

# Terilogy Co., Ltd.

**3356**

TSE JASDAQ Standard

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

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## Summary

### **An IT solutions provider founded in the first year of the Heisei era. Aiming to leap forward under the new slogan of “No.1 in Quality” in the Reiwa era.**

#### **1. Company profile and business description**

Terilogy Co., Ltd.<3356> (hereafter, also “the Company”) is an IT company that has been providing IP network-related products and cutting-edge products and solutions in the network security field since it was founded in July 1989 (the first year of the Heisei era). Its corporate philosophy is “to respond to the needs of our customers and ensure their full satisfaction,” and in the Heisei era, it expanded its business areas to contribute to the construction and development of an Internet society under the slogan “In collaboration with customer” Today, in the Reiwa era, the Company is working to provide solutions to meet the demands of the present age such as productivity improvements, work-style reforms, and for inbound demand-related under its new slogan “No.1 in Quality.”

From the Company’s corporate history, it can be read that it has quickly ascertained the trends of broadband, mobile, and cybersecurity and expanded its business areas to them with the corporate IP network business as its original business. Also, the Company considers its own strengths to be, 1) its ability to find “emerging technologies” and “marketable products” and its “market response,” 2) wide selection of customer solutions, 3) diverse service provision approaches, 4) technical capabilities rooted in experience, and 5) global response capabilities. In particular, the first strength listed above is used in its partnering strategy, which is a feature of the Company, and this is considered to be the core competence on which all other strengths are based.

The Company is currently developing business activities in four sections by products and services; the Network Section, the Security Section, the Monitoring Section, and the Solutions Services Section. Its features include that it has established a 24-hours a day, 365-days a year maintenance system and an excellent distribution function that combines direct and indirect sales.

#### **2. Results have bottomed-out, and profitability and the financial structure are improving**

In the FY3/19 consolidated results, net sales increased 13.6% year-on-year (YoY) to ¥3,660mn, operating income rose 47.0% to ¥244mn, and ordinary income grew 32.3% to ¥229mn. These strong figures suggest that results have bottomed-out.

Looking at the financial indicators also, not only did recurring-type revenue reached its highest level in the last 10 years, but also cash and deposits and shareholders’ equity have greatly increased. In this situation, the indicators of financial stability, including equity ratio and the current ratio, are improving significantly. The Company has also added a transfer of capital reserve, and retained earnings, which are normally the source of dividends, are at a level at which resuming dividend payments is possible.

## Summary

**3. Expects to resume dividend payments in FY3/20 based on organic growth**

For the FY3/20 consolidated results, the Company is forecasting increases in sales and profits in actual terms for the third consecutive fiscal period, with net sales rising 12.8% YoY to ¥4,130mn and operating income growing 14.7% to ¥280mn, and it plans to resume dividend payments (a period-end dividend per share of ¥5). In the current medium-term management plan, the targets for FY3/20 is net sales of ¥5bn and the resumption of dividend payments, as business expansion through M&A and other means is expected. Even on looking only at the part from organic growth, the current situation is that it is implementing a growth strategy basically as planned and clearly has in sight higher sales and profits and resuming dividend payments in FY3/20. Therefore, it is considered that the Company should be positively evaluated to a certain extent.

**4. Has added an M&A strategy to the organic growth, and is expected to announce a new medium-term management plan**

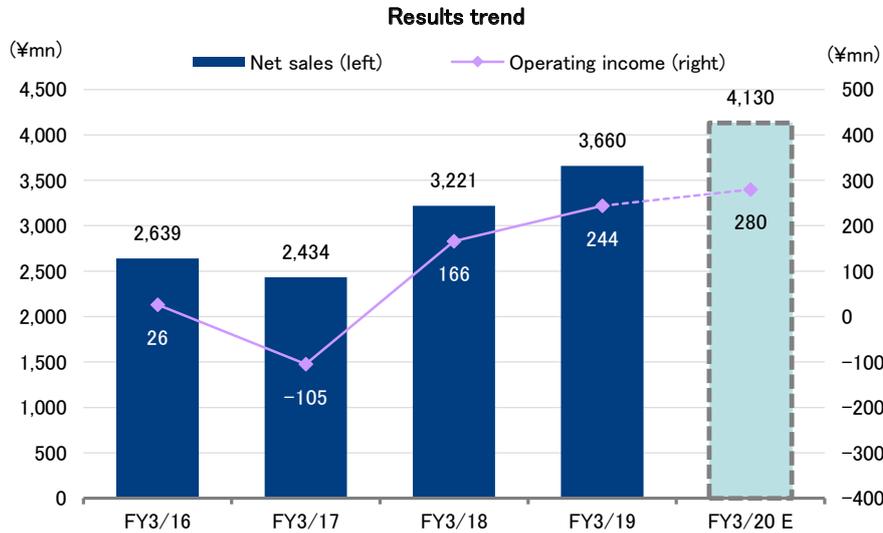
The Company has clarified that it will “implement measures for public relations and publicity activities toward improving medium- to long-term and sustainable enterprise value, while also aiming to maximize enterprise value.” At FISCO, we think it is highly likely that it will announce a new medium-term management plan in the spring of 2020, which is the final year of the current medium-term management plan.

In the new medium-term management plan, we can expect the Company to present an equity story that combines a specific action plan to progress organic growth with an M&A financial strategy based on a highly convincing financial strategy.

**Key Points**

- An IT solutions company that has accumulated a track record in the 30 years since its foundation. The Company is currently conducting business activities through four sections; the Network Section, the Security Section, the Monitoring Section, and the Solutions Services Section.
- It can be read to have a track record of accurately ascertaining the trends of the times and skillfully changing its business focus areas to reflect them.
- Also utilizing its core competence, its ability to find “emerging technologies” and “marketable products” and its “market response,” in its partnering strategy
- In FY3/20, expects to achieve higher sales and profits and to resume dividend payments based on organic growth
- Expected to present an equity story that combines a specific action plan to progress organic growth with an M&A financial strategy in the new medium-term management plan, which is highly likely to be announced in the spring of 2020

Summary



Note: Results are non-consolidated up to FY3/17 and consolidated from FY3/18 onwards  
 Source: Prepared by FISCO from the Company's securities report and financial results

## Company profile

**An IT solutions provider that continues to meet the demands of the present age.**

**Introducing in-house developed products to respond to inbound demand and to work-style reforms**

**1. An IT solutions provider that continues to meet the demands of the present age, with “No.1 in Quality” as its new slogan**

The Company is an IT company that has been providing IP network-related products and cutting-edge products and solutions in the network security field since its foundation in July 1989. In December 2004, it was newly listed on the JASDAQ Securities Exchange (currently, the Tokyo Stock Exchange (TSE) JASDAQ).

Its corporate philosophy is “to respond to the needs of our customers and ensure their full satisfaction,” and in the Heisei era, it expanded its business areas to contribute to the construction and development of the Internet society under the slogan “In collaboration with customer” Today, in the Reiwa era, the Company is working to provide solutions to meet the demands of the present age such as productivity improvements, work-style reforms, and for related of inbound demand under its new slogan “No.1 in Quality.”

