

Serverworks Co., Ltd.

4434

TSE Mothers

30-Jul.-2020

FISCO Ltd. Analyst

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FISCO Ltd.

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

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Summary

The Company is leveraging its technological capabilities and first-mover advantage to continue to achieve high growth in the cloud market

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 is the world’s leading public cloud service, and the company has been continuously selected as the top-ranked partner for AWS since 2014. It is growing rapidly through leveraging its strengths, including its advanced technological capabilities, an abundant track record of implementations (implementations for a total of 780 companies*), and Cloud Automator, its unique operations-automation service. More than 90% of net sales are generated by recurring revenue, such as resales (AWS usage fees, etc.) and MSP (Managed Service Provider: monitoring, maintenance and operations services), so a uniqueness of the Company is that it has high growth potential with a stable earnings foundation.

| * As of March 31, 2020 |

1. FY2020 results

In the FY2020 (March 2019 to February 2020) results, sales and profits increased greatly, with net sales rising 52.1% year-on-year (YoY) to ¥6,811M and operating profit growing 24.4% to ¥417M. The number of companies that have implementing public cloud services to their core/business systems has increased, and the sales have continued to increase significantly, centered on resales business. In addition, the project unit price increased by 10.7% YoY due to the increased scale of cloud integration projects for AWS implementation, and also the repeat orders from existing customers have increased. Even though personnel costs rose based on aggressive recruitment of human resources as well as providing a special lump-sum payment based on the strong results, those costs were absorbed by the increased sales and the operating profit was once again a new record high.

2. FY2021 outlook

The outlook for the FY2021 is at net sales to be increased by 17.5% YoY to ¥8,003M, and operating profit to be unchanged at ¥417M. Benefitting from the progress made by the workstyle reforms and the increase in demand for tele-working, the cloud market continues to expand. However, the Company has set the forecasts from a conservative viewpoint, as it is anticipating that the impact of the COVID-19 spread will continue until the current Q3. Gross profit is forecasted to be increased by 10.5%, but the operating profit is expected to be remain at the same level as FY2020, due to the rise in personnel costs. Conditions for new customer acquisition have become severe than FY2020 since various events have been cancelled. But at FISCO, we think that the forecast is fully achievable based on additional orders from existing customers and accumulation of stock services, such as the resales which provides 90.6% of net sales as well as MSP.

Summary

3. Market outlook and growth strategy

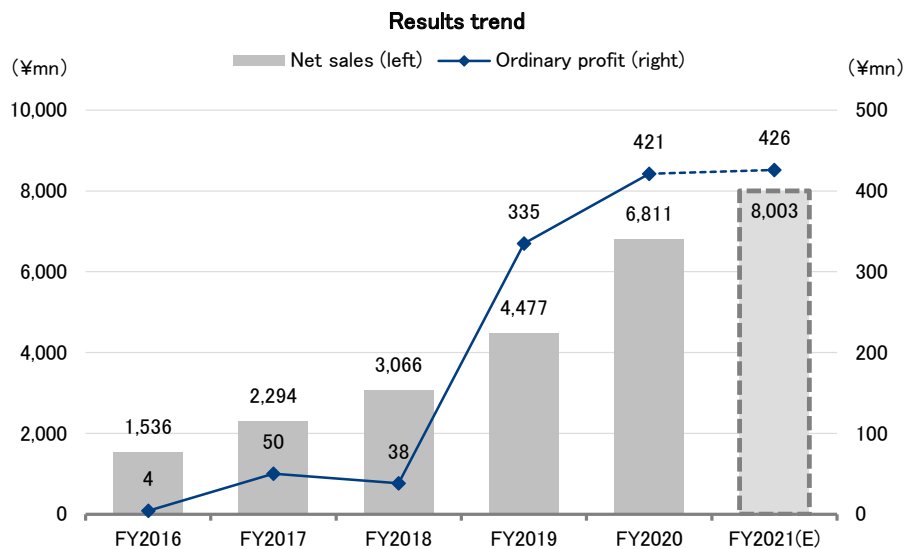
Within Japan, it is said that more than half of all companies still have not use cloud services, and the implementation of cloud services is forecasted to grow continuously as part of companies' measures for digital transformation (DX). A market research company has forecasted*1 that the domestic public cloud services market will continue to grow at an average annual rate of 21.7% between 2018 and 2023. Therefore, it can be said that there is plenty of room for the Company, a major player specializing in AWS business, to grow. Recently, the demand for SRE (Site Reliability Engineering)*2, where specific engineers or teams are assigned to take charge of large-scale projects from construction through to operation, has been increasing. In order to respond to such demands, the Company has reorganized to have three organizational structures; CI (cloud integration), resales, and MSP/SRE, since March 2020 and put its efforts to expand the businesses. For existing customers as well, it is aiming to maximize their LTV (Life Time Value) by proposing various advanced services provided by AWS and supporting their digital transformations. Recently, to respond to teleworking demand, it has been putting huge efforts on proposing virtual desktop service "Amazon WorkSpaces".

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

*2 Implementing measures to improve the reliability of websites and systems (automation, responding to faults, performance management, securing availability (the ability of a system to reliably perform as required without downtimes), etc.), and methodology and roles to improve value

Key Points

- As a top-tiered AWS partner, the company provides a one-stop service, from implementation support through to managed operation and maintenance services
- For FY2021, the company has set the conservative forecasts in consideration of the impact of the COVID-19 spread
- The potential demand for cloud services is strong, and the company is aiming for sales growth above the industry average



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

■ Business overview

As a top-ranked AWS partner, providing leading cloud services, the company provides a one-stop service, from implementation support through to managed operation and maintenance services

1. Company history

Serverworks was founded by the current President and Representative Director Ryo Oishi in February 2000. In 2004, it started to develop a system and started to offer services to provide pass-fail information on the university's entrance exams for students via the Web (PCs and mobile terminals). The service was deployed by nearly 200 universities. However, the demand is concentrated in February as the timing of the announcement of the pass and fail results, so that the service required to utilize 200 servers at the peak time. After such peak time, these servers became idle so that the business model had an investment efficiency issue.

