COMPANY RESEARCH AND ANALYSIS REPORT

Terilogy Co., Ltd.

3356

TSE JASDAQ Standard

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FISCO Ltd. Analyst
Masanobu Mizuta

FISCO Ltd.
https://www.fisco.co.jp

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Summary

An IT solutions provider established in 1989, approaching the stage where its strengths lead to improved profitability.

1. An IT solutions provider established in 1989

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. Currently under the umbrella of the Terilogy Group are 4 consolidated subsidiaries (including a subsidiary's subsidiary) and 1 non-equity-method affiliate.

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, inbound demand, the new way of life under the novel coronavirus (COVID-19) pandemic, DX (Digital Transformation), and the SDGs 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 reflect them with the corporate IP network business.

2. Developing business activities to meet customer needs through a four-section structure

The Company is currently developing business activities in four sections: the Network Section, Security Section, Monitoring Section, and Solutions Services Section. Its features include providing a large number of products and services to meet customer demands and a maintenance system operating 24 hours a day, 365 days a year; and an excellent distribution function that combines direct and indirect sales.

3. Core competencies include the ability find "emerging technologies and marketable products" and to "respond to the market"

The Company's business model shows the ingenuity it employs in putting its corporate philosophy of "focus on the customer" into practice in its business. That, in short, is the creation of a business value chain centered around processes designed to respond to the needs of the customer (technology, product research and discovery, etc.), and processes aimed at ensuring full customer satisfaction (offering solutions combining multiple products, having a maintenance structure in place, etc.).

The Company considers its own strengths to be 1) its ability to find "emerging technologies" and "marketable products" and its "ability to respond to the market," 2) wide selection of customer solutions, 3) diverse service provision approaches, 4) technical capabilities rooted in experience, and 5) global response capabilities. In particular, its competence in "finding emerging technologies and marketable products" and its "ability to respond to the market" is leveraged in processes throughout the value chain, and is the core competence that serves as the base for all of its strengths.

4. Strong results in 1H of FY3/22

In the FY3/22 consolidated results for the cumulative first half ("1H"), net sales increased 21.0% YoY to ¥2,349mn, operating income grew 5.2% to ¥178mn, and ordinary income fell by 2.0% to ¥174mn. The operating income margin was lower by 1.2 pp YoY at 7.6%, while orders received during the period increased 34.5% to ¥2,710mn and outstanding orders at the end of the period rose by 277.4% versus the end of the previous period to ¥1,416mn. Starting this fiscal year, the Company has begun applying the revised Accounting Standard for Revenue Recognition and the Implementation Guidance on revised Accounting Standard for Revenue Recognition, making a straight year-on-year comparison impossible, but its financial results appear to be strong.

The Company is also maintaining a sound financial structure. At the end of 1H of FY3/22, the equity ratio had declined to 41.4% (46.6% at the end of the previous period) and the current ratio to 150.1% (169.9%). Also, the D/E ratio (interest - bearing debt / shareholders' equity) was 0.14 times (0.13 times) and net cash (cash and deposits - interest-bearing debt) was ¥1,952mn (¥2,070mn), so it maintained the levels from the end of the previous fiscal year. On a stand-alone basis, retained earnings, from which the Company normally funds dividend payments, were ¥301mn (¥502mn), so it has secured sufficient capacity to fund dividend payments.

5. The Company's FY3/22 results forecasts are conservative; expectations are on announcement of rolling forecast of numerical targets in the new medium-term management plan

Based on its results in 1H of FY3/22, the Company has revised upward its forecast for F3/22 full-year consolidated results. The outlook for net sales remains unchanged at ¥5,200mn (up 10.6% YoY), while operating income has been revised upward from ¥170mn (-68.5%) to ¥250mn (-53.7%). The Company's forecast of a 2.5% operating income margin would seem too conservative compared to the value the Company is actually capable of (around 7%), even given that its adoption of the revised Accounting Standard for Revenue Recognition is expected to have a strong impact in 2H. It plans to once again pay a period-end dividend per share of ¥5.