## Company profile

## 2. Expanded its business areas to broadband, mobile, and security with the corporate IP network business as its original business

Looking at the Company's corporate history, it can be read that it has quickly ascertained the trends and expanded its business areas to them with the corporate IP network business as its original business. These include 1) the rapid shift from Internet communication using telephone lines and ISDN lines to high-speed Internet communication using broadband lines, such as ADSL and FTTH, 2) the arrival of the mobile era against the backdrop of the spread of smartphones, and 3) the increasing importance of cybersecurity in Internet society.

The Company's corporate IP network business began in 1990 when it entered-into a distribution contract with Wellfleet of the US and started to provide routers, which are one of the main products to build IP networks. Although Wellfleet does not exist today, the company was acquired by Nortel (Canada), the world's second largest computer network device company at the time, to compete against Cisco Systems, Inc. <CSCO> of the US founded in 1984, which was the largest company back then. The Company's discovery of Wellfleet in 1990 can be said to be a good example of its ability to find "emerging technologies" and "marketable products." Currently, the Company is a supplier that handles the routers manufactured by Cisco Systems.

In the broadband area, in 1999 the Company started to provide ADSL-connection software, and subsequently it developed hit products with more than 10 million users, which became a bridgehead into a business for major telecommunication companies. Also, in 1999, it concluded a distribution contract with Redback Networks of the US, and through the introduction of broadband access servers and other products, it contributed to building the FTTH networks of various electric power companies. Also, in mobile-related, it realized growth for DNS/DHCP appliances manufactured by Infoblox Inc. of the US (devices to issue an IP address) and in-house developed solutions for monitoring networks have become its core products following the spread of smartphones. The Company was the first in Japan to conclude a distribution contract with Infoblox of the US, which was founded in 1999. Currently, DNS/DHCP appliances manufactured by Infoblox are handled by major companies in Japan and have acquired the position of being the de-facto standard, so this can also be evaluated as indicating the Company's "foresight."

In the Security field, the Company have provided wide-ranging solutions by concluding a domestic (Japan) master reseller contract with TippingPoint of the US, when it was independent in 2004 (it was acquired by Hewlett-Packard of the US in 2010 and acquired by Trend Micro Inc. <4704> in 2015) followed by concluding reseller contracts with OneSpan Inc. <OSPN> (formerly VASCO) in 2007, Lastline of the US in 2012, RedSeal of the US in 2015, Tempered Networks of the US and KELA (Israel) in 2016, and Nozomi Networks of the US in 2018 (domestic (Japan) reseller contract with Tempered Networks), which is enabling it to provide solutions over a wide range.

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Company profile

**Company history**

<b>July 1989</b>	Terilogy Co., Ltd. established in Kanda, Chiyoda-ku, Tokyo. Enterprise networks business launched.
<b>Apr. 1991</b>	Maintenance outsourcing contract signed with Toshiba Engineering Corporation (now Toshiba IT-Services Corporation) and maintenance service business launched.
<b>May 1996</b>	Outsourcing contract signed with Tokyo NTT Data Communication Systems Corporation (now NTT Data Business Systems Corporation) and customer solutions business launched.
<b>Nov. 1999</b>	Distribution contract signed with American company Redback Networks, Inc. and broadband network business launched, encompassing sales of Redback Networks broadband access servers, Ethernet software from American company Network Telesystems, Inc. (now Affinegy, Inc.), and other such products.
<b>Jan. 2003</b>	DNS/DHCP servers distribution contract signed with Infoblox Inc. of the US.
<b>Oct. 2004</b>	Domestic (Japan) master reseller contract signed with American company TippingPoint Inc. (now Trend Micro Incorporated.).
<b>Dec. 2004</b>	Listed on JASDAQ Securities Exchange.
<b>Sep. 2005</b>	Certified under ISO 27001 information security management system (ISMS) standards.
<b>Nov. 2005</b>	Basic agreement on business collaboration signed with UNIADDEX, Ltd. based on capital tie-up agreement.
<b>Dec. 2006</b>	Domestic (Japan) master reseller contract signed with American company NETSCOUT (now NETSCOUT Systems, Inc.).
<b>Feb. 2007</b>	Distribution contract signed with Belgian company VASCO Data Security International, Inc.
<b>Mar. 2007</b>	Certified under ISO 14001 environmental management system (EMS) standards.
<b>Oct. 2008</b>	Distribution contract signed with Singaporean company eG Innovations Pte Ltd.
<b>Apr. 2010</b>	Following merger of JASDAQ Securities Exchange and Osaka Securities Exchange, Terilogy listed on Osaka Securities Exchange JASDAQ.
<b>Aug. 2010</b>	Domestic (Japan) reseller contract signed with American company APCON, Inc.
<b>Feb. 2011</b>	Asia-Pacific distribution contract signed with American company SevOne, Inc.
<b>June 2012</b>	Sales begun of "momentum," a unique probe software product developed in-house at Terilogy.
<b>Sep. 2012</b>	Distribution contract signed with American company Lastline, Inc.
<b>July 2013</b>	Following merger of Osaka Securities Exchange and Tokyo Stock Exchange, Terilogy listed on JASDAQ (Standard).
<b>July 2013</b>	Fullflex ZG master reseller contract signed with Accense Technology, Inc.
<b>July 2015</b>	Sales begun of CloudTriage, a unique, cloud-based operations monitoring service by Terilogy.
<b>Dec. 2015</b>	Distribution contract signed with American company RedSeal, Inc.
<b>Apr. 2016</b>	Distribution contract signed with Taiwanese system integration company SYSCOM.
<b>Oct. 2016</b>	Distribution contract signed with Canadian company Wedge Networks, Inc.
<b>Oct. 2016</b>	Exclusive domestic reseller contract signed with American company Tempered Networks, Inc.
<b>Nov. 2016</b>	Distribution contract signed with Israeli company KELA.
<b>Jan. 2017</b>	Basic agreement on business collaboration signed with NCXX Group Inc. based on capital tie-up agreement.
<b>Jan. 2017</b>	Basic agreement on joint security-product marketing signed with FISCO Ltd.
<b>Jan. 2017</b>	Basic agreement on business collaboration in the area of transaction security with Fisco Cryptocurrency Exchange Inc.
<b>Jan. 2017</b>	Basic agreement on business collaboration in the area of joint product development for blockchain technology applications signed with SJI Ltd (now CAICA Inc.).
<b>Mar. 2017</b>	Wholly owned subsidiary Terilogy Worx Corporation established.
<b>Dec. 2017</b>	Shares required for ICT-business corporation establishment acquired by ITX Corporation, and wholly-owned consolidated subsidiary Terilogy Serviceware Corporation established.
<b>Apr. 2018</b>	Distribution contract signed with American company Nozomi Networks Inc.
<b>July. 2018</b>	Sales begun of EzAvater, Terilogy's unique, ultra-simple robotic process automation (RPA) tool.
<b>Jan. 2019</b>	Business tie-up agreement signed with Israeli company Harel-Hertz Investment House Ltd.