When company was searching for a solution to this problem, in 2007, the Company discovered about Amazon.com, Inc. <AMZN> who provides 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 convinced that the cloud service would be used widely in the future. From 2009, the company began to provide Cloudworks, its own brand hosting service which was using Amazon EC2, and the company decided to steer its business to specialize in providing AWS solutions.

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

* The nine companies were certified as a premier consulting partner in Japan. The order of acquiring certification is ired, Inc., Nomura Research Institute, Ltd., <4307>, Serverworks, Classmethod, Inc., TIS Inc. <3626>, NTT DATA Corporation <9613>, NEC Corporation <6701>, ITOCHU Techno-Solutions Corporation <4739> and SCSK Corporation <9719>. Under this partner level, there are advanced consulting partners and select consulting partners. The requirements to receive the certification are to reach 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, the company was listed on the TSE Mothers market.

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, the company is aiming to create happier society by making more companies to gain competitiveness and make employees working for those companies to feel "more pleasant environments to work in".

Business overview

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)
June 2009	Started to provide the Cloudworks brand as a hosting service using Amazon EC2, under Cloudworks brand
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 integration business
September 2013	Announced a capital and business partnership with TerraSky Co., Ltd.
July 2014	Started providing AWS automation service, "Cloud Automator"
November 2014	Was selected as an APN (AWS Partner Network) premier consulting partner
March 2015	Started providing a 24 hours, 365 days operation support service at Sky365 Co., Ltd.
September 2015	Acquired APN MSP (Managed Services Provider) Program certificate
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, as a first company in Japan to receive it
February 2020	Announced a capital and business partnership with Monstar Lab, Inc., a digital product development company

*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 for the public cloud service is that the market will continue its high growth rate of 20+ % year-over-year

2. Market environment

(1) About Public cloud services

Public cloud services refer to the service providing to the companies and the individuals, 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 providing its service, is categorized as IaaS and PaaS. In addition, the form of managing systems held in-house, such as using dedicated datacenters and servers, is called "on-premises". In the future, it is expected that there will be a shift from on-premises to the public cloud, for which the initial investment burden and the management costs are low.

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

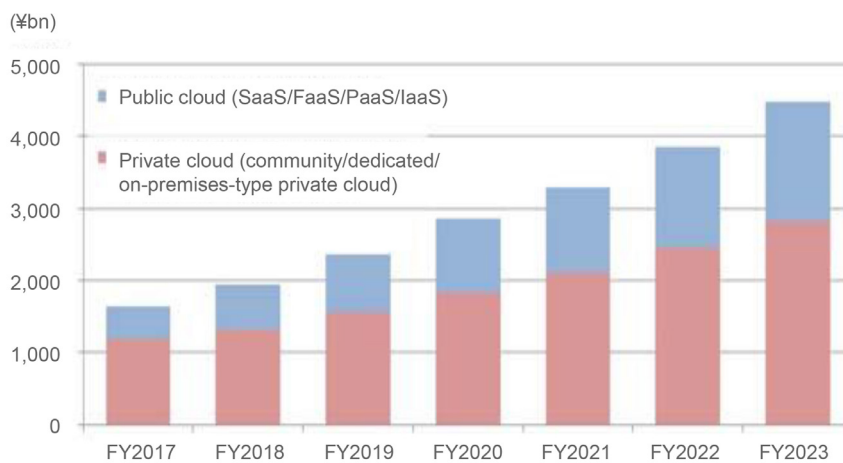
Business overview

(2) Market outlook

According to a survey by the MM Research Institute, the Japanese cloud services market in FY2018 increased 18% YoY to ¥1,942.2bn, while within this amount, the public cloud market rose 34.1% to ¥616.5bn. In the background to this growth is the increasing active movement among companies to migrate their core business systems to the Cloud due to the lower-cost and more flexible operations, and also due to the progress made in strengthening the security. An oligopoly situation is progressing by the major companies, such as AWS and Microsoft Azure. 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, Amazon has by far the leading share at approximately 35% (second-placed Microsoft has 16%). AWS net sales in FY2019 increased 36.5% YoY to US\$35.0bn, so while the growth rate slowed down, sales continue to maintain their previous high growth.

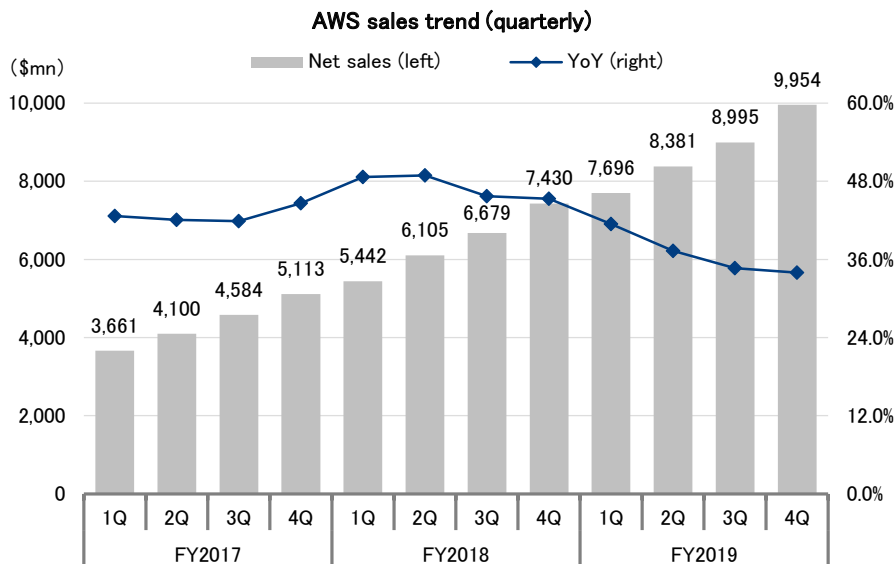
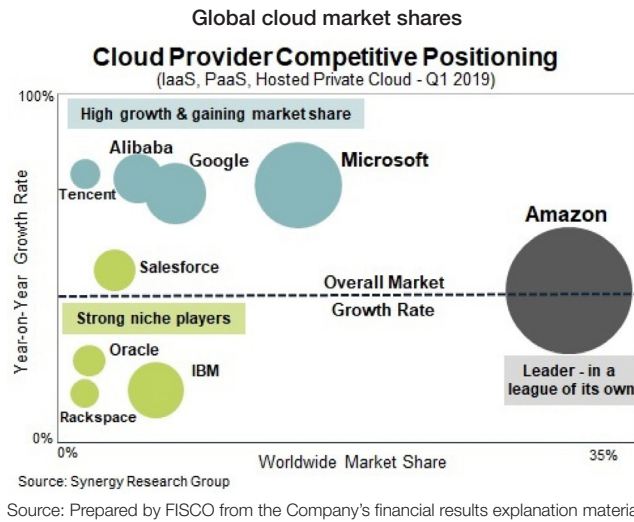
The outlook for public cloud services market in Japan is set to continue to grow greatly, because the percentage of companies that have implemented the cloud services is still less than 50%. The market is forecast to grow to be worth ¥1,649.0bn in FY2023, and the five-year average annual growth rate 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



