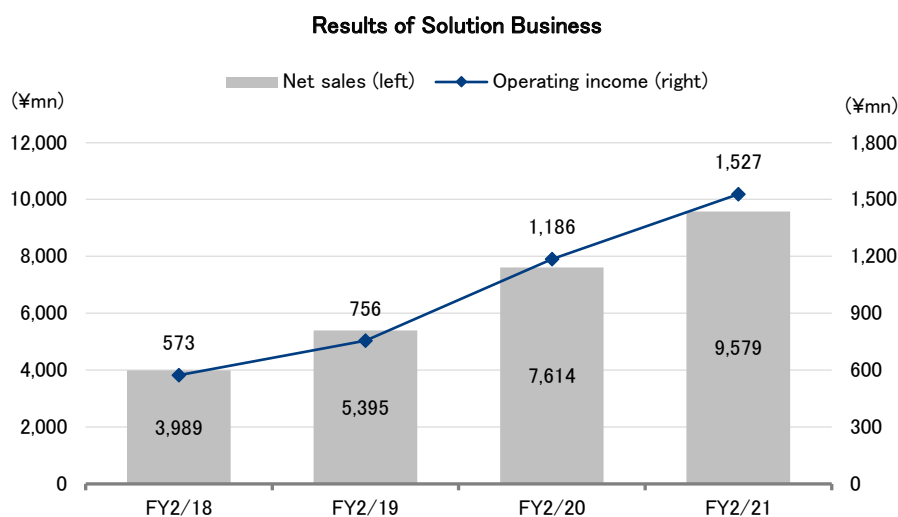
Results trends

Sustained strong growth in Solution Business, sales and profit declines in Product Business on exhaustion of a major project

2. Income trends by business segment and company

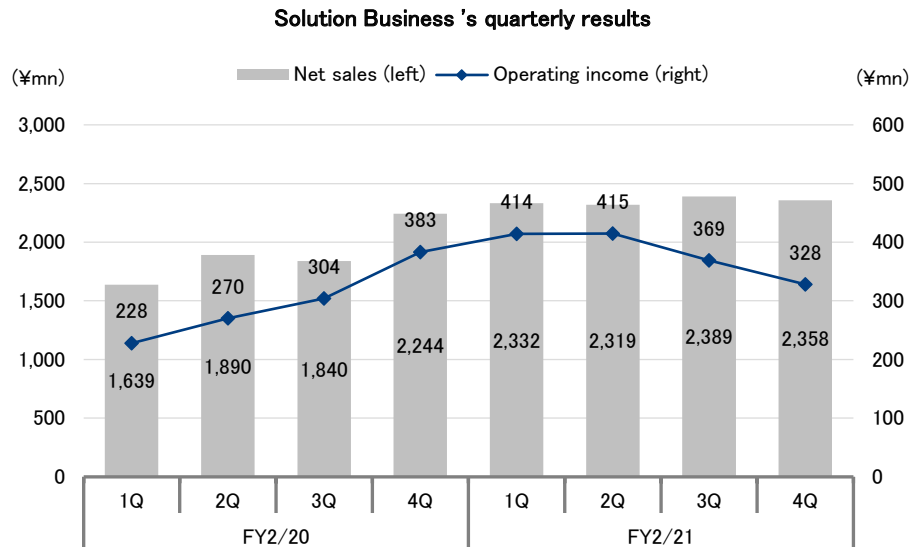
(1) Solution Business

Solution Business continued double-digit sales and profit growth with net sales at ¥9,579mn (+25.8% YoY) and segment profit (operating income) at ¥1,527mn (+28.7%). Main drivers were increased in Salesforce deployment and construction projects primarily at large companies and ongoing demand growth in AWS deployment assistance at BeeX and SAP-system cloud transition projects. At the quarterly level, this segment set all-time high net sales at ¥2,538mn in 4Q (+21.1% YoY) though eased to a decline in operating income at ¥328mn (-14.4%) due to increases in personnel costs and education costs on new hiring, profit-based bonuses at subsidiaries, and higher costs related to establishing LiberSky and TerraSky Technologies in 4Q. Project profitability, meanwhile, seemed to be unchanged. Orders climbed by over 20% YoY as the Company continued to encounter inquiries beyond its capacity to accommodate all of the demand.