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

## Company profile

### 3. Core competence is its ability to find “emerging technologies” and “marketable products” and its “market response”

The Company considers its strengths to be 1) its ability to find “emerging technologies” and “marketable products” and its “market response,” which is the discernment required to find and identify progressive, leading-edge technologies and deploy them in markets in ways adapted specifically to local customers; 2) wide selection of customer solutions, of a diverse selection of security and safety solutions for varying applications, encompassing everything from network infrastructure to communication endpoints; 3) diverse service provision approaches, of a flexible Terilogy-product provision comprising diverse intermixing of products and services, encompassing everything from products utilizing leading-edge technologies through to maintenance services, software products developed in-house, and new services; 4) technical capabilities rooted in experience, of technical strengths and abilities forged, since its founding, through three decades of reliable, customer-tailored service provision; and 5) global response capabilities, of products and services for global markets, including the rapidly growing markets of emerging nations in Asia. Each of these strengths are backed-up by a track record of results, but in particular, the Company’s ability to find “emerging technologies” and “marketable products” and its “market response” would seem to be its core competence on which all of the other strengths are based.

The Company’s ability to find “emerging technologies” and “marketable products” is “after accurately ascertain the trends of the times and incorporating them into its business areas, the ability to find the latest technologies in overseas venture companies and to conclude a distributor contracts and other contracts with them,” and it has no shortage of experience in discovering the latest technologies in overseas venture companies. In addition to Wellfleet and Infoblox, which were introduced as good examples in the previous section, we can also mention TippingPoint (Trend Micro), OneSpan, and Lastline as examples in the security field.

TippingPoint is a cybersecurity company specializing in ISP (Intrusion Prevention System) that was acquired by Trend Micro in 2015 for approximately US\$ 0.3bn. However, the Company concluded a domestic (Japan) master reseller contract and accumulated a track record with TippingPoint 11 years before its acquisition, and it continues to have a presence in which it is relied on by Trend Micro. Also, in 2007, the Company became the first in Japan to handle OneSpan’s one-time password technology, which today has been adopted by all of Japan’s megabanks and become an essential part of Internet banking. Moreover, in 2012, the Company started selling the targeted-attack countermeasure cloud services of Lastline of the US, and as is clear from the trend in the number of targeted-attack emails ascertained by the National Police Agency (2014: 1,723 cases→2015: 3,828 cases→2016: 4,046 cases→2017: 6,027 cases→2018: 6,740 cases), in recent years, malware and other targeted attacks have come to be recognized as a major threat. This example would seem to clearly demonstrate the Company’s ability to accurately ascertain the technological trends and cutting-edge technologies that it should precisely focus on as its business areas and its ability to find “emerging technologies” and “marketable products” with “foresight.”

So why does the Company select overseas venture companies as its partners? The reason is the height of its “market response” that it has fine-tuned since its foundation by implementing a management strategy that is supported by its corporate philosophy of prioritizing customers’ needs and levels of satisfaction.

Company profile

The sources of the Company’s “market response” are 1) its ability to combine imported technologies with its proprietary technologies to develop solutions with high levels of customer satisfaction, and 2) its ability to fill-in missing parts by fully utilizing an alliance and M&A strategy. In general, even if venture companies are able to create good technologies and products, in many cases they are inferior to major companies in the value chain for aspects like maintenance and sales. But in the case of the Company, in 1991, two years after it was founded, it concluded a maintenance outsourcing contract with Toshiba IT-Services Corporation (formerly Toshiba Engineering Co., Ltd.) For sales, one of its features is that it has not only established an indirect sales network, including through alliances, but that it has also worked to strengthen its direct sales force, such as by acquiring customer touch points through business and capital alliances and M&A.

The Company has been highly evaluated by influential customers for its active utilization of a partnering strategy for the entire value chain, from product development (combining imported technologies with its proprietary technologies) through to sales (using both direct and indirect agency network sales) and maintenance (in which the Company itself identifies problems and then outsources the actual maintenance work), and it is efficiently building an excellent customer base (more than 300 companies, mainly major companies, and it conducts business directly with around 90% of customers). This has formed the “excellent distribution capabilities in Japan” (a wealth of customer information, a maintenance system that operates 24 hours a day, 365 days a year, and extensive customer contact points through combining direct sales with indirect sales) and it became the deciding factor for the overseas venture companies to choose the Company as its partners in Japan.

The Company’s value chain



Source: The Company’s website

## Business description

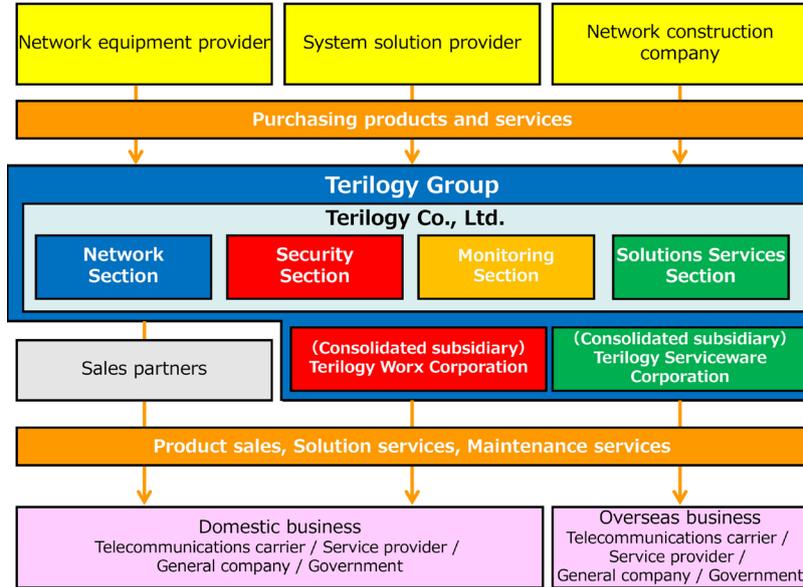
### Develops its business in four sections; the Network Section, the Security Section, the Monitoring Section, and the Solutions Services Section

#### 1. Develops its business in four sections by products and services

The Company does not disclose segment information, but it develops its business activities in four sections according to products and services; the Network Section, the Security Section, the Monitoring Section, and the Solutions Services Section.

Business description

Diagram of the business structure



Source: The Company's securities report

2. Network Section

In the Network Section in FY3/19, net sales were ¥970mn, which provided 26.5% of total net sales. The main products and services it handles are 1) network products (routers, switches, and wireless LAN, DNS/DHCP), 2) design and build of in-company information and communication systems and infrastructure, and 3) sales of a wide range of network-related products, such as TV conferencing systems, and provision of professional services. The Company takes pride in its ability to provide solutions optimized to meet customer needs because of the track records accumulated in the 30 years since its foundation. In addition, it has a system in place to respond 24 hours a day, 365 days a year for the maintenance work for the networks and incidental devices provided by this section.

Main products in the Network Section

	
<p>Network</p> <p><b>Appliances</b></p> <p>NonStop/distribution/ centralized management for identity-driven networks, such as DNS/DHCP/RADIUS</p>	<p>Network</p> <p><b>Aerohive</b></p> <p>Fully control-less, cloud-based next-generation WiFi solutions</p>

Source: The Company's website

Business description

3. Security Section

In the Security Section in FY3/19, net sales were ¥1,245mn, which provided 34.0% of total net sales and it is the Company's main business pillar. The main products and services it handles are 1) network security products (firewalls, intrusion detection and prevention countermeasures, information leakage countermeasures, etc.), 2) security authentication infrastructure (identifying service users on a network), and 3) security systems to prevent unauthorized intrusions (one-time password products). In addition, it has a system in place able to respond 24 hours a day, 365 days a year for maintenance work for the security devices and software products provided by this section.