Recurring revenue constitutes 90% 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: the cloud integration service which provides the implementation of the Cloud, from planning to designing and building of the infrastructure and implementation support; the resale service which provides its own value added services to the AWS cloud services; and the MSP and SRE services, which include monitoring as well as an operation and maintenance service for the systems built on AWS. Other than those sales, it records sales from the university entrance exam pass-fail notification service business.

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

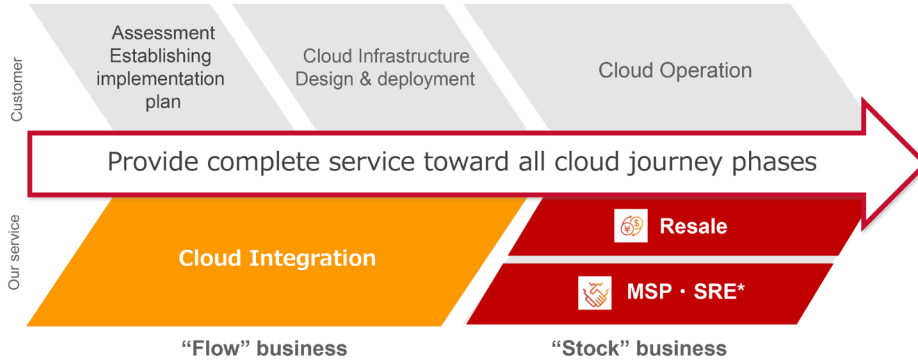
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Business overview

Business model

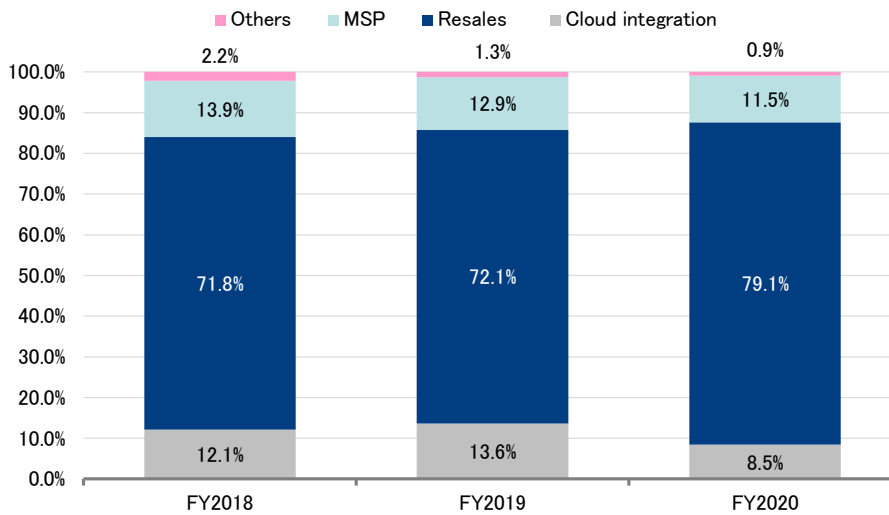


*SRE: Site Reliability Engineering. A concept advocated by Google Inc. in 2003 to operate an expanding large-scale IT system. The mission is to improve performance, availability, elasticity, security, etc. in order to secure the reliability of the IT system and build a system that can be continuously improved by introducing various tools and strengthening collaboration with customers.

Source: From the Company's financial results explanation material

The percentages of total net sales of resale services, in recent three years, is at around 70% which generate the majority of the revenue, followed by cloud integration and MSP services at approximately 10% each. Among these, resale services and MSP services are recurring businesses from existing customers, and they provided around 90.6% of total sales in FY2020. Therefore, even if the number of new-implementation projects declines, the impact to the total net sales would be small. The public cloud market is in a high-growth period, so earnings are increasing in a stable manner and with a high growth rate.

Percentages of total sales by service



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

Business overview

(1) Cloud integration

The Company provides implementation-support services in order for companies to migrate their mission-critical and business systems that they manage in an on-premises environment to AWS. At the end of March 2020, the accumulated total number of companies implemented AWS were 780 companies and the number of projects was 7,900, and in the last few years, the average unit price per project has also been trending upward. This is mainly because large companies have started to migrate to the Cloud, so an increasing number of the projects ordered becomes comparatively large scale. Also, among those projects, there are many additional projects coming from existing customers and this is typical AWS business trend. This is because the migration happens in stages when implementing the Cloud and this tendency is particularly strong in large enterprise companies. For example, Marubeni Corporation<8002>, which started its implementation in 2013, continues with additional projects even today.

The average unit price per project in FY2020 was ¥1,339,000, which is comparatively inexpensive. Also, because the project period, from the development until the implementation, is at two to three months, which is relatively short, the risk of having unprofitable projects is extremely low.