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

Results trends



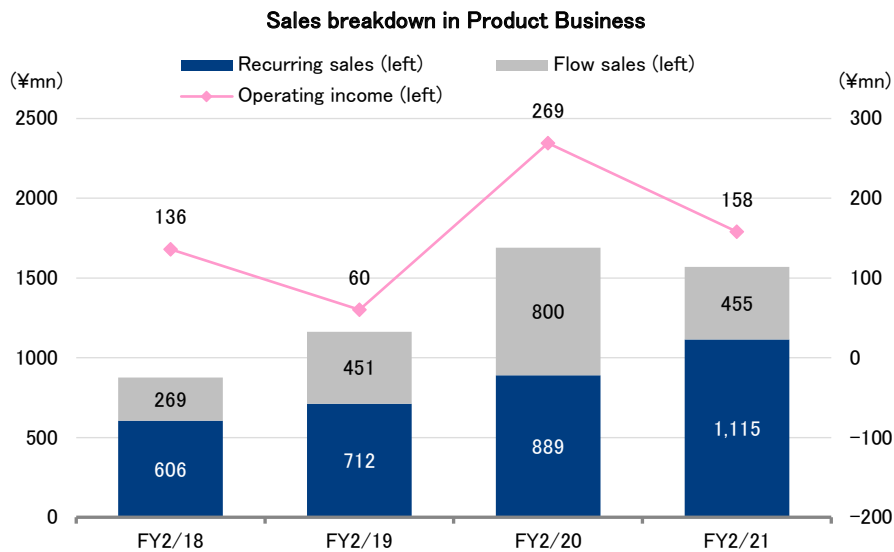
Source: Prepared by FISCO from the Company's financial results

(2) Product Business

Product Business weakened to sales and profit declines with net sales at ¥1,570mn (-7.1%) and segment profit (operating income) at ¥158mn (-41.2%). Main sources of the income setbacks were a substantial drop in flow income (one-time sales from system deployment) to ¥455mn (-43.1%) on completion of a major deployment related to DataSpider Cloud in 1Q and increase in depreciation costs related to developing its own products. Recurring income, meanwhile, steadily accumulated and was at ¥1,115mn (+25.4%) on increases in DataSpider Cloud, SkyVisualEditor, and mitoco contract levels. The Company achieved progress in strengthening its income base.

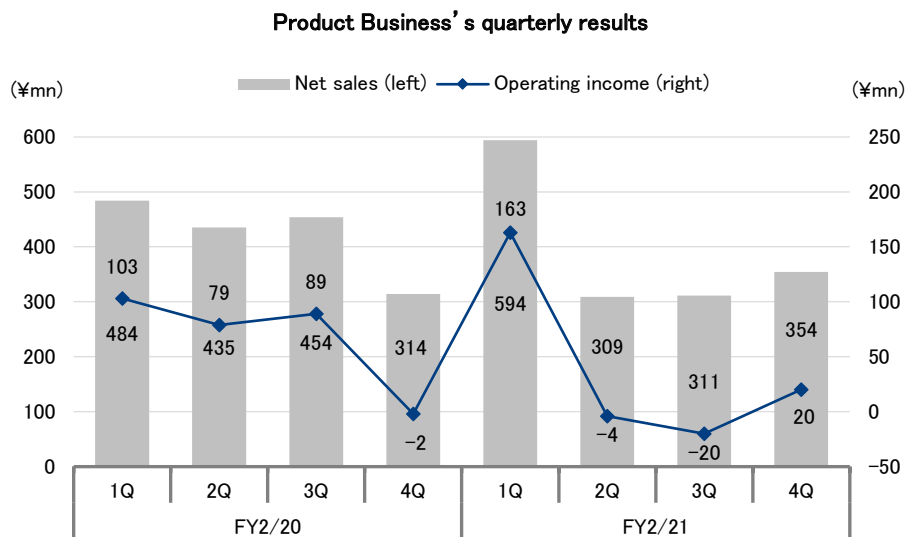
In product sales trends, DataSpider Cloud sales fell YoY on a slump in flow income, SkyVisualEditor sales slightly increased, and other product sales (led by "mitoco") significantly improved. Companies are adopting "mitoco" as a communication platform as they implement telework initiatives, and addition as a service under the "telework deployment assistance program" provided by Sumitomo Mitsui Financial Group <8316> in June 2020 contributed to increase in contract volume too.