Main products in the Security Section

			
Security	Security	Security	Security
<b>Lastline</b> Protection from the latest threats in customers' public cloud environments (cloud infrastructure and cloud email) and in on-premises environments.	<b>Trend Micro TippingPoint</b> Has the leading track record for intrusion prevention systems as in-line type and network-type IPS appliances	<b>One Span (Former Vasco Data Security)</b> Secure user authentication that is more secure than fixed passwords by using a hard-software token to automatically generate a disposable, one-time password	<b>REDSEAL</b> Realizes proactive security by automatically generating an access map and attaching the results of a scan of the access map's vulnerabilities.

Source: The Company's website

4. Monitoring Section

In the Monitoring Section in FY3/19, net sales were ¥590mn, which provided 16.1% of total net sales, while a feature of this section is the handling of the Company's own-brand products. The main products and services it handles are 1) packet analysis using an in-house developed product (momentum), 2) cloud-based monitoring services (CloudTriage), and 3) network operation, management, and monitoring devices. In addition, it has a system in place able to respond 24 hours a day, 365 days a year for the maintenance work for the in-house developed products (momentum), and network operation, management, and monitoring devices and software products provided by this section.

The Company's own brands are "momentum," (network packet capture products developed completely in-house), which constitutes the core of the Monitoring Section, and "CloudTriage" (IT systems operation monitoring cloud services managed under its own brand), which use a monthly billing model and forms part of the support business section. In "momentum," data (packets) exchanged on a network are collected in a storage device and analyzed and made visible in order to validate service quality, specify locations of defects, and provide support measures. It is, so to speak, a drive recorder-like solution on a network, and the Company has successfully acquired important customers, such as major mobile communication carriers. Also, "CloudTriage" measures the operation conditions of IT systems from the user's viewpoint, and in the event of a decline in performance, like a delay in remote access, it specifies the cause. It is provided inexpensively as a monthly billing cloud service.

Business description

Main products in the Monitoring Section

<p><b>Operation &amp; management</b> CloudTriage RCA</p>	<p><b>Operation &amp; management</b> momentum</p>	<p><b>Operation &amp; management</b> eG Enterprise</p>	<p><b>Operation &amp; management</b> SevOne</p>
<p>Skilfully identifies bottlenecks in the user's system and presents improvement points.</p>	<p>High performance capture ring software that enables high-speed packet capture and packet storage.</p>	<p>Conducts real-time monitoring of IT infrastructure, makes visible performance, analyzes the causes of problems, and automates specified tasks</p>	<p>A high-speed network performance management tool that collects and monitors every kind of data and enables application identification</p>

Source: The Company's website

5. Solutions Services Section

In the Solutions Services Section in FY3/19, net sales were ¥853mn, which provided 23.3% of total net sales. The main products and services it handles are 1) an in-house developed software Robot Process Automation (RPA) tool (EzAvater), 2) a multi-lingual real-time video interpretation service (Mieru-Tsuyaku), 3) a cloud-based, managed VPN service (MORA VPN Zero-Con), 4) a Web conference service (MORA Video Conference), 5) a corporate Internet connection service (MORA Hikari), and 6) a high-speed mobile data communication service (MORA Mobile).

The core of this section is formed by Terilogy Serviceware Corporation (changed corporate name from ITX Corporation's corporate ICT services business that was acquired from the Nojima Corporation <7419> Group in December 2017), and in its M&A strategy, the Company is acquiring new business domains and a customer base of medium-sized and SME customers, which it has had few of in the past. The point to focus on for this is the lineup of new products matched to medium-sized and SME customer groups, such as the RPA tool (EzAvater) which is attracting attention toward realizing work-style reforms and improved work efficiency, and the multi-lingual, real-time video interpretation service (Mieru-Tsuyaku), which can be used to respond to inbound demand.

Main products in the Solutions Services Section

<p><b>Operation &amp; management</b> RPA EzAvater</p>	<p><b>Network</b> Mieru Interpreter A multi-lingual video interpretation service</p>	<p><b>Security</b> Inter-site VPN services</p>	<p><b>Network</b> MORA Video Conference A fully pay-as-you-go WEB conference (TV conference) service</p>
<p>An RPA tool developed in-house for customers who want to build robots and automate routine tasks.</p>	<p>A video interpretation service useable with 10 languages, including English, Chinese, and Vietnamese, and sign language (Japanese sign language) by connecting to an interpretation operator.</p>	<p>One stop managed a simple connection, low-cost VPN service that ensured a location change for customers at the time of installation or during connection failure.</p>	<p>A Web conference service that the Company has provided for more than 10 years that realizes a worry-free, simple connection with a stable operating rate of 99.9%</p>

Source: The Company's website

## Business description

The features of “EzAvater” include it is extremely easy (robots for everyone = intuitive operations to enable the creation of scenarios to automate routine tasks), it makes delays unlikely (the robots work at the speed of the system, and it creates templates for exception processing and realizes stable operations), it does not matter what app is used (through the adoption of image recognition technology, work can be automated regardless of the app, as long as it is operating on Windows) and it can start small (can be introduced starting from a single PC). Due to these features, “EzAvater” overcomes many of the weaknesses of RPA tools, such as that if there is no specialist IT department, it is difficult to create the robots and the introduction costs and maintenance burden are large. This software made it possible for a utilization method that creates robots that reflect the needs of work sites in each department and to have them carry out daily management tasks. For sales of “EzAvater,” the Company is actively utilizing a partnering strategy (it has introduced the Gold Partner system) with the aim of spreading its use among a wide range of user groups, and it concluded reseller contracts in rapid succession during 2019, with NCXX Solutions Inc., in April; with Panasonic Solution Technologies Co., Ltd., and Resona Gate Co., Ltd., in June; with Yamazakibuneidou, Inc., in July; with Nextage Co., Ltd. and islenet Inc., in August; and with UCHIDA ESCO Co., Ltd. in September.

## Results trends

**Results have bottomed-out and the ordinary income margin is up to around 6%.**

**The financial structure has greatly improved from the effects of utilizing treasury shares to increase capital**

### 1. The FY3/19 figures show that results have bottomed-out

In the FY3/19 consolidated results, net sales increased 13.6% YoY to ¥3,660mn, operating income rose 47.0% to ¥244mn, ordinary income grew 32.3% to ¥229mn, and net income attributable to owners of parent climbed 34.6% to ¥207mn. Looking at the rates of progress for the initial Company forecasts, net sales were 3.7% below forecast. But operating income and ordinary income were above forecast by 22.1% and 25.6%, respectively. Net income attributable to owners of parent was significantly above forecast, by 62.3%, due to the recording of a gain on sales of investment securities in extraordinary income. So these figures can be evaluated as positive, suggesting that results have bottomed-out.

The gross profit margin has improved greatly, from 20.6% (non-consolidated) in FY3/15 to 38.3% in FY3/19, this was due to the effects of the improved product mix following the launches of highly profitable in-house products and services, which are highly profitable. Looking at the level of the ordinary income margin also, it was 6.3% in FY3/19 (up 0.9 of a percentage point (pp) YoY), which is at a level approaching the highest rate since the listing, at 7.1% in FY3/04, and based on this and the fact that results have bottomed-out, it looks like the Company’s earnings capability is greatly improving. In FY3/19, the SG&A expenses ratio was 31.7% from the effects of the higher sales and efforts to keep down costs. Although it rose from 26.6% in FY3/18, which was the lowest level in the last 10 years (including non-consolidated results), this was due to an increase in costs from aiming to further strengthen the ability to acquire earnings, and it is not considered to be a cause for concern.

