

Serverworks Co., Ltd.

4434

TSE Mothers

25-Nov.-2019

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FISCO Ltd.

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

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Summary

Continuous high growth in results as a major company specializing in AWS implementation-support and operations services

Serverworks Co., Ltd. <4434> (hereafter, also “the Company”) is a major company specializing in implementation-support and maintenance and operations services for Amazon Web Services (AWS), which are the world’s leading public cloud services, and since 2014 it has been continuously selected as the top-ranked partner for AWS. It is growing rapidly through leveraging its strengths, including its advanced technological capabilities, an abundant track record of introductions (introductions for a total of 740 companies as of October 1, 2019), and Cloud Automator, its in-Company developed operations-automation service. More than 80% of net sales are provided by recurring revenue, such as resales (AWS usage fees, etc.) and MSP (Managed Service Provider: monitoring, maintenance and operations services), so a feature of the Company is that it has high growth potential at the same time as it is building a stable earnings foundation. It was listed on the Tokyo Stock Exchange (TSE) Mothers market in March 2019.

1. 1H FY2/20 results

In the 1H FY2/20 (March to August 2019) results, sales and profits increased greatly, with net sales rising 60.4% year-on-year (YoY) to ¥3,074mn and operating profit growing 58.9% to ¥200mn. The movement among companies to migrate to the Cloud for their core and business systems is becoming more active, so orders were strong, both for repeat orders from existing customers and orders from new customers. In sales by service, due to the rise in the number of contracts, resales increased rapidly, up 76.0% to ¥2,367mn, while cloud integration grew 17.5% and MSP rose 33.2%, contributing to the higher profits.

2. FY2/20 outlook

For the FY2/20 results, the forecasts are that net sales will increase 34.1% YoY to ¥6,005mn and operating profit will rise 11.1% to ¥372mn. The rates of progress in the 1H for the full fiscal-year forecasts were 51.2% for net sales and 53.8% for operating profit, which is above the pace of results in the previous fiscal period (42.8% for net sales and 37.6% for operating profit in the previous fiscal period). Due to the rise in the number of contracts, results are continuing to grow from the upward trend in sales of resales and MSP, which provide recurring revenue. Therefore at FISCO, we think it is highly likely that the results will achieve the Company’s forecasts. The profit margin is expected to decline slightly compared to in the previous fiscal period due to the changes to the percentages of total net sales, and also as the Company will actively invest in human resources.

Summary

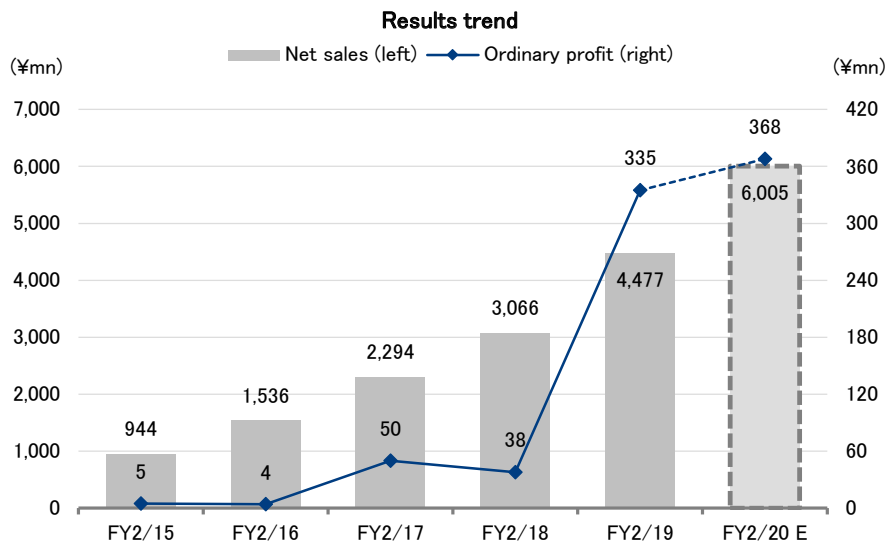
3. Market outlook and growth strategy

In Japan, it is said that more than half of all companies are still not using cloud services, so going forward, it seems that the migrate from on-premises to on the Cloud will accelerate. According to the forecast of a research company, the public cloud services market in Japan is set to grow by an average annual growth rate of 21.7% in the five years to 2023*, so there can be said to be plenty of room for the Company, which is a major player specializing in AWS, to grow. It is acquiring customers mainly among medium- to large-sized companies, while its policy is also to work to acquire large-scale projects for extremely large companies and in the public sector through its partnership with NTT DATA Corporation <9613>, with which it entered-into a capital and business partnership in 2018. For existing customers also, it is working to maximize LTV by proposing to them a variety of advanced AWS services and supporting their digital transformations. In order to achieve growth that exceeds market growth, the Company's policy is to actively recruit human resources, while in terms of targets, it is targeting continuous annual growth of 30% and net sales of ¥10bn in three years' time.

* MM Research Institute, Ltd. Survey on Cloud Services Demand Trends in Japan, 2019.

Key Points

- Is rapidly growing as a major company specializing in implementation-support and operations and maintenance services for AWS, the biggest cloud service
- Recurring revenue constitutes more than 80% of net sales and has established an earnings structure that realizes both high growth and stability
- Growing as resales and MSP services, which are recurring businesses



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

■ Business overview

Rapidly growing as a major company specializing in implementation-support and operations and maintenance services for AWS, the world's leading cloud services

1. Company history

Serverworks was founded by the current President and Representative Director Ryo Ooishi in February 2000. In 2004, it started to develop systems and offer services to provide pass-fail information on the entrance exams of university students via the Web (PCs and mobile terminals). This served as the trigger for its subsequent entry into the cloud services market, and it has introduced these services into nearly 200 universities. Demand is concentrated in February as the timing of the announcement of the pass and fail results, so at the peak time it needed 200 servers. But past the peak time these servers became idle, so it wanted a business model to address this problem of investment efficiency.