Results trends



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

In quarterly trends, income weakened from 2Q on completion of the rollout of a major project from the previous fiscal year in 1Q, as mentioned above, and resulting contraction of flow income. This impact hence will last through 1Q FY2/22.



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

Results trends

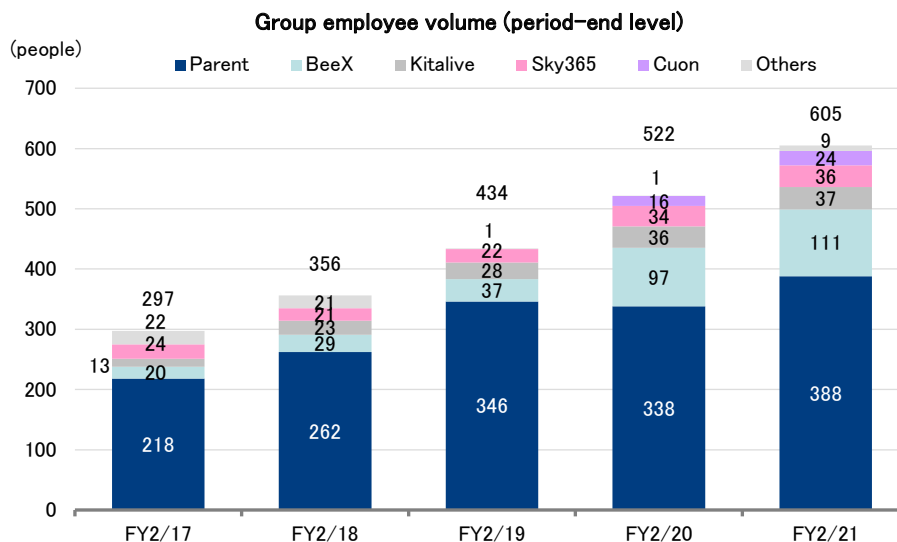
(3) Trends by company

Parent results were ¥6,074mn in net sales (+3.6% YoY) and ¥367mn in ordinary income (-35.2%). While Salesforce deployment and construction projects were upbeat, decline in Product Business weighed on profits. BeeX business posted sharply higher sales and ordinary income. Successful acquisition of robust demand, including AWS deployment assistance and SAP-system cloud transition assistance, substantially boosted results. Kitalive, which handles Salesforce deployment assistance in the Hokkaido area, Sky365, which supplies MSP service, and Cuon, which the Company acquired as a subsidiary in May 2019, smoothly expanded income too. At Cuon, the start of Shopify deployment assistance contributed to higher income too.

Quemix, the R&D subsidiary, meanwhile, develops algorithms for analysis of big data and other data using a quantum computer. Specifically, it conducts joint research on algorithms with universities that addresses financial and chemical (drug creation, materials science) themes and has a strategy of acquiring income from development of an algorithm library and licensing algorithms in the future.

Additionally, the Thai subsidiary founded in December 2019 effectively halted business activities due to COVID-19 impact as mentioned earlier. 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.

Consolidated employee volume at end-FY2/21 rose by 83 people versus the period-end level to 605 employees, including additions of 50 people at the parent, 14 people at BeeX, and eight people at Cuon.



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

Results trends

Net cash climbed significantly on the sale of some Serverworks shares

3. Financial position and management indicators

Total assets increased by ¥116mn YoY to ¥15,562mn at the end of FY2/21. Main changes were additions of ¥2,691mn in cash and deposits and ¥307mn in accounts receivable – trade in current assets and a decline of ¥3,070mn in investment securities in non-current assets on the sale of some Serverworks shares.

Total liabilities dropped by ¥782mn YoY to ¥5,107mn. Main changes were an increase of ¥418mn in income taxes payable versus declines of ¥142mn in interest-bearing debt and ¥957mn in deferred tax liabilities. Net assets climbed by ¥898mn YoY to ¥10,454mn. Retained earnings increased by ¥2,459mn, while the valuation difference on available-for-sale securities was down by ¥2,158mn accompanying the sale of some Serverworks shares.