(2) Resales

The Company conducts resales business (a payments-agency service) as an AWS reseller in Japan. The customers can contract directly with AWS, but there are several restrictions such as US dollar-based payments, which causes inconveniences. Resellers, such as the Company, provide a payments-agency service which accepting payments in Japanese yen (invoice by converting to yen at the end-of-month rate), while the company also provides the service in combination with AWS operation automation service, Cloud Automator, which enables improved operation conveniences and reduction in operating costs. These services lead to gaining resales contracts.

The AWS fees are pay-as-you-go basis based on the usage, but there are also services called Reserved Instance* and Savings Plans, which significantly discount the usage fees by reserving the server specification and usage periods in advance. Many customers use these services. Currently, there are many companies selects Reserved Instance service to prepay in December. Therefore sales for resale business tends to be concentrated in the 4Q.

* There are two types of term, one year and three years and there are three payment options such as "prepayment of full amount," "partial prepayment" and "no prepayment." For "partial prepayment" and "no prepayment," the remaining amount is paid monthly basis during the contracted usage period.

The in-house developed "Cloud Automator" is a service with features that contribute to improving usability as well as saving costs. This includes operation automation features such as Data back-ups and Instance start/stop which customer can setup the schedule and a feature that periodically review the configuration to check whether AWS resources are configured accordingly to the specified rules. This "Cloud Automator" was a decisive factor for customers 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 FY2020, the number of AWS accounts (the number of resales contracts) had continued to grow, up 41.3% from the end of the same period at the previous fiscal year and increased to 1,140 accounts. There are companies with the multiple accounts in each department. The main factor behind this high growth rate is because the company set a rule to include resale and MSP business for cloud implementation-support projects in FY2020.

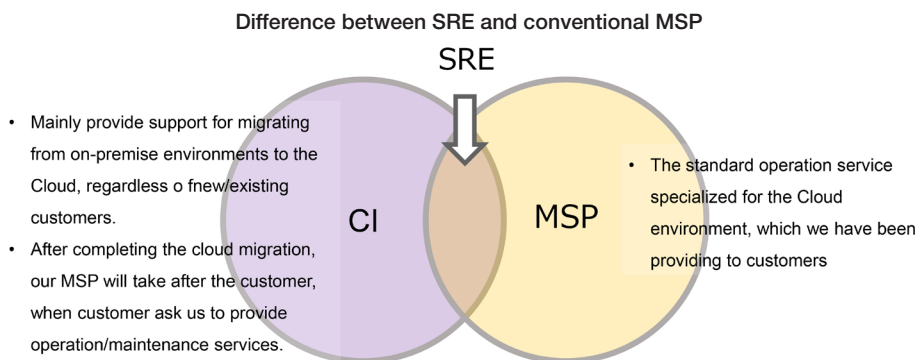
Business overview

The profitability of the resales business is relatively low compared to that of other services. But since it is a recurring business, which revenue increases along with the number of contracts, it contributes to its earnings growth as a stable revenue source. Although there are some contracts being canceled, the majority of the reasons are because those purpose of the cloud use were for a temporary use (such as for a campaign or a test use).

(3) MSP

The outsource service for customers to provide monitoring, operations, and maintenance of virtual servers and networks deployed in AWS environment. Sky365 Co., Ltd., which was jointly established with TerraSky, provides 24 hours/365 days operations services, including performance monitoring, fault monitoring and recovery, and backups. The fees are charged according to the usage period so that it is a recurring business for the company.

Also, in recent one or two years, there has been an increase in needs, mainly among large customers, which cannot be met by standard MSP services. For those cases, the members or the team involved in the development project continue to cover the operation and maintenance stages. This sort of business is called SRE (Site Reliability Engineering) and these types of projects are also included in MSP.



Source: From the Company's financial results explanation material

As a top-ranked partner for AWS, has the leading track record for implementations 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 certification for AWS partners. Among more than 300 companies listed as AWS partners in Japan, only nine have received the top-ranked certification, positioning them as major companies specializing in providing AWS implementation support. Among these nine companies, three are ventures, including Serverworks (also irect and Classmethod), and the remaining six companies are major system integrators. As it competes with the major Sler, people think that competition for winning orders is severe. However, the major Sler have a bottleneck of having in-house data centers, so many of their proposals are based on the hybrid cloud basis (a combination of in-house infrastructure and AWS), which leads to higher costs. Therefore, they do not seem to be a big threat for the company.

Business overview

AWS premier consulting partners

	Year of certification as a top-ranked partner	Remarks
Serverworks	2014	Total number of implementations, 780 companies; a track record of more than 7,900 projects (as of the end of March 2020) FY2020 net sales, ¥6.8bn; number of employees, 137 (as of the end of February 2020)
iret, Inc.	2013	Total number of implementations, more than 1,900 companies; a track record of more than 2,600 projects annually (as of the end of March 2020) KDDI's subsidiary. FY2018 net sales ¥16.8bn; number of employees, 513 (as of the end of October 2019)
Classmethod, Inc.	2014	Total number of implementations, more than 1,200 companies; number of AWS certification holders, more than 500 FY6/19 net sales ¥13.1bn; operating profit ¥1.1bn; number of employees, 245 (as of the end of June 2019)
Nomura Research Institute, Ltd.	2013	-
TIS Inc.	2015	-
NTT DATA Corporation	2016	-
NEC Corporation	2016	-
ITOCHU Techno-Solutions Corporation	2017	-
SCSK Corporation	2019	-

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 March 31, 2020, the total number of implementations was 780 companies and it had conducted more than 7,900 projects, so it is accumulating an abundant track record and expertise
- d) As an additional service, it provides Cloud Automator, which is the originally developed AWS operations-automation service
- e) The Company is building a virtuous circle by utilizing its excellent name awareness as a pioneer in the industry, which leads to recurring-revenue business from acquisitions of new leads, and it then publishes implementation case studies on the company homepage and elsewhere, which in turn leads to further acquisitions of new leads

With regards to the people with certifications, there are total of 232 certification had been acquired as of the end of March 2020, on following five types of AWS certifications. As the ability to accept orders changes depending on the number of certification holders, the Company's policy is to continuously increase its number of certification holders in the future.