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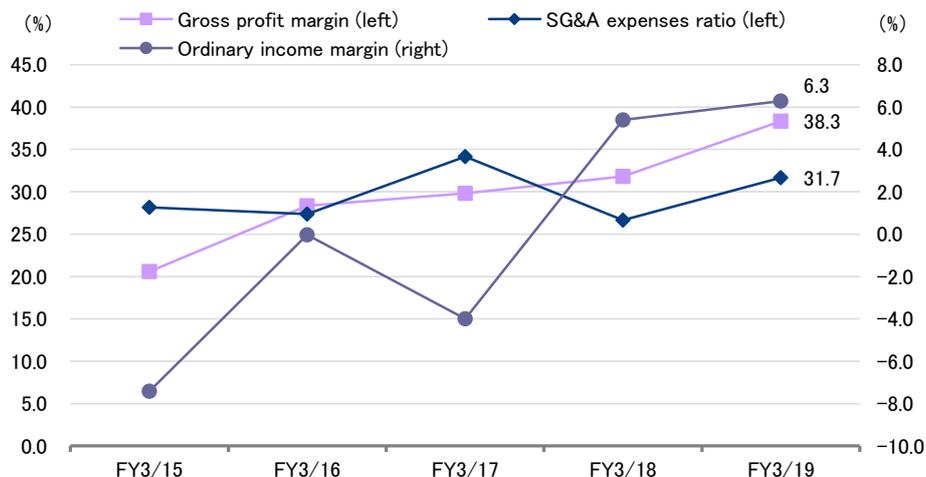
## Results trends

## Simplified income statement

	(¥mn)				
	FY3/15	FY3/16	FY3/17	FY3/18	FY3/19
Net sales	2,804	2,639	2,434	3,221	3,660
YoY	9.5%	-5.9%	-7.7%	-	13.6%
Cost of sales	2,226	1,890	1,709	2,197	2,256
YoY	19.2%	-15.1%	-9.6%	-	2.7%
Gross profit	577	748	725	1,024	1,403
YoY	-16.6%	29.7%	-3.0%	-	37.0%
SG&A expenses	789	721	831	858	1,159
YoY	-3.0%	-8.6%	15.2%	-	35.0%
Operating income	-212	26	-105	166	244
YoY	-	-	-	-	47.0%
Ordinary income	-207	-0	-97	173	229
YoY	-	-	-	-	32.3%
Net income	-211	-19	-99	154	207
YoY	-	-	-	-	34.6%

Note: Results are non-consolidated up to FY3/17 and consolidated from FY3/18 onwards  
 From FY3/18, net income attributable to owners of parent  
 Source: Prepared by FISCO from the Company's financial results and securities report

## Trends in the profit margins, etc.



Note: Results are non-consolidated up to FY3/17 and consolidated from FY3/18 onwards  
 Source: Prepared by FISCO from the Company's securities report

At the end of FY3/18, total assets were ¥3,194mn and total net assets were ¥1,441mn. We can see some noticeable changes compared to FY3/18, including that notes and accounts receivable – trade decreased ¥120mn, short-term borrowings declined ¥1,039mn, and total net assets increased ¥678mn. Looking at the indicators of financial stability, the equity ratio rose significantly, up 20.6 pp compared to 45.0% at the end of the previous fiscal period. This was due to the effects of sales of treasury shares and the completion of the exercise of share acquisition rights, in addition to improved earnings results. The current ratio also improved to 179.2% from 99.0% at the end of the previous fiscal period.

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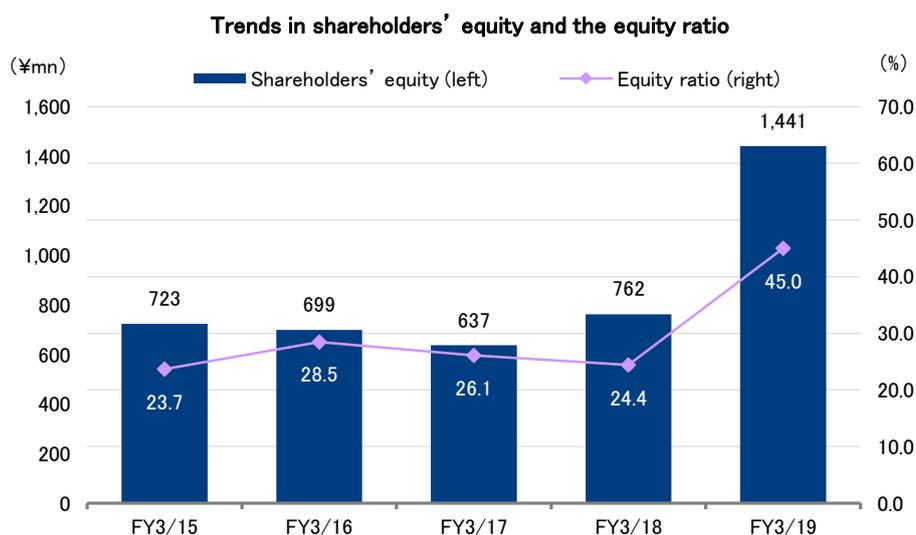
Results trends

Based on the financial results report, ROE declined 1.4 pp YoY to 18.8%, but this was alongside the increase in shareholders' equity and is not a problem. In fact, ROA (Return on Assets) rose by 1.7 pp to 7.3%, which is its highest value in the last 10 years (including non-consolidated results), and overall, the profitability of assets continues to improve.

Simplified balance sheet

	(¥mn)					
	End of FY3/15	End of FY3/16	End of FY3/17	End of FY3/18	End of FY3/19	Change
<b>Current assets</b>	2,614	2,019	2,063	2,288	2,355	66
Cash and deposits	1,578	1,007	1,098	972	1,064	92
Notes and accounts receivable - trade	516	524	493	863	742	-120
Inventory assets	45	64	24	35	56	21
<b>Non-current assets</b>	438	435	375	834	839	5
Property, plant and equipment	121	108	93	131	148	17
Intangible assets	76	87	63	381	353	-28
Investments and other assets	240	239	218	321	337	16
<b>Total assets</b>	3,052	2,455	2,439	3,123	3,194	71
<b>Current liabilities</b>	2,219	1,676	1,752	2,312	1,314	-998
Accounts payable - trade	388	106	315	252	243	-8
Short-term borrowings	1,107	928	750	1,177	137	-1,039
<b>Non-current liabilities</b>	109	78	49	48	439	391
Long-term borrowings	-	-	-	-	386	386
Lease obligations	98	67	35	9	11	2
<b>Total liabilities</b>	2,329	1,755	1,802	2,361	1,753	-607
Interest-bearing debt	1,107	928	750	1,177	524	-653
<b>Total net assets</b>	723	699	637	762	1,441	678

Note: Results are non-consolidated up to FY3/17 and consolidated from FY3/18 onwards  
 Source: Prepared by FISCO from the Company's financial results and securities report



Note: Results are non-consolidated up to FY3/17 and consolidated from FY3/18 onwards  
 Source: Prepared by FISCO from the Company's securities report

Results trends

At the end of FY3/19, cash and cash equivalents were ¥569mn. Looking at each of the cash flow conditions, cash flow provided by operating activities was ¥374mn, mainly due to net income before taxes of ¥279mn, while cash flow used in investing activities was ¥55mn, which is a return to the natural situation from the temporary increase in expenditure seen in the previous fiscal year due to the M&A. Conversely, cash flow used in financial activities was ¥218mn overall, this was due to net decrease in short-term borrowings of ¥1,177mn which was partially offset by revenue from the exercise of share acquisition rights of ¥468mn.