In management indicators, the Company achieved significant progress in bolstering its financial basis with a rise in the equity ratio from 58.5% to 62.1% on increase in net assets, decline in the interest-bearing debt ratio from 9.1% to 7.0%, and improvement in net cash (cash and deposits – interest-bearing debt) with an addition of ¥2,834mn YoY to ¥5,414mn. In profitability, while ROE climbed from FY2/20's 14.7% to 26.3% on booking a large profit on stock sales, operating margin declined from 7.8% to 7.0% and ROA fell from 7.2% to 5.0%. The Company intends to continue aggressive investments in human resources that enable it to handle robust demand. It plans to promote business with expansion of sales and the customer base as top priorities.

Consolidated balance sheet

	(¥mn)				
	FY2/18	FY2/19	FY2/20	FY2/21	Change
Current assets	2,320	3,581	5,670	8,845	3,175
(Cash and deposits)	1,089	1,900	3,402	6,094	2,691
Non-current assets	1,495	2,048	9,774	6,716	-3,058
Total assets	3,817	5,630	15,445	15,562	117
Total liabilities	2,155	2,417	5,889	5,107	-782
(Interest-bearing debt)	1,049	868	822	680	-142
Net assets	1,661	3,212	9,556	10,454	898
Management indicators					
(Stability)					
Equity ratio	38.5%	52.5%	58.5%	62.1%	3.6pt
Interest-bearing debt ratio	71.4%	29.4%	9.1%	7.0%	-2.1pt
Net cash	39	1,032	2,580	5,414	2,834
(Profitability)					
ROA	9.6%	4.1%	7.2%	5.0%	-2.2pt
ROE	13.1%	7.1%	14.7%	26.3%	11.6pt
Operating income margin to net sales	5.5%	1.9%	7.8%	7.0%	-0.8pt

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

■ Outlook

Conservatively forecasts lower profit on increased sales in FY2/22 due to factoring in upfront investment costs at subsidiaries

1. Forecasts for FY2/22

In FY2/22 consolidated results forecasts, the Company projects lower profit on increased sales with net sales at ¥13,159mn (+18.1% YoY), ¥536mn in operating income (-31.2%), ¥523mn in ordinary income (-32.9%), and ¥206mn in net income attributable to owners of parent (-91.6%). While it expects sales to sustain double-digit growth as cloud system deployment and construction demand remains strong, the Company forecasts profit decline because of upfront investments aimed at longer-term growth, including launch-related losses at TerraSky Technologies and LiberSky founded in 4Q FY2/21, ramp-up costs premised on starting operations at the Thai subsidiary that had been halted by COVID-19 conditions, development costs at Quemix, and increases in human resource hiring and education costs.

In hiring, the Company plans to recruit about 180 people for the entire group (including 38 new university graduates at the parent), which is roughly twice the level in the previous fiscal year. Actual costs might be lower if hiring does not proceed as planned. Additionally, the president of the Thai subsidiary being dispatched from Japan has not left the country yet. Given uncertainty about the timing of a full-fledged start in business activities, costs might undershoot the plan just as in FY2/21. The Company intends to gradually move forward in the Thai business without rushing due to COVID-19 situation. FISCO thus thinks the Company prepared conservative forecasts, just as in FY2/21, and sees a possibility of results exceeding the plan.

Forecast for FY2/22 consolidated results

	FY2/21		FY2/22 E		YoY
	Results	% of sales	Forecast	% of sales	
Net sales	11,144	-	13,159	-	18.1%
Operating income	779	7.0%	536	4.1%	-31.2%
Ordinary income	780	7.0%	523	4.0%	-32.9%
Extraordinary income (loss)	2,803	-	-	-	-
Net income attributable to owners of parent	2,459	22.1%	206	1.6%	-91.6%
Earnings per share (¥)	194.01		16.33		

Note: Net income attributable to owners of parent is the upward-revised value announced on April 30, 2021

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

(1) Sales outlook by business segments

Net sales by business segment

	FY2/21					
	FY2/18	FY2/19	FY2/20	FY2/21	FY2/22 E	YoY
Solution Business	3,989	5,395	7,614	9,579	11,446	19.4%
Product Business	875	1,163	1,689	1,570	1,713	9.1%
(Recurring-type income)	606	712	889	1,115	1,509	35.3%
(Flow-type income)	269	451	800	455	204	-55.2%
Total	4,864	6,558	9,303	11,149	13,159	18.1%