Number of AWS certification holders

	(people)	
	Feb. 28, 2019	Mar. 31, 2020
Solutions Architect Professional	28	38
DevOps Engineer Professional	14	22
Solutions Architect Associate	52	85
Developer Associate	27	39
SysOps Administrator Associate	31	48

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

Business overview

(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, BCP* countermeasures and benefits as a measure against labor shortages. At FISCO, we think that the likelihood of this risk being realized is low.

* Business Continuity Plan: a plan so that a company's important business activities are not interrupted even if unforeseen circumstances occur, such as a natural disaster like an earthquake or flood, the spread of an infectious disease, or a major accident. Also, even if they are interrupted, the plan indicates the policies, structures, and procedures to restore them in the shortest possible time.

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 implementations, 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, Amazon would lose its excellent partners to Microsoft and lead to 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.

Results trend

In the FY2020 results, sales and profits significantly increased exceeding the company's initial forecast

1. FY2020 results

In FY2020, net sales increased 52.1% YoY to ¥6,811mn, operating profit rose 24.4% to ¥417mn, ordinary profit grew 25.5% to ¥421mn, and profit decreased 6.5% to ¥333mn. Benefitting from the expansion of the public cloud market, net sales increased significantly, particularly AWS resales and MSP. The gross profit margin fell 3.3% YoY to 15.9%, but this was mainly because product cost of sales increased ¥1,795mn from last year due to the higher resales business. In order to respond to the strong demand, in FY2020 the Company recruited 34 new employees, mainly engineers, so personnel costs increased ¥182mn, while business outsourcing costs also rose ¥79mn. But these increases were absorbed by the effects of the higher sales. Declined profit from the last year is due to the decrease of extraordinary profit (gained on the sale of TerraSky shares last year).

Compared to the initial Company forecasts, net sales and the net income were all more than 10% higher than the forecast. This was mainly because resales business grew more than expected as the projects of existing customers have grown larger and the progress made in promoting the use of AWS. Also, from the cost perspective, SG&A expenses were less than forecast. As the Company achieved strong results, it paid a special lump-sum payment of ¥48mn at the end of the period.

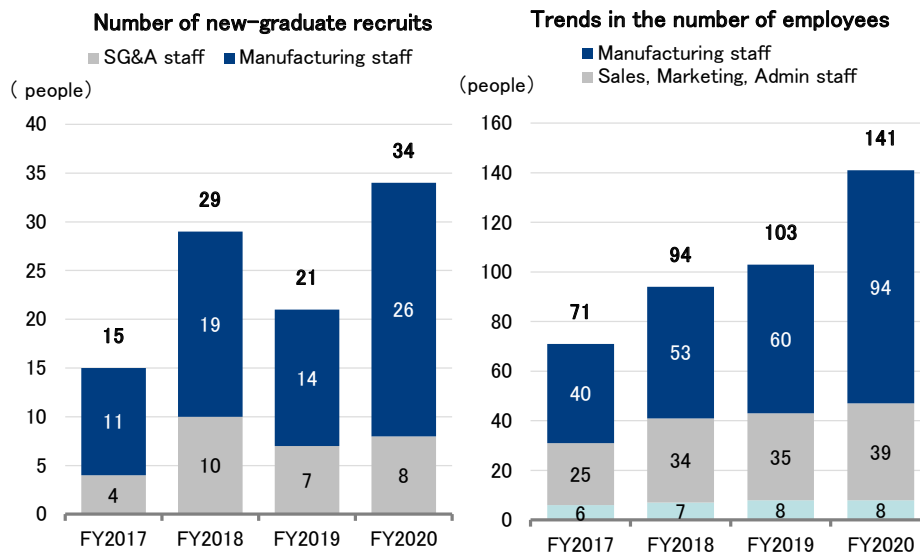
Results trend

FY2020 results

(¥mn)

	FY2019		Initial forecast	FY2020			
	Result	% of net sales		Result	% of net sales	YoY change	Vs. forecast
Net sales	4,477	-	6,005	6,811	-	52.1%	13.4%
Gross profit	859	19.2%	1,069	1,086	15.9%	26.3%	1.6%
SG&A expenses	524	11.7%	696	668	9.8%	27.5%	-4.0%
Operating profit	335	7.5%	372	417	6.1%	24.4%	12.3%
Ordinary profit	335	7.5%	368	421	6.2%	25.5%	14.5%
Extraordinary profit (loss)	207	-	-	37	-	-	-
Profit	356	8.0%	292	333	4.9%	-6.5%	14.2%

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



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

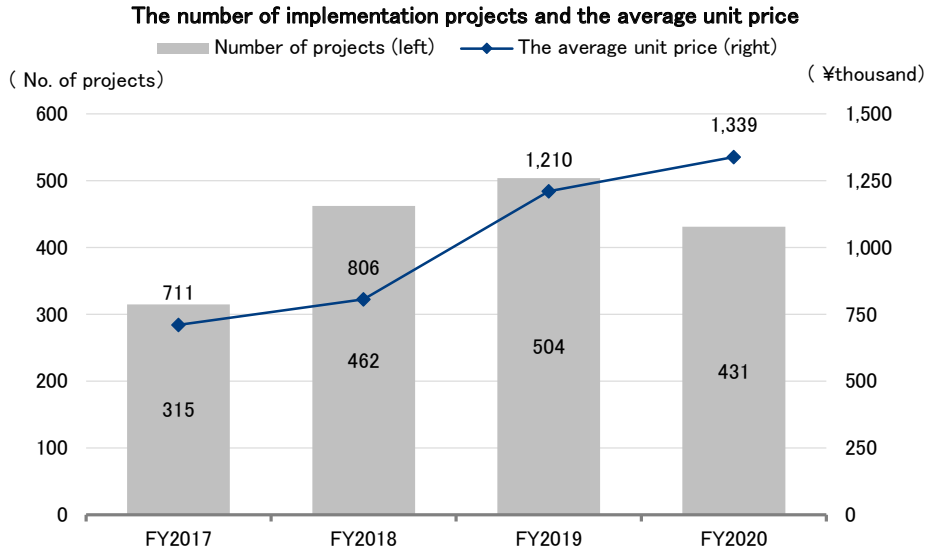
The Company is making progress in increase the size of projects, and resales grew rapidly, up 66% YoY

2. Net sales by service

(1) Cloud integration

Cloud integration net sales decreased 5.4% YoY to ¥577mn. The number of projects declined to 431 from last year's 504, but this was mainly because the Company allocated engineer resources to MSP services in order to meet the existing customers demands. As stated in this report, there have been an increasing number of cases where same member or team is assigned, from the construction through to management, for large projects. The project unit price was ¥1,339,000 and it continues its upward trend.