**Simplified cash flow statement**

	(¥mn)				
	FY3/15	FY3/16	FY3/17	FY3/18	FY3/19
Net cash provided by (used in) operating activities (a)	150	-223	291	-55	374
Net cash provided by (used in) investing activities (b)	-49	-4	-0	-440	-55
Net cash provided by (used in) financing activities	146	-231	-219	391	-218
Free cash flow (a) + (b)	100	-228	291	-495	318
Cash and cash equivalents at end of period	934	445	535	462	569

Note: Results are non-consolidated up to FY3/17 and consolidated from FY3/18 onwards  
 Source: Prepared by FISCO from the Company's financial results

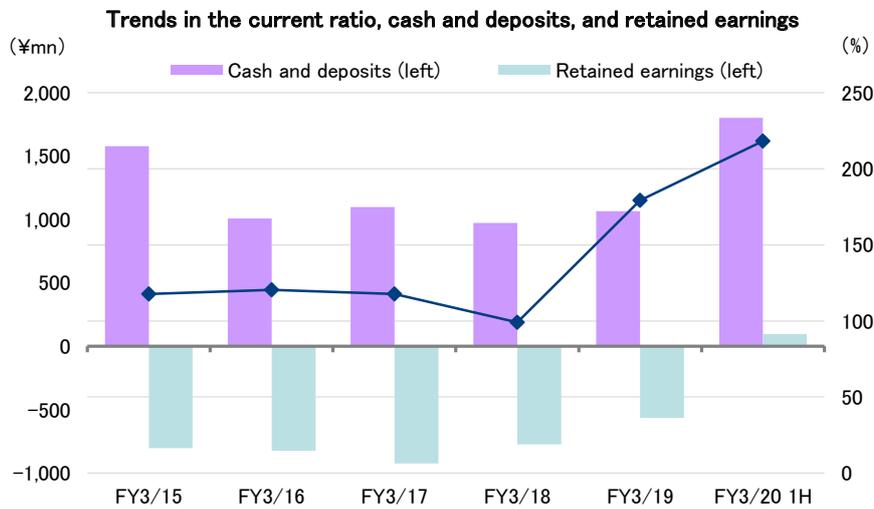
**2. Achieved higher sales and profits in actual terms in FY3/20 1H**

In the FY3/20 1H consolidated results, net sales increased 18.4% YoY to ¥1,839mn, operating income rose 8.8% to ¥61mn, and ordinary income grew 65.2% to ¥72mn. Net income attributable to owners of parent decreased 37.3% to ¥43mn. This was due to the absence of gain on sales of investment securities recorded in the same period in the previous fiscal year, and when excluding the effects of this, we can see that in actual terms, sales and profits increased.

The rates of progress toward achieving the initial Company forecasts are 44.5% for net sales, 21.9% for operating income, 28.0% for ordinary income, and 24.0% for net income attributable to owners of parent. Looking at the rates of progress in FY3/19 1H for the full fiscal year forecasts, they were 42.5% for net sales, 23.1% for operating income, 19.2% for ordinary income, and 33.3% for net income attributable to owners of parent. We see that results tend to be concentrated in the 2H considering its business characteristics, so the current 1H results can be thought to be basically in line with the forecasts.

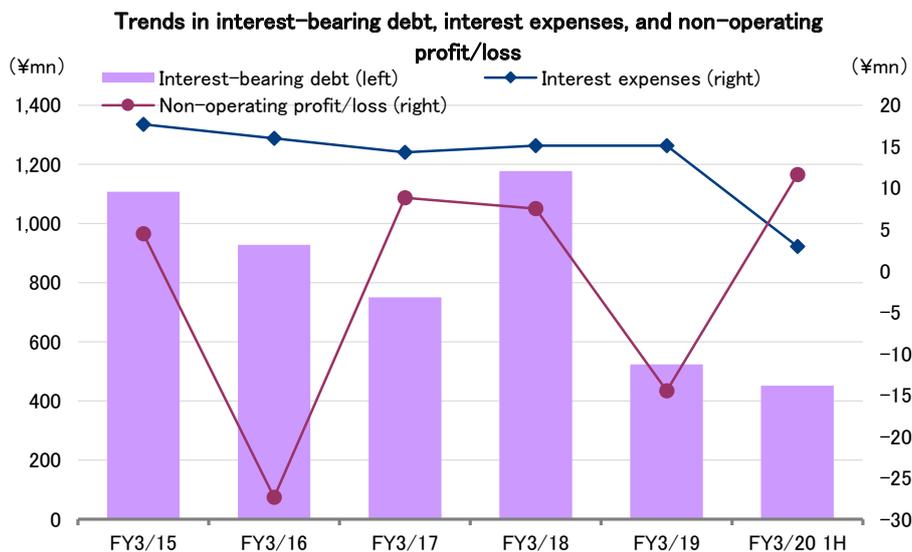
What is noteworthy about the 1H results is the improved soundness of the financial structure. Looking at the indicators of financial stability at the end of the 1H, equity ratio had further risen from 45.0% at the end of the previous fiscal period to 55.1%, while the current ratio was also above 200%, at 224.2%, indicating a sufficient level of solvency. Breaking down current assets, cash and deposits were ¥1,800mn, which constitutes 60.2% of the total. Also, shareholders' equity has risen as high as ¥2,096mn and retained earnings, which are the source of dividend payments, were ¥95mn shifting from a negative level (¥565mn) to a positive due mainly to a transfer from capital surplus. The Company has thus already secured a sufficient source of funds at the end of FY3/20 1H for the planned period-end dividend payments of ¥81mn at ¥5 per share.

Results trends



Note: Results are non-consolidated up to FY3/17 and consolidated from FY3/18 onwards  
 Source: Prepared by FISCO from the Company's securities report

Also, the greater soundness of the financial structure has led to an improvement in non-operating profit/loss. In the case of the Company, which handles imported goods as its mainstay products, the impact of foreign exchange profit/loss on non-operating revenue cannot be completely eliminated. But in FY3/20 1H, the effects of reducing the interest-bearing debt became apparent (interest expenses decreased by 66.2% YoY), which played a role in improving the non-operating profit/loss.