When it was searching for a solution to this problem, in 2007 the Company discovered that Amazon.com, Inc. <AMZN> was providing a service (Amazon EC2) to rent a virtual server with pay-as-you-go fees, and it started using this service from 2008. Through its own use of this Amazon service, the Company was able to feel how convenient and cost effective it was, and it became convinced that cloud services would spread in the future. From 2009, it began provided Cloudworks, its own brand hosting service that uses Amazon EC2, and in such ways it has been steering a course for management to specialize in providing AWS solutions.

An opportunity for the Company to increase its name awareness was its recovery support project for the Japanese Red Cross Society following the Great East Japan Earthquake in March 2011. After this earthquake, there was an overwhelming number of accesses to the Japanese Red Cross Society's website, which caused the server to shut down. However, as part of its volunteer support activities, the Company recovered the website on AWS in 30 minutes, and in the next 48 hours it also developed a donation system. This case was widely reported in the media at that time, and it can be said to have helped to raise awareness about cloud services. Subsequently, the Company accumulated a track record for supporting the introduction of AWS, and in 2014 it ranked top among Amazon's AWS partners. It has been certified as an AWS Partner Network (APN) premier consulting partner* (continuously certified since 2014).

* The eight companies certified as premier consulting partners in Japan, in the order of acquiring certification, are ired, Inc., Nomura Research Institute, Ltd., <4307>, Serverworks, Classmethod, Inc., TIS Inc. <3626>, NTT DATA Corporation, NEC Corporation <6701>, and ITOCHU Techno-Solutions Corporation <4739>. Under them are 59 companies that are certified as advanced consulting partners and 268 companies that are certified as select consulting partners (as of April 2019). The requirements for certification must be reached for each respective certification level for "knowledge" (the number of AWS certification holders), "experience" (the number of launches, forecast monthly earnings, etc.), and "customer success" (the number of publishable case studies and the number of customer-satisfaction responses).

In the capital area, the Company entered-into capital and business partnerships with TerraSky Co., Ltd.<3915> in 2013, and with NTT DATA and NTT Communications Corporation in 2018. In March 2019, it was listed on the TSE Mothers market.

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Business overview

The company has set the management mission of “Make world more productive with the Cloud”. By spreading the use of cloud services throughout the world, it is aiming to realize happier societies in which more companies are competitive and in which the employees who work for them have “more pleasant environments to work in.”

Company history

Date	Main events
February 2000	With the aim of providing ASP with EC functions, the Company was founded as Websenka Limited Company (changed its name to Serverworks Co., Ltd. in 2002)
2004	Started a pass-fail introduction service for universities
January 2008	Issued a ban on purchasing in-Company servers and started using Amazon EC2 for all its in-Company servers
June 2009	Started providing the Cloudworks brand as a hosting service using Amazon EC2
January 2011	Was certified as an AWS solutions provider by Amazon Web Services LLC (currently Amazon Web Services, Inc.)
July 2011	Concluded a VAR agreement with Amazon Web Services (a value-added reseller agreement) and fully launched a cloud business
December 2012	Acquired ISMS certification (ISO27001)
September 2013	Announced a capital and business partnership with TerraSky Co., Ltd.
July 2014	Started providing Cloud Automator, an AWS automation service
November 2014	Was selected as an APN (AWS Partner Network) premier consulting partner
March 2015	Started providing a 24 hours-a-day, 365 days-a-year operations-support service for Sky365 Co., Ltd.
September 2015	Acquired membership of the APN MSP (Managed Services Provider) Program
November 2017	Started a partnership with NTT DATA Corporation <9613>
July 2018	Started capital and business partnerships with NTT Communications Corporation and NTT DATA and conducted a capital increase through a third-party allocation underwritten by these two companies
November 2018	Concluded a SPA* agreement with Amazon Web Services
March 2019	Listed on the TSE Mothers market
March 2019	Started a partnership with INTAGE TECHNOSPHERE Inc., and began providing AI solutions
August 2019	Acquired the AWS End-user Computer Competency certification, the first such acquisition in Japan

*An abbreviation of Solution Provider Addendum. Transitioned to a VAR agreement alongside the change to the AWS reseller program.
 Source: Prepared by FISCO from the Company's securities report

The outlook is that the public cloud services market will continue its high growth of more than 20% a year

2. Market environment

(1) Public cloud services

Public cloud services refer to services provided to companies, individuals, and others via the Internet for functions including software, databases, servers, and storage. Also, public cloud services are categorized into types that include Infrastructure as a Service (IaaS), Platform as a Service (PaaS), and Software as a Service (SaaS), depending on the form of use. AWS, in which the Company is engaged, is categorized into IaaS and PaaS. In addition, a cloud built by a company itself for its own use is called a private cloud.

Types of cloud services

Type	Representative example	Explanation
IaaS	AWS	Service to provide an IT infrastructure, such as servers and network, via the Internet.
PaaS	AWS, Microsoft Azure	Service to provide a platform on which to execute applications via the Internet.
SaaS	Salesforce.com, Office365	Service to provide software that was previously provided as packaged products via the Internet.