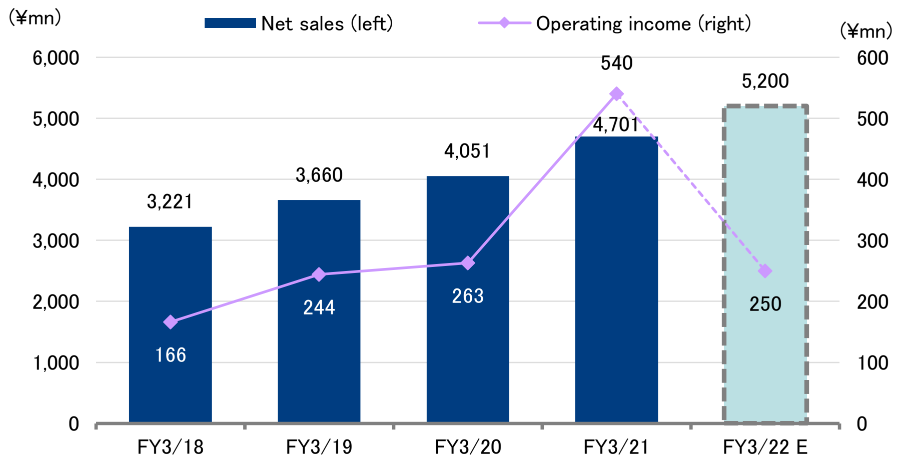
The Company has stated that it will "implement measures for public relations and publicity activities aimed at improving medium- to long-term and sustainable corporate value, while also aiming to maximize corporate value." In May 2021 as one part of these efforts, it announced its new three-year medium-term management plan.

For FY3/22, the plan's first fiscal year, the new medium-term management plan incorporates "numerical targets for organic growth," "the basic strategy and priority measures to achieve the targets" and "the basic approach for implementing the M&A and business alliance strategy." More specifically, it shows the path toward achieving net sales of ¥10bn, which is worthy of praise. We also look forward to the announcement of rolling forecast of numerical targets, given that the results for FY3/22, the first year of the new medium-term management plan, are on an upward trend.

Key Points

- An IT solutions company that has accumulated a track record in the 30 years since its foundation. The Company, which forms a corporate group with four consolidated subsidiaries (including second-generation subsidiaries) and one affiliated company not counted for using the equity method as its affiliates, is currently conducting business activities.
- From the Company's corporate history, 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. The Company is currently developing its business activities in four sections: the Network Section, Security Section, Monitoring Section, and the Solutions Services Section.
- The Company has built a business model backed by its corporate philosophy of "focus on the customer." The strength of its core competence in "finding emerging technologies and marketable products" and its "ability to respond to the market" has become evident in its business performance as well.
- 1H of FY3/22results were steady; the Company's has issued a conservative forecast for FY3/22 full-year results.
- The new medium-term management plan announced in May 2021 shows the path to achieving net sales of ¥10bn

Results trend



Note: From FY3/22, adopted the "revised Accounting Standard for Revenue Recognition"
Source: Prepared by FISCO from the Company's securities report and financial results

Company profile

An IT solutions provider established in 1989. As it pursues its corporate philosophy of "focus on the customer" it has expanded its areas of business.

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

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 Standard).

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, inbound demand, the new way of life under COVID-19 and SDGs under its new slogan "No. 1 in Quality."

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 reflect 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 an internet society.

* Listed companies noted in this report are presented in the format "company name + <securities code>" on first mention, and then presented without the securities code on second and subsequent mention. Unlisted companies are presented on first mention with the company name followed by denotation as to the type of business entity, and then presented without the business entity denotation on second and subsequent mention.
However, securities codes and business entity type are noted on first mention only in tables depicting company history, etc.