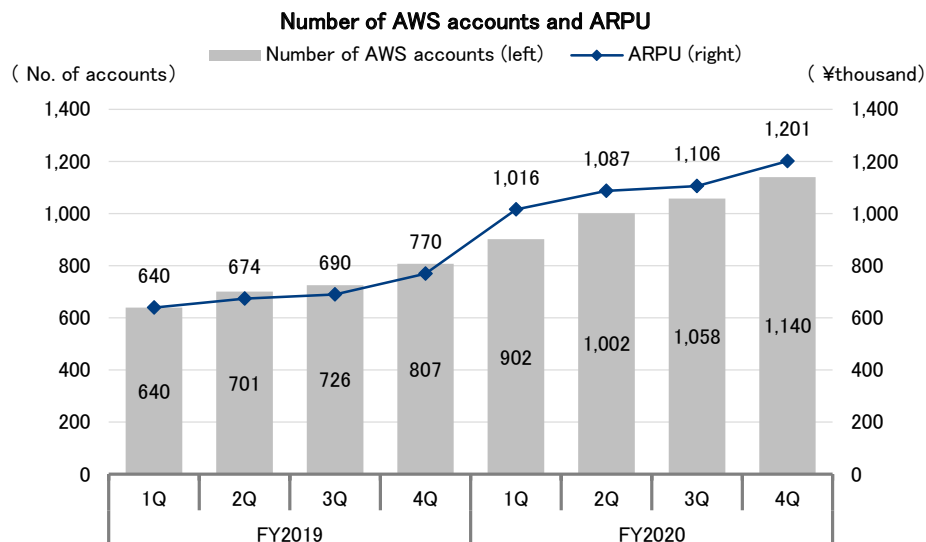
Results trend



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

(2) Resales

For resales services, net sales increased rapidly, rising 66.9% YoY to ¥5,390mn. The higher sales were mainly due to the continuous orders from existing customers, the increase in AWS usage fees from large customers, and also the progress made in acquiring new customers. At the end of FY2020, the number of AWS accounts had risen 41.3% from the previous year to 1,140 accounts, while ARPU also increased 56.0% to ¥1,201,000, so both continue its upward and growth trend.



The value calculated by AWS usage fee, including reserved instance, divided by number of customers
Source: Prepared by FISCO from the Company's financial results explanation material

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<https://www.serverworks.co.jp/ir/>

Results trend

(3) MSP

MSP net sales increased 35.3% YoY to ¥784mn. The same as for resales services, this was due to the continuous orders from existing customers, an increase in large project orders, and acquisition of new customers which are leading the stable increase in total number of contracts. Another factor behind the higher sales was due to the increase in SRE projects.

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 of FY2020, total assets were up ¥1,300mn from the end of the previous period to ¥4,472mn. The main factors of this increase in current assets were the increase in cash and deposits at ¥818mn, based on the capital increase through a public offering, and the increase in accounts receivable at ¥290mn following the growth of the sales. On the other hand, for the fixed assets, due to the increase in valuation of TerraSky shares and also the acquisition of the Monstar Lab, Inc. shares, the investments and other assets have increased by ¥235mn. The Monstar Lab, Inc. is an IT company with digital product development capabilities and the Company concluded a capital and business partnership agreement and invested ¥99mn in February 2020 aiming to strengthening its ability to provide comprehensive support to customer's various needs in using AWS, from the application layer to the infrastructure layer, so that the company will be able to contribute to support customers' digital transformations journeys.

Total liabilities were up ¥1mn compared to the end of the previous fiscal year to ¥1,437mn. The main change factors were that accounts payable increased by ¥359mn, but the interest-bearing debt of ¥300mn was completely paid and payable income taxes decreased by ¥133mn. Net assets were up to ¥1,298mn from the end of the previous period to ¥3,035mn. Both capital and capital surplus rose ¥440mn, mainly due to the capital increase through a public offering following the stock market listing, and also because the net income of ¥333mn was recorded and the valuation gain on other available-for-sale securities increased by ¥84mn based on the rise in the valuation of TerraSky shares.

Looking at the management indicators, the current ratio and the capital adequacy ratio, which indicate management stability, rose considerably compared to that of the previous period because the Company raised capital through a public offering, as well as increased its growth earnings. The Company's financial constitution has improved significantly in such way that company is practicing debt-free management. Conversely, looking at the indicators of profitability, the operating profit margin declined 1.4pp YoY, while ROA and ROE also both decreased. By breaking down ROE, we see that it declined because although the total assets turnover rate rose from 1.56 times in the previous period to 1.78 times, the net profit margin fell from 8.0% to 4.9%, while financial leverage (total assets ÷ shareholders' equity) decreased from 1.87 times to 1.60 times. The main factor for the decline in net profit margin was due to the decline in extraordinary profit. For financial leverage, the factors were supplemented shareholders' equity by the capital increase through a public offering and the complete repayment of interest-bearing debt. In FY2021, it is estimated that ROE will be around the 10% level, assuming results will be in line with the Company's forecasts.