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

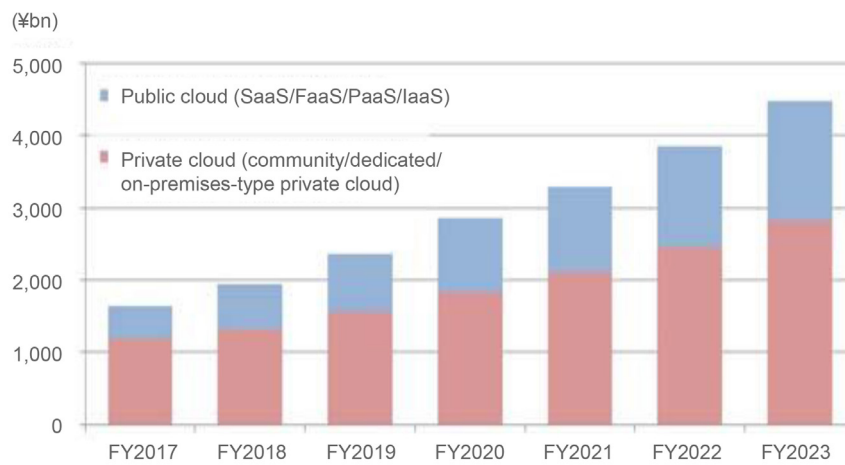
Business overview

(2) Market outlook

According to a survey by the MM Research Institute, the value of the Japanese cloud services market in FY2018 increased 18% YoY to ¥1.9422tn, while within this amount, the value of the public cloud market rose 34.1% to ¥616.5bn. In the background to this growth is the increasingly active movement among companies to migrate to the Cloud for their core and business systems, including because this enables them to realize lower-cost and more flexible operations, and also due to the progress made in strengthening the security aspect. Within this environment, an oligopoly situation for the services of the major companies, such as AWS and Microsoft Azure, is progressing. The main factors behind this are cost competitiveness derived from scale merits and also the spread of the disparities between these majors and the other service providers in terms of technological capabilities and security. Looking at the global market shares also, Amazon has by far the leading share at approximately 35% (second-placed Microsoft has 16%). AWS net sales in 1H FY12/19 increased 37.3% YoY to US\$8,381mn, so while the growth rate slowed down, sales continue to maintain their previous high growth.

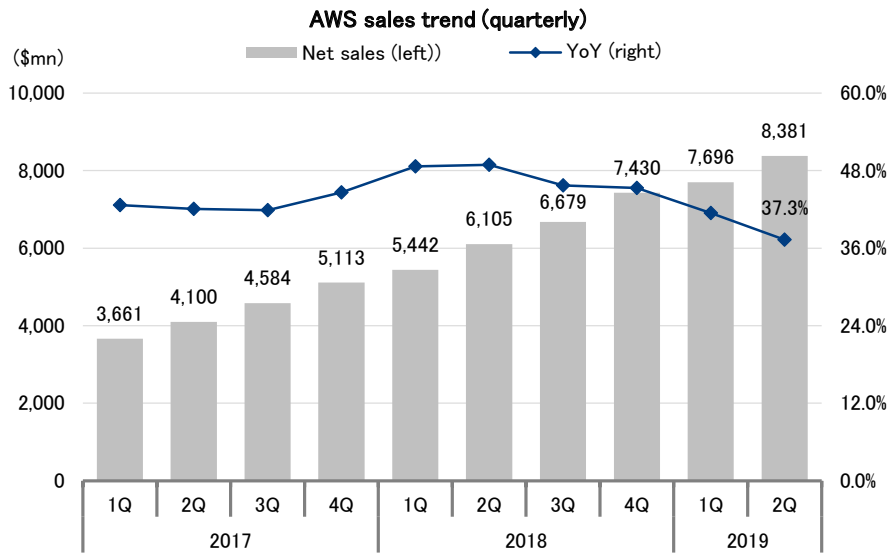
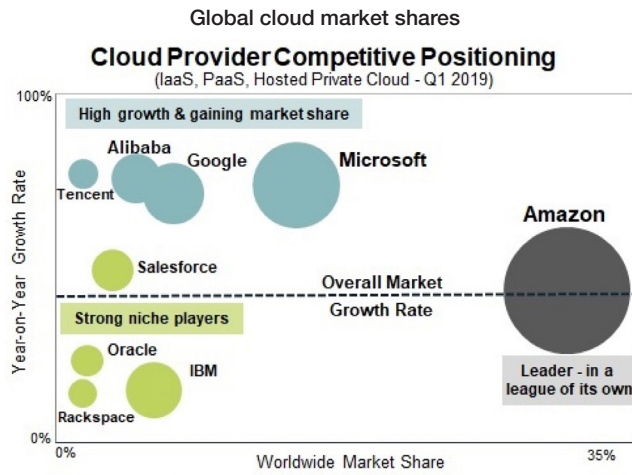
The outlook for public cloud services market in Japan is that it is set to continue to grow greatly, because the percentage of companies that have introduced cloud services is still less than 50%. The market is forecast to grow to be worth ¥1.649tn in FY2023, and the five-year average annual growth rate will be 21.7%. The same or even higher growth is expected for the Company as well, as a specialist in AWS implementation support and a premier consulting partner.

The scale of the cloud services market in Japan Results and forecasts



Source: MM Research Institute, Ltd. Survey on Cloud Services Demand Trends in Japan, 2019.

Business overview

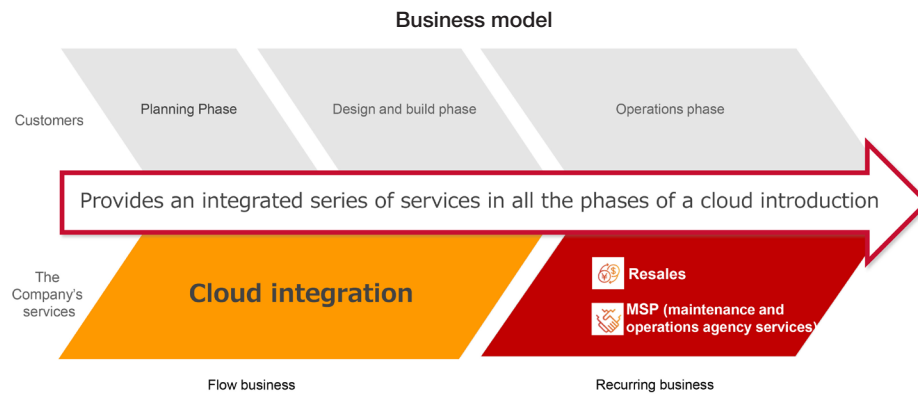


Business overview

Recurring revenue constitutes more than 80% of net sales and has established an earnings structure that realizes both high growth and stability