Note: Results are non-consolidated up to FY3/17 and consolidated from FY3/18 onwards  
 Source: Prepared by FISCO from the Company's securities report

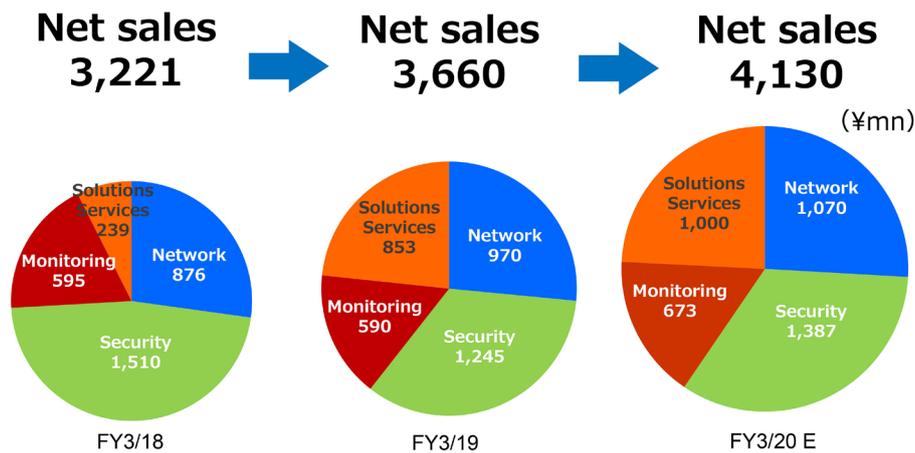
## ■ Outlook

### The business environment is favorable, and the Company is first aiming for ¥5bn in net sales by resuming the M&A strategy

#### 1. In FY3/20, expects to resume dividend payments based on organic growth

For the FY3/20 consolidated results, based on the continuing favorable business environment, the Company has left unchanged its initial forecasts that it announced on May 10, 2019, with net sales to increase 12.8% YoY to ¥4,130mn, operating income to rise 14.7% to ¥280mn, ordinary income to grow 13.2% to ¥260mn, and net income attributable to owners of parent to decrease 13.2% to ¥180mn. However, for the dividend policy, on May 30, 2019, it announced that it was “targeting a dividend payout ratio of 50% or above” and that it plans to pay a period-end dividend per share of ¥5. The Company also expects total sales by business section to increase.

Outlook for net sales by business section in FY3/20

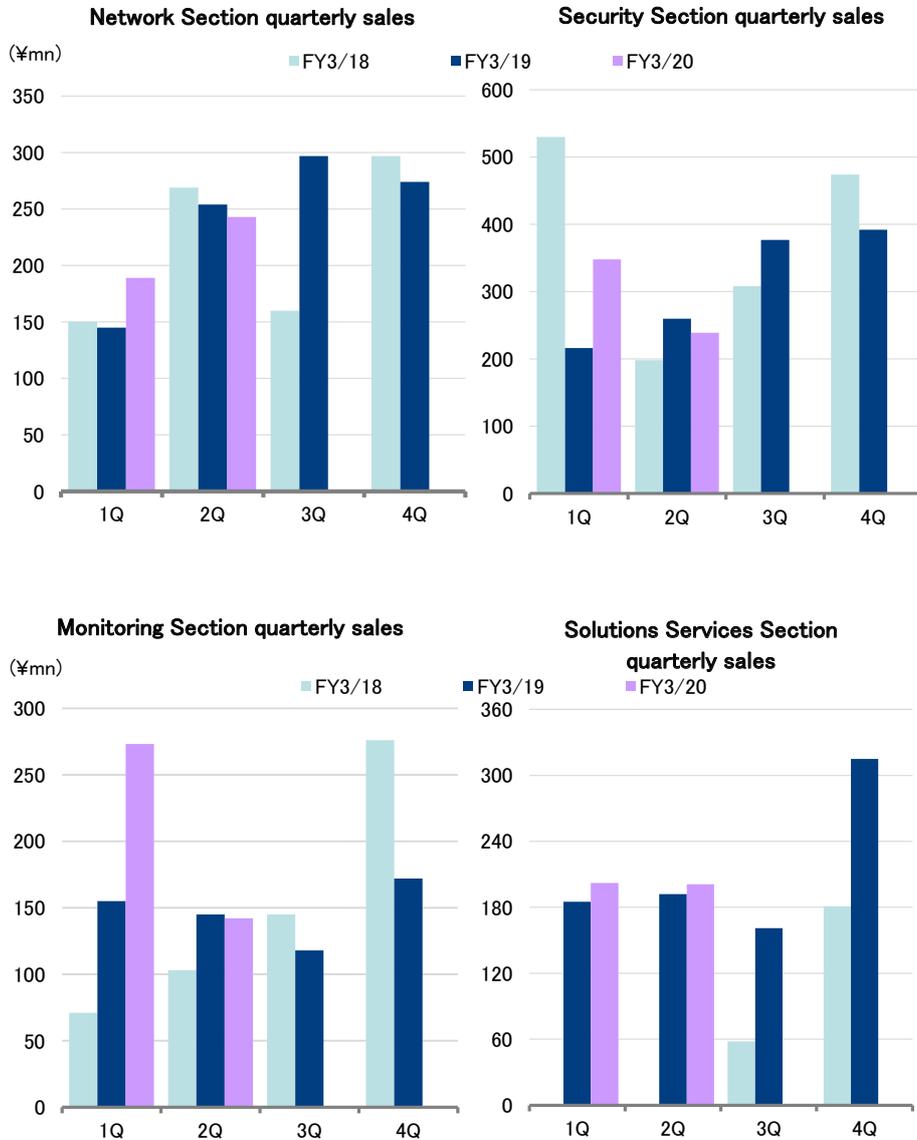


Source: The Company materials

Looking at the FY3/20 1H results and the ordering trends in each section at the present time, we think it is highly likely that sales and profit will increase. Also, steady progress is being made not only for recurring-type revenue, but also in improving the balance sheet, so it seems likely that the Company will pay a period-end dividend of ¥5 as planned. Conversely, for the question of whether all four of the business sections can achieve higher sales, it will be necessary to pay attention to the 4Q results, as this quarter provides a high percentage of annual sales in each section.

Outlook

Trends in quarterly net sales by business section



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

Outlook

2. The Security Section is benefiting in advance of the mega event in 2020

The business environment continues to be favorable at the present time. First, in the Network Section, there is an abundance of demand relating to the establishment of next-generation network infrastructure, and ordering activities on the whole are trending strongly, particularly from the major manufacturing industries in Japan, which are the main customers. In the Monitoring Section as well, ordering activities are trending steadily for the Company's highly profitable proprietary services, and it can be highly evaluated on the points that its own products and services, of "momentum" and "CloudTriage," are starting to demonstrate a value mix with the products of other companies. The former are the firewalls manufactured by Palo Alto Networks, Inc. <PANW> in the US, which have globally excellent reputations, and the malware countermeasures manufactured by Lastline, Inc. of the US, while for the latter, it is realizing collaborations with the Wi-Fi solutions of Aerohive Network of the US, which are attracting attention as next-generation wireless LAN, and this is playing a role in strengthening sales and expanding the market.

In the Security Section, threats such as cyberattacks and unauthorized access have become increasing familiar to many companies, and in this situation, market interest in cybersecurity is further increasing. In addition, in advance of the Tokyo 2020 Olympic and Paralympic Games, services to collect and analyze malicious information such as that exchanged between cybercrime groups and to provide intelligence on cyberthreats to contracting companies, are attracting more and more attention. Also, in workplaces and buildings that are advancing the utilization of IoT, cybersecurity measures have become a pressing issue. It can be said that the favorable market conditions are becoming increasing apparent for the Company, which has a full lineup of security services, including KELA's threat monitoring solutions that have a track record in preventing terrorism at the 2012 London Olympics and Paralympic Games, cyber-defense products that protect the safety of companies' inter-site communication (manufactured by Tempered Networks), and Industrial Control Systems (ICS) manufactured by Nozomi Networks to quickly detect cyberthreats and abnormal processes in industrial control systems, such as in societal infrastructure and plants.