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

Outlook

In Solution Business, the Company targets ¥11,446mn in net sales (+19.4% YoY) on the prospect of increases in cloud-system deployment assistance and ERP-system cloud transition projects amid ongoing pick-up in corporate DX initiatives. In Product Business, it forecasts a switch to sales increase with a 9.1% YoY gain to ¥1,713mn. Despite expecting decline in flow income due to non-recurrence of a major project that contributed in 1Q FY2/21 and a conservative assumption of almost no new projects, the sales increase driver is substantial growth in recurring income to ¥1,509mn (+35.3% YoY) in increase in contract volume. In particular, it anticipates contributions from “mitoco” growth. The Company also expects restoration of a gain in operating income on increase in recurring income.

(2) Subsidiary outlook

a) TerraSky Technologies

TerraSky Technologies is an important point in the FY2/22 business plan. The Company created this subsidiary to resolve issues presented by chronic shortages in cloud human resources. It aims to actively hire recent graduates with work experience, ordinary adults, and others without experience in the field and dispatch them to customers mainly as cloud system operation and maintenance personnel. TerraSky Technologies acquired a personnel dispatching license in May 2021 and a recruitment license in June and hopes to hire about 100 people in the first fiscal year.

The training period until personnel are ready for dispatching takes a few months. During this period, TerraSky Technologies plans to utilize the educational program already utilized at parent TerraSky and prepare its personnel to mainly acquire certifications for Salesforce. It hence sees the initial two years as the upfront investment period and expects full-year income contributions to begin from the third year.

FISCO expects hiring to proceed relatively smoothly because inexperienced hires will go through a solid educational program after joining and should be capable of acquiring Salesforce certification. If this initiative ramps up, it could resolve personnel shortages facing the Company. Developments in this area should be closely monitored.

b) LiberSky

The Company established LiberSky as a consulting company to promote utilization of cloud big data and AI. GCP's BigQuery, which operates at a low cost and with fast processing performance, is the most widely utilized tool for cloud big data and AI, and LiberSky is likely to primarily assist BigQuery deployments. LiberSky has just over 10 employees as of June. Since it also requires AI-related knowhow, management intends to expand business while working with iFocus network, an AI platform developer, acquired by the Company as a subsidiary in February. This business should contribute to income in the near future because of robust demand in big data and AI areas, though FY2/22 forecasts indicate a slight operating loss.

c) iFocus network

iFocus network provides the ENOKI AI platform as its own brand and on an OEM basis. The platform's technology is highly rated as seen in adoption as part of AI conversation in a car navigation system for Japanese luxury car. iFocus network currently has about five employees and aims to bolster sales by utilizing TerraSky's sales capabilities from October 2021.

Outlook

d) BeeX

BeeX continues to receive robust inquiries mainly for SAP-system cloud transition assistance projects and is also still facing personnel shortages. The main driver of this activity is expiration of standard support for SAP's existing system in 2027. Roughly 4,000 companies deploy SAP systems in Japan and need to decide whether to transition the existing system to the successor system (SAP S/4HANA) or replace it with a non-SAP ERP system by 2027. SAP's successor system supports on-premises and cloud formats. While not all of these systems will transition to the cloud, the cloud ratio should increase from the current level. FISCO expects busy conditions to persist at BeeX, which is the domestic leader in cloud transition assistance, until at least 2027, and BeeX is likely to continue facing a challenge with personnel operations.

Intends to sustain roughly 20% annual sales growth and broaden Salesforce deployments to local government entities with goals of revitalizing tourism and promoting regional DX

2. Growth strategy

The domestic public cloud services market should sustain a strong growth pace. Corporate efforts to accelerate management DX initiatives with COVID-19 conditions as a catalyst are evident. The Company is strengthening development capabilities, including human resource training at TerraSky Technologies and aims to achieve sales growth that outpaces the industry average.