3. Business description

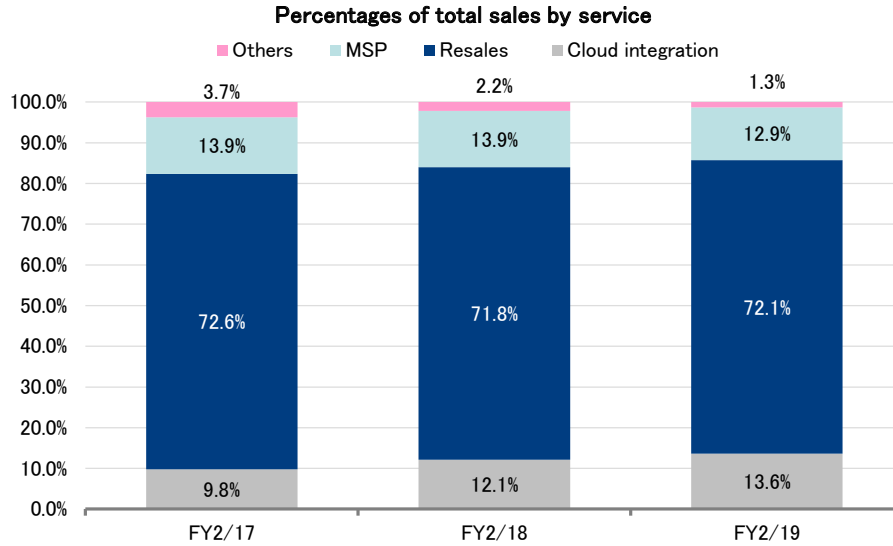
The Company provides an integrated series of services for companies migrating to the Cloud, from the consulting, design and building phases through to the operations and maintenance phases. Its services are comprised of three types of service: cloud integration services on the introduction of the Cloud, from plan design through to infrastructure design and implementation support; its own additional services to the cloud services, centered on AWS; and MSP services, which include resales services for sales to customers and outsourcing of fault monitoring of systems built on AWS and of operations and maintenance. Other than these, it records sales from the university pass-fail notification service business.



Source: From the Company's results briefing material

In the percentages of total net sales in the last three years, resales services have provided the majority, at around 72%, followed by cloud integration and MSP services at approximately 13% each. Among these, resales services and MSP services are recurring businesses, in which sales are expected to be recorded regularly from existing customers, and they provide around 85% of total sales. Therefore, even if the number of new-introduction projects declines, the impact of this on total net sales would be small, and the Company can be expected to realize stable earnings growth through the increase in recurring-revenue sales.

Business overview

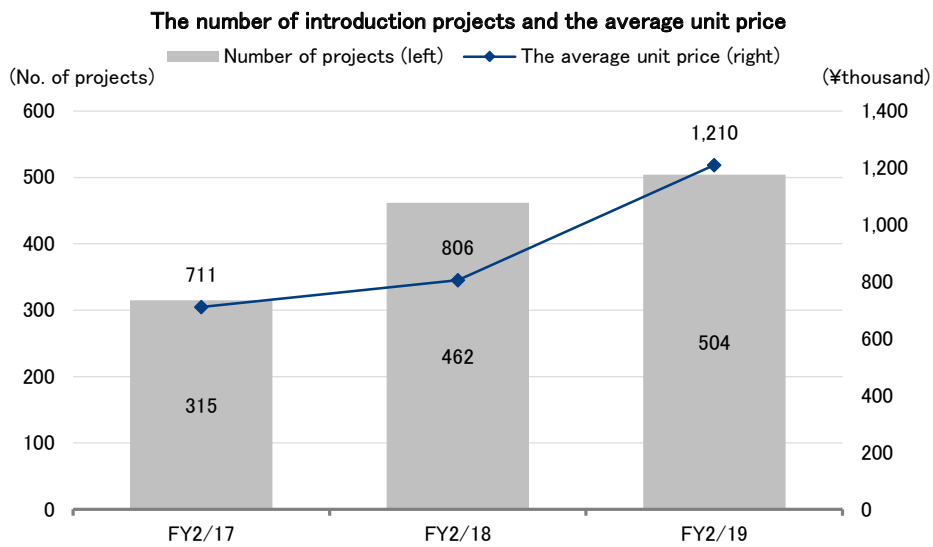


Source: Prepared by FISCO from the Company's results briefing material

(1) Cloud integration

The Company provides implementation-support services to companies that are migrating to AWS their core and business systems that they had been operating in on-premises environments.

As of October 1, 2019, the total number of introducing companies was 740 companies, while the number of projects was more than 6,900. In the last few years, the average unit price per project has been trending upward. This is mainly because major companies have started migrating to the Cloud, so the number of comparatively large-scale projects is increasing.



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

Business overview

(2) Resales

The Company has been conducting resales in Japan as an AWS reseller since it concluded a VAR agreement with AWS in July 2011. It provides a payments-agency service together with Cloud Automator, which is the in-Company developed AWS operations-automation service, and it concludes resales agreements by identifying the merits for customers.

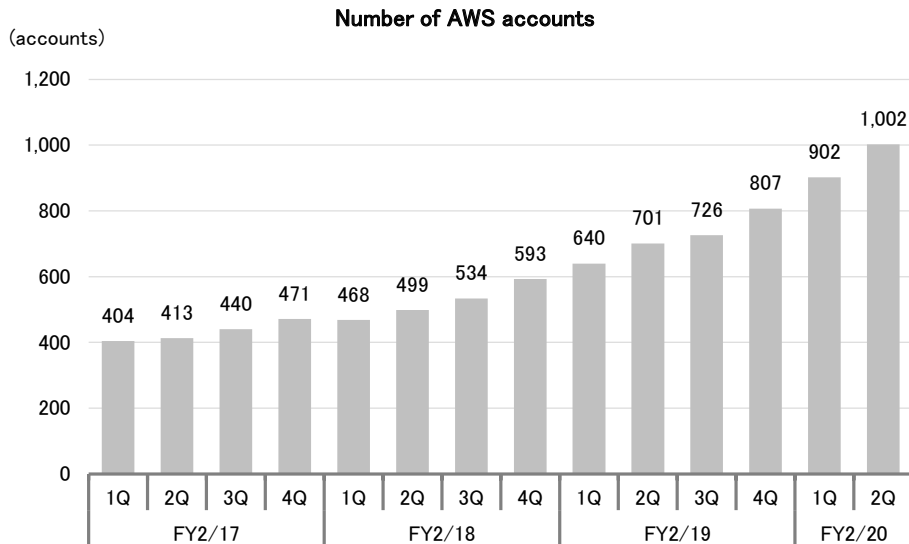
The payment-agency service is a service in which, in order to pay the AWS usage fees in US dollars, the Company makes the payment on behalf of customers and it then issues an invoice to them converted into Japanese yen (invoices are converted into yen by the exchange rate at the end of the month), which reduces the work burden for customers. In addition, although AWS fees use a pay-as-you-go system according to the usage time, there is a service called Reserved Instance* that applies major discounts to fees through reservations in advance, such as reserving the server specs to be used and the usage time, and many companies are using this service.