Source: The Company's results briefing materials

Outlook

**3. Solutions Services Section is expected to build a new customer base**

In the Solutions Services Section, due to the ongoing rise in the number of foreigners visiting Japan, there continue to be opportunities to increase introductions of the multi-lingual, real-time video interpretation service (Mieru-Tsuyaku). "Mieru-Tsuyaku" is a video interpretation service that is usable anytime, anywhere, and with one touch, by using a tablet or smartphone, with a call operator providing support such as for customer service. It provides an interpretation service for English, Chinese, Korean, Thai, Russian, Portuguese, Spanish, Vietnamese, French, Tagalog, and Japanese sign language for a flat rate (¥15,000 per month in the light plan, usable from 10am to 9pm, and ¥25,000 per month in the standard plan, usable 24 hours a day). Moreover, the Company has also prepared medical interpreting options (Only in English, Chinese, and Korean, ¥35,000 per month) in order to respond to demand arising from medical tourism, which is increasingly attracting attention as Chinese tourists' shopping sprees begin to wane. Introduced companies include Aeon Co., Ltd. <8267>, H.I.S. Co., Ltd. <9603>, HINKA RINKA, West Nippon Expressway Company Limited, Nishi - Nippon Railroad Co., Ltd. <9031>, Nojima Corporation, AOYAMA TRADING Co., Ltd. <8219>, AOKI Holdings Inc. <8214>, Victoria Inc., Zoff Co., Ltd., Tokyo International Air Terminal Corporation, and SEIBU RAILWAY Co., Ltd., DESCENTE LTD.<8114>, and steadily spreading mainly among leading companies.

The Company is working to expand its customer base as the solution service provider supporting "proactive marketing" for inbound-related demand with the growth of "Mieru-Tsuyaku" in advance of the mega event in 2020, in May 2019 the Company started provided it as a package service with "arrows hello AT01," which is a multi-interpretation device manufactured by FUJITSU LIMITED <6702>.

For "EzAvater" also, which is an extremely simple RPA tool, the previously mentioned Golden Partner system is expected to have the effect of increasing sales. For remote-conference services as well, the Company is strengthening its service lineup of new products and responding to the increase in demand relating to supporting work-style reforms through improving productivity and increasing work efficiency.

**Solutions services supporting "proactive marketing" for inbound-related demand**

**Multi-language translator device 「arrows hello AT01」**

- Instant translation with one touch from sleep
- Visual and easy-to-understand language selection
- Supports 3 languages offline (Japanese / English / Chinese) and 28 languages online (Wi-Fi)
- Text translation is possible by holding the camera (21 languages)
- Capturing and translating characters such as product packages and menus

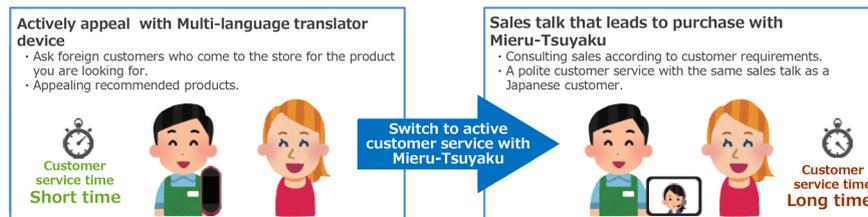


**Multi-lingual Real-Time Video Interpreter "Mieru-Tsuyaku" for tablets and smartphones**



Compatible with 10 foreign languages and Japanese sign language interpretation

■ From defense to "Attending customer service"



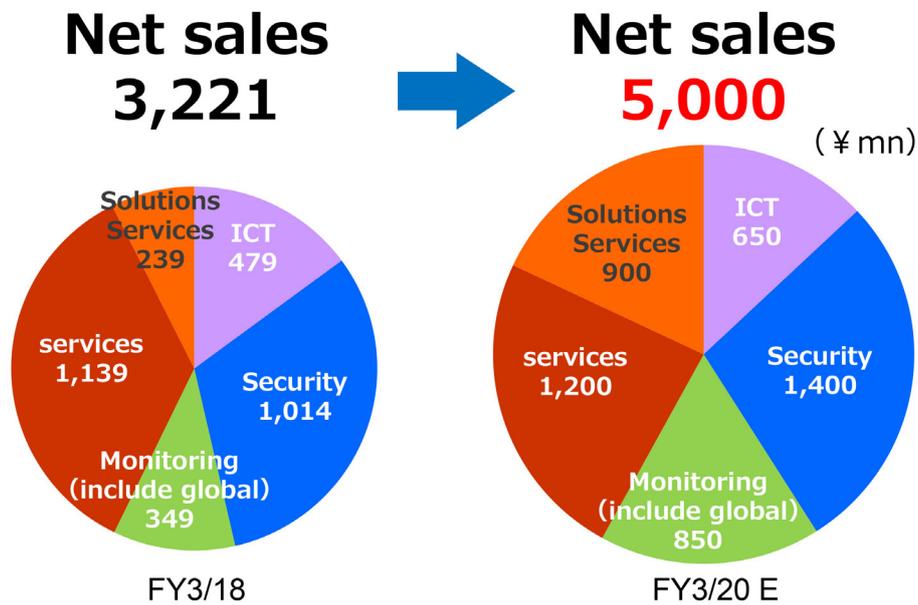
Source: The Company's results briefing materials

Outlook

4. Expected to announce a new medium-term management plan with an M&A strategy added to the organic growth

In May 2018, the Company announced a medium-term management plan themed “Toward Terilogy in Three Years’ Time.” In it, it sets the targets for the medium-term management plan’s final fiscal year of FY3/20; net sales ¥5bn and resuming dividend payments. This would be achieved through the growth strategy, whose main pillars are 1) business expansion through M&A and alliances, 2) providing product and services installed with the latest technologies 3) a value mix with the products of other companies, with its own products as the core products, and 4) taking on the challenge of conducting an inbound-demand business and implementing measures to contribute to society.

Numerical targets in the medium-term management plan (before the review of the business sections)



Source: The Company's results briefing materials

The net sales target of ¥5bn ultimately includes business expansion from M&A and alliances, and on looking only at the part from organic growth, the current situation is that it is implementing a growth strategy basically as planned and clearly has in sight higher sales and profits and resuming dividend payments in FY3/20. Therefore, it is considered that the Company should be positively evaluated to a certain extent. Also, on looking at the improvements made in its financial structure and considerable amount of current assets secured, for the M&A and alliances as well, it seems it is steadily working below the surface to finetune the strategy.

On December 2, 2019, the Company issued a press release titled “Measures on activities in our company’s information disclosure and public-relations fields for shareholders and investors,” in which it clarified that it will “Implement measures for public relations and publicity activities toward improving medium- to long-term and sustainable enterprise value, while also aiming to maximize enterprise value.” So we think it is highly likely that it will announce a new medium-term management plan in the spring of 2020, which is the final year of the current medium-term management plan.

In the new medium-term management plan, we can expect the Company to present an equity story that combines a specific action plan to progress organic growth with an M&A financial strategy based on a highly convincing financial strategy.

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