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Results trend

Balance sheet

	FY2018	FY2019	FY2020	Change
	(¥mn)			
Current assets	1,065	1,963	3,004	1,041
(Cash and deposits)	357	760	1,579	818
Non-current assets	1,488	1,208	1,467	258
Total assets	2,553	3,171	4,472	1,300
Current liabilities	825	1,182	1,148	-33
Non-current liabilities	409	253	288	35
Total liabilities	1,235	1,435	1,437	1
(Interest-bearing debt)	410	300	-	-300
Total net assets	1,318	1,736	3,035	1,298
(Stability)				
Current ratio	129.1%	166.1%	261.7%	95.6pt
Equity ratio	51.6%	54.8%	67.9%	13.1pt
Interest-bearing debt ratio	31.1%	17.3%	-	-17.3pt
(Profitability)				
ROA	1.8%	11.7%	11.0%	-0.7pt
ROE	16.3%	23.4%	14.0%	-9.4pt
Net profit margin	1.7%	7.5%	6.1%	-1.4pt

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

Outlook

The outlook for FY2021 is conservative, in consideration of the COVID-19 impact

1. FY2021 outlook

For FY2021, the Company forecasts net sales to increase 17.5% YoY to ¥8,003mn, operating profit to remain unchanged at ¥417mn, ordinary profit to rise 1.2% YoY to ¥426mn, and net profit to decrease 7.9% to ¥306mn. The Company set these forecasts from a conservative viewpoint, as it estimates that the negative impact from the COVID-19 spread will continue until the 3Q.

FY2021 outlook

	FY2020		FY2021		
	Result	% of net sales	Full-year forecast	% of net sales	YoY change
Net sales	6,811	-	8,003	-	17.5%
Gross profit	1,086	15.9%	1,200	15.0%	10.5%
SG&A expenses	668	9.8%	782	9.8%	17.0%
Operating profit	417	6.1%	417	5.2%	0.0%
Ordinary profit	421	6.2%	426	5.3%	1.2%
Profit	333	4.9%	306	3.8%	-7.9%

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

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Outlook

(1) The impact of the COVID-19 pandemic

The COVID-19 pandemic has some positive aspects, such as progressing workstyle reforms and increasing the teleworking demand, to response to its spread. On the other hand, it leads to cancel various events, such as one of AWS's largest event, the AWS Summit, that was scheduled to be held in Tokyo and Osaka in May and June, which leading to acquire new businesses and also forcing the Company to self-restraint to hold its own events. The Company is anticipating that these negative effects will continue. The reason why the Company is still forecasting a double-digit increase in sales, despite these anticipated negative effects, is that approximately 90% of net sales are from recurring-revenue business, and that Resales and MSP business will increase due to the accumulation of contracts from the previous fiscal period. It is highly possible that the number of newly acquired customers will decrease due to the cancellation of the AWS Summit, where the Company acquires most of its new customers over the course of the year. But orders for additional projects from existing customers are continuing, so at the current point in time, there is hardly seen any negative impact. Therefore, as long as the impact from the COVID-19 pandemic does not become even more severe, at FISCO we think the Company's results forecasts are at fully achievable levels.

In terms of the impact on the Company's financial position, at the end of FY2020 it had cash and deposits of ¥1,579mn, its current ratio was 261.7%, and it is practicing debt-free management. Therefore, there is no problem on the stability of the business continuity point of view. That said, in order to prepare for the prolonged COVID-19 pandemic, the Company sets the policy is to consider measures in timely manner and to work to ensure securing cash on hand.

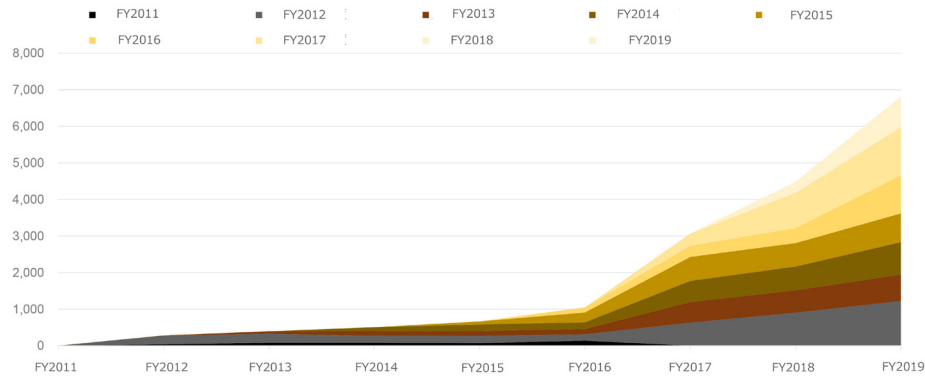
In terms of the Company's responses for its employees, it recommended that all employees to work from home as much as possible to eliminate the risk of infection even before the Japanese government declared a state of emergency. Since April 6, its measures have included that, employees are to stop coming to the office and to change to deal customer inquiries to online sales discussions or to postpone the meeting, as a general rule. Also, with the aim of securing a work environment in which productivity does not decline due to employees working at home, it is paying its employees a work-from-home allowance of ¥20,000 a month until it lifts the suspension of employees to coming to office, which started from April.

(2) Factors of business results increase-decrease

The Company does not disclose net sales forecasts by services. However, it is possible that cloud integration will be affected by the decrease in new customers and the increase in SRE projects, while resales will benefit from the accumulation of sales from new contracts and also the increases from the existing customers' usage fees. Therefore, the outlook of the double-digit increase in sales is anticipated to continue. At AWS, it is enhancing new services, including cloud call centers and AI services, and the company is expected to see the rise in ARPU is from the use of these new services. For the outlook of the MSP business also to be increased based on the increase in SRE projects, on top of the accumulation of existing service sales. In March 2020, the Company newly organized and established an SRE dedicated department in order to optimize the allocation of personnel alongside the increase in SRE projects, and it has been separated from CI (cloud integration). In terms of personnel (including contracted engineers), there are 94 manufacturing staff for CI and SRE total. The total sales amount from the Company's existing customers (the total of CI, resales, and MSP) has been increasing every year, and the same trend is expected to continue in the future as well.