* The two time periods are for one year and for three years, and there are three payment options of "prepayment of the full amount," "partial prepayment" and "no prepayment." For "partial prepayment" and "no prepayment," the remaining amount is paid as a monthly amount across the usage period.

The insurance service is a service to compensate customer companies in the event that they incur damages due to a system failure on AWS. For the "Cloud Automator", it provides operation automation features such as Data back-ups and Instance start/stop which customer can setup the schedule. Also, it provides feature which periodically review the configuration to check whether AWS resources are configured accordingly to the specified rules. These features contributes to improving usability as well as saving costs. This "Cloud Automator" was a decisive factor to partner with the company to implement AWS. When implementing AWS for Marubeni group, 2000 servers were required. However, since they would not use the servers during weekends and late at night, how to reduce AWS usage cost was an issue. They found out that by using automated stop feature from "Cloud Automator", it was possible to reduce costs by ¥270mn over five years.

At the end of 1H FY2/20, the number of AWS accounts (the number of resales contracts) had continued to grow significantly, up 42.9% on the end of the same period in the previous fiscal year to 1,002 accounts. It seems that the main factor behind this high growth is that from FY2/20, on the order of a cloud implementation-support project, there has been a condition to add a set contract for resales or MSP, which is described below. A feature of resales revenue is that its profitability is relatively low compared to that of other services. But as it is a recurring business in which revenue rises alongside the increase in the number of contracts, it is contributing to earnings growth as a stable source of earnings. Although some contracts are canceled, in the majority of cases this is because the purpose of use was a temporary one (such as for a campaign or test use).

Business overview



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

(3) MSP

In the services to outsource for customers the monitoring, operations, and maintenance of virtual servers and networks developed on AWS, Sky365 Co., Ltd., which was jointly established with TerraSky, provides 24-hours-a-day, 365-days-a-year operations services, including for performance monitoring, fault monitoring and recovery, and backups. The fees system is that it uses a subscription-based business model in which fees are charged according to the usage period, and it is positioned as a recurring business in which stable revenue can be expected to be generated continuously and over the long term.

As a top-ranked partner for AWS, has the leading track record for introductions in Japan

4. Competition conditions, the Company's strengths, and risk factors

(1) Competition conditions

Since 2014, the Company has been continuously certified as a premier consulting partner, which is the top rank of certification for AWS partners. From among the more than 300 companies that are AWS partners in Japan, only eight have received the top-ranked certification, positioning them as major companies specializing in AWS implementation support. Among these eight companies, three are ventures, including the Company (also iret and Classmethod), and the remaining five companies are major system integrators.

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Business overview

AWS premier consulting partners

	Year of certification as a top-ranked partner	Remarks
Serverworks	2014	Introductions for a total of 740 companies and 6,900 projects (as of October 2019). FY2/19 net sales, ¥4.4bn. No. of employees, 92 people.
iret, Inc.	2013	Introductions for a total of more than 1,200 companies (as of August 2018). A subsidiary of KDDI. FY2018 net sales, ¥16.8bn. No. of employees, 435 people.
Classmethod, Inc.	2014	Introductions for a total of more than 1,200 companies, No. of AWS certification holders, more than 500 people. FY2018 net sales, ¥13bn. No. of employees, 300 people.
Nomura Research Institute	2013	-
TIS	2015	-
NTT DATA	2016	-
NEC	2016	-
ITOCHU Techno-Solutions	2017	-

Source: From each company's disclosure materials

(2) Strengths

The Company's strengths can be summarized into the following five points.

- a) A top-ranked partner for AWS certification
- b) Has many highly skilled engineers with advanced specialist skills that are backed-up by AWS certification, and it possesses advanced technological capabilities
- c) As of October 1, 2019, the total number of introductions was 740 companies and it had conducted more than 6,900 projects, so it is accumulating an abundant track record and expertise
- d) As an additional service, it provides Cloud Automator, which is the in-Company developed AWS operations-automation service
- e) Leveraging its outstanding name recognition as a forerunner and building a virtuous cycle for growth

Of these, for holders of an AWS certification, as of October 1, 2019, a total of 194 employees held one of the five certifications. As the Company's ability to respond to orders changes according to its number of certification holders, going forward it intends to continuously increase this number. Also, the virtuous cycle for growth refers to the fact that alongside the rapid growth of the AWS market, the Company's name recognition as a top-ranked partner is further improving to create a situation in which it is able to acquire orders for projects through prelude*, so recurring revenue accumulates through the acquisition of orders for projects. And the Company discloses more than ten of these examples of introductions on its website, which in turn is leading to the further improvement of its name recognition for AWS.

| * A situation of inquiries from potential customers without a company itself having to actively conduct sales activities |

Number of holders of AWS certification

	(people)	
	Feb. 28, 2019	Oct. 1, 2019
Solutions Architect Professional	28	29
DevOps Engineer Professional	14	18
Solutions Architect Associate	52	66
Developer Associate	27	29
SysOps Administrator Associate	31	37

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

(3) Risk factors

A risk factor is that the Company may be negatively impacted in the event that companies reduce their investment in information technologies due to an economic downturn. However, the current situation is that less than 50% of companies have migrated to the Cloud, and rather it is possible that such a downturn will accelerate their shift to the Cloud due to its cost merits. At FISCO, we think that the likelihood of this risk being realized is low.