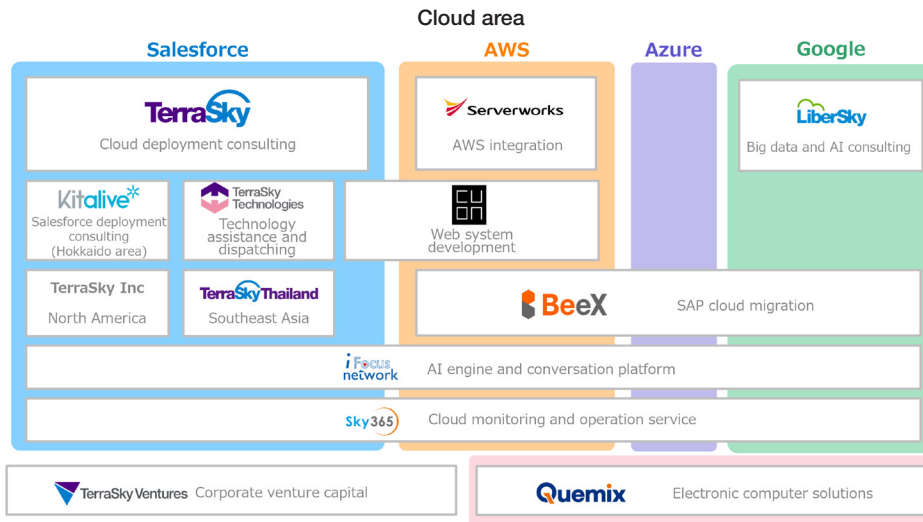
As initiatives in Solution Business, the Company is focusing on DX Ready (DX updates of existing systems), reinforcement of customer contacts, and continuous improvement of operations (CoE*) as it strives to expand orders. In particular, training specialty cloud personnel is important in continually improving operations, and above-mentioned TerraSky Technologies should hold a core role in personnel supply.

* CoE (Center of Excellence) refers to placement of personnel with expertise across an organization to build efficient system development and operation system within a company.

Amid domination of IaaS/PaaS markets by AWS, Microsoft Azure, and Alphabet (GCP), the three top platforms, subsidiary BeeX mainly deployed AWS up to now (though also handles transition projects to Azure for ERP systems). The Company aims to expand business in big data analysis and AI areas with robust demand following the establishment of LiberSky and addition of GCP-related deployment projects explained above.

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Outlook



Source: From the Company's results briefing materials

The Company is focusing on the public sector as a new market opportunity as well. Amid shift to cloud services by government ministries and agencies and local government entities, in fall 2020, it started assisting Salesforce deployments at local governments and building “regional CRM” and digital marketing frameworks in collaboration with Salesforce.com and JTB* with goals of revitalizing tourism and driving stimulation of local economies. While it only has 20-30 installation projects in FY2/21, once the market confirms deployment benefits in these precursor cases, the Company expects full-fledged spread of deployments at other local government entities and tourism associations and contributions to income from FY2/22. These trends deserve attention.

* Salesforce.com and JTB concluded an “agreement for a comprehensive alliance and cooperation” to promote regional DX in August 2020, and the Company is also working within this framework.

In Product Business, the Company continues to promote UI improvements aimed at enhancing functions and boosting convenience and collaboration with systems from other companies in order to expand sales of the “mitoco” communications platform, a key product. While this also requires outlays of development costs, it hopes to achieve profitability from FY2/22 through expansion of sales scale with build-up of deployed company volume.

The Company has actively invested in human resources, including M&A deals, with the aim of achieving longer-term growth in the past few years. It also built management and financial foundations to realize sustainable growth. Nevertheless, since the cloud services market is likely to maintain high growth at a roughly 20% annual rate, FISCO thinks the Company will need to continue investing in human resources in order to sustain growth on par with the industry. Core points for lifting profitability hence are increasing Solution Business productivity, expanding sales in Product Business, cultivating iFocus network’s AI platform, and monetizing Quemix’s intellectual property strategy. Close attention should be given to the growth strategy content, including medium-term results target.

■ 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. The Company intends to review implementing dividends in the future once it has leeway to stably distribute profits based on comprehensive assessment of fiscal conditions and management results. It has adopted a shareholder benefits program instead and provides QUO cards worth ¥1,000 uniformly to shareholders at the end of February each year.

■ 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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