Outlook

Results trend



* The sales revenue before FY2017 is an estimated value based on re-calculated AWS resale revenue using recent results

Source: From the Company's financial results explanation material

The outlook of gross profit margin is expected to decline 0.9pp YoY to 15.0% due to the continuous increase of the resale sales percentage in the total sales, while gross profit will increase 10.5%. SG&A expenses are expected to rise 17.0% YoY, mainly due to increases in personnel costs and advertising costs. But the impression is that the forecast is conservative when considering that a special lump-sum payment of ¥48mn was recorded in the previous period. For personnel recruitment, by considering the market situation, the Company keeps the plan to be lower, which it plans to hire slightly more than 20 people. However, the Company has a plan to conduct additional recruitments should the COVID-19 crisis settle down.

The training of engineers requires from half a year to around a year, while new-graduate employees spend one year in rotation training to experience 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 become actively contributing employees. The Company recruited six new graduates in the spring of 2020.

The potential demand for cloud services is strong, and is aiming for sales growth above the industry average

2. Growth strategy

The percentage of companies using cloud services is still less than 50%. The large companies are implementing the cloud partially, but only few companies actually are migrating to the cloud completely. However due to the workstyle reforms and labor shortages, the digital transformation activity becomes more active and it is anticipated that the companies are continue to migrate their information systems from on-premises to on the Cloud. In the public sector as well, the government is progressing the migration to the Cloud, including its decision to adopt AWS for the Government Shared Platform which is scheduled to start its operations from October 2020. Therefore the public cloud services market, which includes cloud migration in the public sector, is forecasted to continue to grow at the high rate at more than 20% YoY in the future.

Outlook

The growth rate may temporarily slow down in FY2021 due to the impact of the COVID-19 pandemic. But it is considered that there will be no change to its double-digit pace of growth, while the Company's policy is to continue to aim for growth exceeding the market average. In addition, it is targeting around the 10% level for operating profit margin in the long-term. Resales' gross profit margin is estimated to be at little over 10%, so in order to achieve an operating profit margin of 10%, it seems that it is necessary to increase sales and also to make progress in enhancing the In-house developed services.

Cloud Automator, which is an in-house developed service, currently provides functions including job automation, configuration review, inventory, and multi-account. Going forward, the Company's policy is to aim to differentiate it from the products of other AWS partners by enhancing functions for which customer needs are high and contributing to reducing their management costs, and thereby improve profitability by increasing the number of contracts. Also, by establishing the SRE department, it is actively progressing the acquisitions of large-scale migration projects, targeting enterprise-related IT systems and other areas.

Overview of Cloud Automator

Functions	Description
Job automation	The automation of various functions, including backups, start / stop instances, those are essential for AWS management.
Configuration review	Regularly review whether the AWS resources have been configured in accordance with the determined rules
Inventory	The resource information on WorkSpace, which is a virtual desktop service, can be browsed through simple operations, reducing the resource management work burden
Multi-account	Reduces security risk by creating multiple user accounts, setting authorities for possible operations for each user, and sharing log-in information
Price plan	The Company has prepared three plans – professional (¥24,000/month), business (¥48,000/ a month), and enterprise (¥148,000/a month) depending on the conditions, including the number of users, the number of groups, and the upper-limit number for management job executions.

Source: Prepared by FISCO from the Company's website

Other than the above, the Company is also focusing on proposals for WorkSpaces, which is a virtual desktop service provided by AWS as a solution with the keywords of “workstyle reforms x security” and “teleworking.” It meets the needs of those wanting to realize the low cost environment in which people can work anywhere (teleworking) with high levels of security. A virtual desktop is a solution which an OS, such as Windows and Linux, and applications are aggregated and managed at server side, and the end point terminals, which require comparatively low processing loads and only installed the client applications for use with the virtual desktop, to access the server. 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 end point terminal side. As the data is managed without being stored in the client end-point terminal, the risk of data leaks when the end-point terminal is taken to outside of a company is reduced, and also it enables teleworking and remote working to be conducted more securely.

The Company was the first to acquire certification for WorkSpaces in Japan and has been conducting sales since 2013. Also, although the number of implementations is still small, interest in teleworking is rising, so inquiries are increasing. Going forward, the Company intends to strengthen measures to improve its name awareness, which is also expected to contribute to an increase in resales sale. As a solution to improve the convenience of using WorkSpaces, in April 2020, the Company added a function at the Cloud Automator to allow It to launch WorkSpaces. According to WorkSpaces specification, it takes long time from when user to initiate launching the service to when use can actually use it. Therefore, for a smooth operation, it is necessary to set the work schedule manually in advance. This task is automated by Cloud Automator.

Outlook

In July 2018, the Company concluded capital and business partnerships with NTT Communications and NTT DATA (investment rate, 4.3% for both companies). NTT Communications provides its own services as a cloud-services business, while it also offers a multi-cloud environment that enables multiple cloud services to be seamlessly used, including in a hybrid cloud environment combining on-premises and the Cloud, such as on Microsoft Azure and Google Cloud Platform. By partnering with the Company, which has advanced technological capabilities and expertise for AWS implementations, NTT Communications is aiming to further strengthen their hybrid and multi-cloud environment solution capabilities. Among NTT Communication's customer companies, the Company provides implementation support for those companies wanting to implement AWS. The partnership started in December 2018, and it is contributing to increasing the resale sales.

The Company has been collaborating with NTT DATA since November 2017, but with the objective of further strengthening their relationship, they entered-into a capital and business partnership. NTT Data is also one of the AWS Premier Consulting Partner companies, and it has a track record in areas such as enterprise-related construction, operations, and management. Through this capital and business partnership, the companies are progressing joint development, including new services, applications, and programs. They are also jointly conducting large-scale cloud implementation projects for AWS in the public sector and for extremely large companies. As yet there are no specific results for this partnership, should there be orders going forward, they will be large scale, so we will be paying attention to their future development.

■ Shareholder return policy

For the time being, the company policy is to allocate funds to invest in growth, and to reward shareholders by improving company value

The Company considers returning profits to shareholders to be one of its most important management matters. However, the Company is considering that now is a growth period for the Company so that it is aiming to supplement internal reserves and to allocate funds to invest in business expansion for further growth and to establish organizational systems as well as a systems environments for the moment. The Company is considering that this will lead to maximize the profit return to shareholders by improving enterprise value through earnings growth. Therefore, for the time being, the Company intends to continue to not pay a dividend.



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