It is also considered that there is a risk that a change to the AWS partner agreement will have a negative impact on earnings. But in the public cloud market, in which a system is being built comprised of two strong companies, Amazon and Microsoft <MSFT>, Microsoft is taking measures that prioritize support for its partners that have strong track records of introductions, and in this situation, it is considered extremely unlikely that Amazon will change the agreement to one that is disadvantageous to its partners. This is because if it did this, Amazon would lose its excellent partners to Microsoft and invite a decline in market share. Therefore, in the future also, it is considered that it will keep the same agreement as in the past for partners with strong track records.

Other than these, there is a risk of the occurrence of loss-making projects among the implementation-support projects. But the shift from on-premises to on the Cloud entails work to migrate the systems that have already been developed, and almost no specification changes or bugs occur during this work, so it is considered that the likelihood of this risk being realized is low. Looking at seasonal changes in earnings, resales sales tend to be concentrated in the 4Q. This is revenue from the Reserved Instances, and at the current time this is a factor that occurs comparatively frequently in the 4Q. However, if customer numbers increase in the future, it is expected that this seasonal concentration will be eliminated.

■ Results trend

In the 1H FY2/20 results, sales and profits continued to increase significantly

1. 1H FY2/20 results

In 1H FY2/20, sales and profits increased significantly, with net sales rising 60.4% YoY to ¥3,074mn, operating profit growing 58.9% to ¥200mn, ordinary profit climbing 54.0% to ¥190mn, and profit increasing 68.0% to ¥164mn. Net sales were strong, as sales of resales services continued their high growth, up 76.0% YoY, while cloud integration and MSP services also achieved double-digit increases in sales.

Results trend

1H FY2/20 results

	1H FY2/19		1H FY2/20		YoY change (%)
	Results	% of net sales	Results	% of net sales	
Net sales	1,916	-	3,074	-	60.4%
Cloud integration	269	14.1%	316	10.3%	17.5%
Resales	1,345	70.2%	2,367	77.0%	76.0%
MSP	271	14.2%	362	11.8%	33.2%
Other businesses	30	1.6%	28	0.9%	-3.2%
Gross profit	372	19.4%	516	16.8%	38.7%
SG&A expenses	246	12.9%	315	10.3%	28.0%
Operating profit	125	6.6%	200	6.5%	58.9%
Ordinary profit	123	2.4%	190	6.2%	54.0%
Extraordinary profit (loss)	-	-	37	-	-
Profit	98	1.7%	164	5.3%	68.0%

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

The gross profit margin declined from 19.4% in the same period in the previous fiscal year to 16.8% due to the effects of the rise in the percentage of total net sales from resales services. But profits still increased significantly because the effects of the higher sales absorbed the increases in purchasing prices, labor costs, and SG&A expenses. The non-operating balance worsened ¥7mn YoY, but this was mainly due to the recording of expenses relating to the Company's listing (share-issuance expenses of ¥4mn and going public expenses of ¥2mn). In extraordinary profit, ¥37mn was recorded as a gain on the sale of shares of TerraSky.

2. Sales trends by service

(1) Cloud integration

Cloud integration net sales increased 17.5% YoY to ¥316mn. There were many inquiries for "migration projects" to migrate core and business systems to the Cloud, and orders increased for additional projects from existing customers and for large-scale projects. Steady progress was also made in acquiring new customers. The number of projects decreased by 208 YoY, but sales still increased because the projects became larger in scale, and therefore the average unit price rose by 26% compared to the average in the previous fiscal period.

(2) Resales

Resales services net sales increased rapidly, up 76.0% YoY to ¥2,367mn. As previously explained, the factors behind the higher sales were that the number of AWS accounts rose 42.9% YoY to 1,002 accounts, that AWS usage fees from large customers increased, and that progress was made in acquiring new customers.

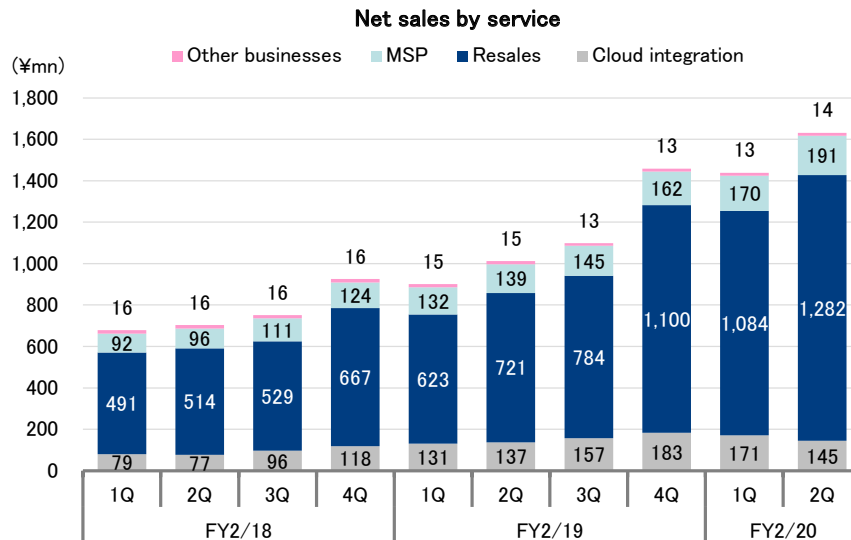
(3) MSP

MSP net sales increased 33.2% YoY to ¥362mn. The same as for resales services, sales continued to increase at a double-digit pace due to the rise in orders from existing customers and the acquisition of new customers.

(4) Other businesses

Other businesses net sales decreased 3.2% YoY to ¥28mn. Due to the decline in the number of students taking university entrance exams, sales from the university entrance exam pass-fail introduction service contracted.

Results trend



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

Financial structure improved greatly by fund raising through a capital increase from a public offering, and is practicing debt-free management

3. Financial position

Looking at the financial position at the end 1H FY2/20, total assets had increased ¥353mn on the end of the previous fiscal year to ¥3,525mn. The main change factors were that in current assets, cash and deposits increased ¥459mn, but non-current assets declined ¥163mn, mainly due to the sale of the shares of TerraSky.

Total liabilities were down ¥559mn on the end of the previous fiscal year to ¥875mn. The main change factors were that interest-bearing debt, which was ¥300mn in the previous fiscal year, was completely eliminated, while income taxes payable declined ¥111mn. Net assets increased ¥913mn on the end of the previous fiscal year to ¥2,649mn. Following the Company's listing, capital and the capital surplus both rose ¥439mn due to the capital increase from a public offering. Conversely, valuation difference on available-for-sale securities declined ¥131mn, mainly due to the sale of the shares of TerraSky.

Looking at the management indicators, the current ratio and the equity ratio, which indicate management stability, rose greatly compared to in the previous fiscal period due to the implementation of fund raising through a capital increase from a public offering. The Company has also realized debt-free management, so its financial structure can be said to have improved greatly.

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Results trend

Balance sheet

	(¥mn)			
	FY2/18	FY2/19	FY2/20	Change
Current assets	1,065	1,963	2,480	517
(Cash and deposits)	357	760	1,220	459
Non-current assets	1,488	1,208	1,044	-163
Total assets	2,553	3,171	3,525	353
Current liabilities	825	1,182	680	-501
Non-current liabilities	409	253	195	-58
Total liabilities	1,235	1,435	875	-559
(Interest-bearing debt)	410	300	-	-300
Total net assets	1,318	1,736	2,649	913
(Stability)				
Current ratio	129.07%	166.10%	364.44%	
Equity ratio	51.62%	54.75%	75.16%	
Interest-bearing debt ratio	31.10%	17.27%	-	

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

■ Outlook

Growing as resales and MSP services, which are recurring businesses, and the FY2/20 results are likely to exceed the Company forecasts

1. FY2/20 outlook

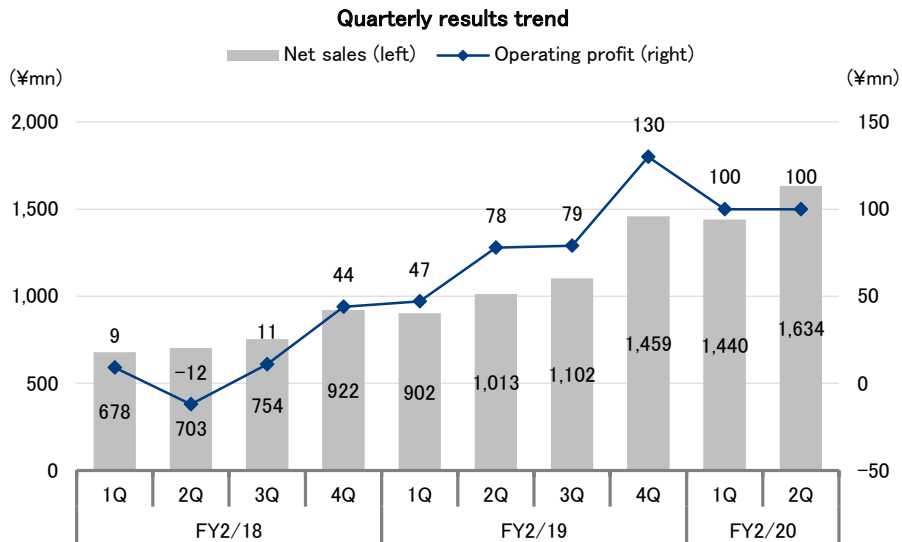
For the FY2/20 results, the Company has left the initial forecasts unchanged, of net sales to increase 34.1% YoY to ¥6,005mn, operating profit to grow 11.1% to ¥372mn, ordinary profit to rise 9.8% to ¥368mn, and profit to decrease 17.9% to ¥292mn. In the public cloud market, which continues to grow rapidly, the Company intends to accelerate the recruitment of excellent human resources and actively work to acquire new customers in order to further increase its market share. The rates of progress for the full fiscal year forecasts up to 1H were 51.2%, for net sales and 53.8% for operating profit, and growth is expected from the upward trends in the results of resales and MSP services, which are recurring businesses. Therefore at FISCO, we think it is highly likely that the full fiscal-year results will exceed the Company forecasts.

FY2/20 outlook

	FY2/19		FY2/20				
	Result	% of net sales	1H forecast	Full-year forecast	% of net sales	YoY change	1H progress rate
Net sales	4,477	100.0%	2,725	6,005	100.0%	+34.1%	51.2%
Gross profit	859	19.2%	-	1,069	17.8%	+24.4%	48.3%
SG&A expenses	524	11.7%	-	697	11.6%	+33.0%	45.3%
Operating profit	335	7.5%	109	372	6.2%	+11.1%	53.8%
Ordinary profit	335	7.5%	102	368	6.1%	+9.8%	51.6%
Extraordinary profit (loss)	207	-	37	37	-	-	-
Profit	356	8.0%	100	292	4.9%	-17.9%	56.2%

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

Outlook



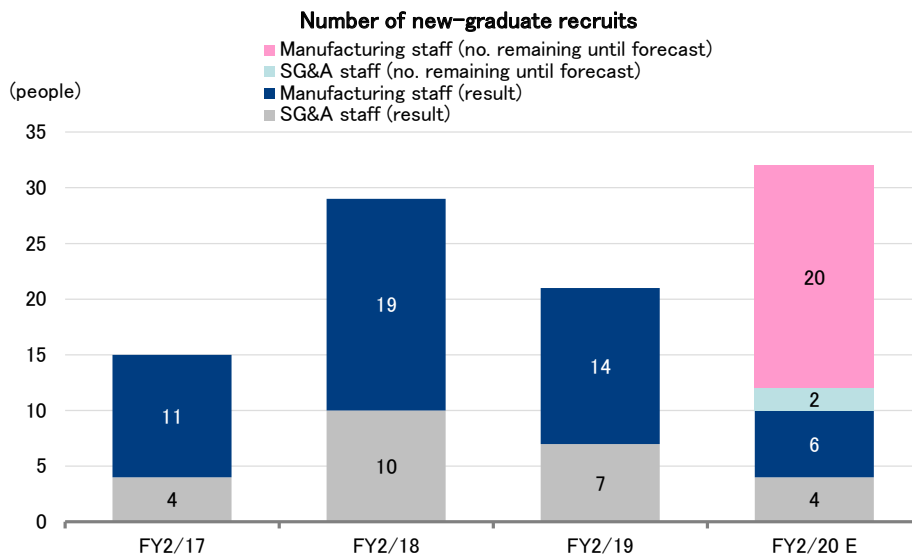
Source: Prepared by FISCO from the Company's results briefing material

Net sales are expected to grow greatly, because from the 3Q onwards, sales of cloud integration services will continue to rise from the increase in orders from existing customers and new customers, and also from the increases in the number of contracts for resales and MSP services. The operating profit margin will decline from 7.5% in the previous fiscal period to 6.2%, but the factors behind this will be the changes in the percentages of total net sales and the active investment in human resources toward growth in the future.

In FY2/20, the Company plans to increase the number of new recruits by 11 compared to in the previous fiscal year to 32 people. The number of employees is expected to increase by approximately 30% from 92 people at the end of the previous fiscal period. In the IT industry, there are many companies that are struggling with recruitment due to the chronic shortage of engineers, but the Company can be said to be making steady progress for recruitment, including for new graduates and mid-career hires. Other than the fact that its results are growing rapidly, the main reasons for this is that the Company's vision, of "Creating environments that are pleasant to work in" is spreading within the Company itself as well, and also that it has established not only a system for improving skills, but also Tech Channel on Slack (a communication tool) as a forum in which young employees and others can consult on technical matters that they have questions about. Employees are able to improve their own skills by using the Tech Channel to communicate with other employees who have strengths in a variety of technical fields. The existence of this channel is one of the Company's strengths. Another one of its features is that its employee-turnover rate is 6%, which is a low level compared to the IT industry average of 11%.

The training of engineers requires from half a year to around a year, while new-graduate employees spend one year in rotation training in all of the Company's departments, and they are allocated to a department after they understand all of the work flows. Therefore, a time lag occurs from when new graduates are recruited until they are actively contributing as employees. The Company recruited six new graduates in the spring of 2019 and plans to recruit six in the spring of 2020. It also intends to actively recruit human resources in FY2/21, and at the current point in time it estimates it will recruit around 40 to 50 people in the year.

Outlook



Note: the FY2/20 result is the number of mid-career hires as of July 1, 2019
 Source: Prepared by FISCO from the Company's results briefing material

Aiming for annual growth of 30% while maintaining the percentage of sales from recurring businesses at around 80%

2. Growth strategy

The percentage of companies using cloud services is still less than 50%, and in particular, some large companies have been partially introducing the Cloud, yet few companies have completely migrated to it. But in the future, the number of companies engaged in a digital transformation will increase, and in this situation, it is forecast that the shift from on-premises to on the Cloud will accelerate and the market will continue to grow significantly. Going forward, the Company is aiming for net sales to continue to grow at 30% a year, and it is targeting net sales of ¥10bn in three years' time. Its policy is also to keep the percentage of total net sales from the recurring businesses (resales, MSP, etc.) at around 80%.

In this situation, the point to focus on is the Company's partnership strategy, of its announcement in July 2018 of capital and business partnerships with NTT Communications and NTT DATA (investment ratios of 4.3% for both companies). NTT Communications provides its own services as a cloud-services provider, while it also provides a hybrid-cloud environment that combines on-premises and the Cloud, and a multi-cloud environment that can be used seamlessly with multiple cloud services such as Microsoft Azure and Google Cloud Platform. For AWS introductions, by partnering with the Company, which has advanced technological capabilities and expertise, it is aiming for a business partnership that will further strengthen its ability to provide solutions in the hybrid- and multi-cloud environments. If there are companies among NTT Communication's customer companies who want to introduce AWS, the Company will support these introductions. The partnership was started in December 2018 and orders have already begun to appear, and it is expected to contribute to earnings in the future.

Outlook

The Company had already started a partnership with NTT DATA from November 2017, and the companies then concluded a capital and business partnership with the aim of further strengthening their relationship. NTT DATA is also a AWS premier consulting partner company, and it has a track record in areas such as enterprise-related build, operations, and management. Through this capital and business partnership, the companies will progress joint developments, including of new services, applications, and programs. They will also strengthen the system for joint proposals, build, and operations, anticipating large-scale cloud introductions in the public sector and for extremely large companies. The Company has no track record of introductions in the public sector because it does not hold the qualification to engage in bidding, but through this partnership with NTT DATA, it will be able to participate in joint projects. As yet they have had no orders, but we shall be paying attention to developments in the future solely from the perspective of the increase in the scale of order per project.

Other than the above, the Company is also focusing on proposals for Amazon WorkSpaces, which is a virtual desktop service provided by AWS as a solution with the keywords of “workstyle reforms x security.” It meets the needs of those wanting to realize at low cost an environment in which people can work anywhere (teleworking) with high levels of security. A virtual desktop refers to a configuration in which an OS, such as Windows and Linux, and applications, are aggregated and managed on a server, and the terminal to access the server only has installed on it the client applications for use with the virtual desktop, which require comparatively low processing loads. It is a service in which the actually-operated OS and the applications and data are executed and stored on the server side, and only the execution-screen data is sent to and used on the terminal side. As the data is managed without being stored in the client terminal, the risk of information leaks when the terminal is taken outside of a company is reduced, and it enables teleworking and remote working to be conducted more securely. Examples of its introduction by large companies are starting to increase, and it is expected to contribute to the growth of resales sales.

■ Shareholder return policy

For the time being is allocating funds to invest in growth, and its policy is to reward shareholders by improving enterprise value

The Company considers returning profits to shareholders to be one of its most important management issues. But on considering that it is currently in a growth process, for the time being it is aiming to supplement internal reserves. Therefore, its policy is to allocate funds for investment, including for business expansion for further growth and to establish organizational systems and a systems environment. It is thought that this will lead to the maximization of returns to shareholders by improving enterprise value through earnings growth. Therefore, for the time being the Company intends to continue to not pay a dividend. Also, with August 31, 2019 as the reference date, it conducted a 2 for 1 share split with the aim of expanding its investor groups and improving the liquidity of its shares.



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