Company history

July 1989	Terilogy Co., Ltd. established in Kanda, Chiyoda-ku, Tokyo. Enterprise networks business launched.
Apr. 1991	Maintenance outsourcing contract signed with Toshiba Engineering Corporation (now Toshiba IT-Services Corporation) and maintenance service business launched.
May 1996	Outsourcing contract signed with Tokyo NTT Data Communication Systems Corporation (now NTT Data Business Systems Corporation) and customer solutions business launched.
Nov. 1999	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.
Jan. 2003	DNS/DHCP servers distribution contract signed with Infoblox Inc. <BLOX> of the US.
Oct. 2004	Domestic (Japan) master reseller contract signed with American company TippingPoint Inc. (now Trend Micro Inc. <4704>).
Dec. 2004	Listed on the JASDAQ Securities Exchange.
Sep. 2005	Certified under ISO 27001 information security management system (ISMS) standards.
Nov. 2005	Basic agreement on business collaboration signed with UNIADEX, Ltd. based on a capital tie-up agreement.
Dec. 2006	Domestic (Japan) master reseller contract signed with American company NETSCOUT Systems, Inc.
Feb. 2007	Distribution contract signed with Belgian company VASCO Data Security, Inc. (now OneSpan Inc. <OSPN>).
Mar. 2007	Certified under ISO 14001 environmental management system (EMS) standards.
Oct. 2008	Distribution contract signed with Singaporean company eG Innovations Pte Ltd.
Apr. 2010	Following merger of JASDAQ Securities Exchange and Osaka Securities Exchange, Terilogy listed on Osaka Securities Exchange JASDAQ (currently called the Osaka Exchange).
Aug. 2010	Domestic (Japan) reseller contract signed with American company APCON, Inc.
Feb. 2011	Asia-Pacific distribution contract signed with American company SevOne, Inc.
June 2012	Sales begun of momentum, a unique probe software product developed in-house at Terilogy.
Sep. 2012	Distribution contract signed with Lastline Inc. of the US (now VMware, Inc. <VMW>).
July 2013	Following merger of Osaka Securities Exchange and Tokyo Stock Exchange, Terilogy listed on TSE JASDAQ Standard.
July 2013	Fullflex ZG master reseller contract signed with Accense Technology, Inc.
July 2015	Sales begun of CloudTriage, a unique, cloud-based operations monitoring service by Terilogy.
Dec. 2015	Distribution contract signed with American company RedSeal, Inc.
Apr. 2016	Distribution contract signed with Taiwanese system integration company SYSCOM.
Oct. 2016	Exclusive domestic reseller contract signed with American company Tempered Networks, Inc.
Nov. 2016	Distribution contract signed with Israeli company KELA.
Jan. 2017	Basic agreement on business collaboration signed with NCXX Group Inc. <6634> based on a capital tie-up agreement.
Jan. 2017	Basic agreement on joint marketing for security products signed with FISCO Ltd. <3807>.
Jan. 2017	Basic agreement on business collaboration in the area of transaction security with Fisco Cryptocurrency Exchange Inc.
Jan. 2017	Basic agreement on business collaboration in the area of joint product development for blockchain technology applications signed with SJI Ltd. (now CAICA Inc. <2315>).
Mar. 2017	Wholly owned subsidiary Terilogy Worx Corporation established.
Dec. 2017	Shares required for ICT business corporation establishment acquired by ITX Corporation, and wholly owned consolidated subsidiary Terilogy Serviceware Corporation established.
Apr. 2018	Distribution contract signed with American company Nozomi Networks Inc.
July 2018	Sales begun of EzAvater, Terilogy's unique, ultra-simple robotic process automation (RPA) tool.
Jan. 2019	Business tie-up agreement signed with Israeli company Harel-Hertz Investment House Ltd.
May 2019	Launched security risk assessment services for industrial control systems involving critical infrastructure, factory, and building management jointly with BroadBand Security, Inc. <4398>.
June 2019	Business tie-up with American company Sumo Logic, Inc.
July 2019	Consolidated subsidiary Terilogy Worx Corporation concluded distribution contract with American company BitSight Technologies, Inc.
Aug. 2019	Distribution contract concluded with Israeli company TechSee Augmented Vision Ltd.
June–Sept. 2019	Distribution contracts for Company-developed RPA tool EzAvater concluded with Panasonic Solution Technologies Co., Ltd., Resona Gate Co., Ltd., Yamazakibuneidou, Inc., Nextage Co., Ltd., islenet Inc., and UCHIDA ESCO Co., Ltd. <4699>.
Feb. 2020	Distribution contracts for Company-developed RPA tool EzAvater concluded with Hitachi Systems, Ltd.
Mar. 2020	Consolidated subsidiary Terilogy Serviceware Corporation concluded a business tie-up with Towa Engineering Corporation.
Mar. 2020	Distributor contract concluded with Israeli company Radware Ltd. <RDWR>.
Apr. 2020	Established joint venture with Vietnam Cyberspace Security Technology JSC, a subsidiary of Vietnamese telecom provider Hanoi Telecom, based on a strategic business tie-up.
May 2020	Consolidated subsidiary Terilogy Serviceware Corporation acquired shares of IGLOOO Inc., making it a subsidiary.
June 2020	Distributor contract for Company-developed RPA tool EzAvater concluded with Computer Engineering & Consulting Ltd. <9692>.
Nov. 2020	The Company and VNCS Global Solution Technology Joint Stock Company signed a memorandum of understanding with BroadBand Security regarding business development in Vietnam related to PCI DSS international security standards.

Nov. 2020	Consolidated subsidiary IGLOOO formed a business alliance with unbot inc., a digital marketing business serving China, whereby IGLOOO acts as an exclusive partner for promoting European, US, and Australian tourism in the Chinese market.
Nov. 2020	CAICA Technologies Inc. launched sales of the Company-developed EzAvater RPA tool.
Dec. 2020	RICOH JAPAN Corp. and NIPPON TELEGRAPH AND TELEPHONE EAST CORPORATION began handling Mieru-Tsuyaku, a multilingual video communication interpretation service of consolidated subsidiary Terilogy Serviceware Corporation.
Mar. 2021	Acquired certification as a DX certified business Acquired the shares of CRESEED Corp. and made it a subsidiary
Apr. 2021	Consolidated subsidiary Terilogy Worx concluded a distribution contract with GitGuardian of France
May. 2021	Concluded a distribution contract with Pebble Corporation for EzAvater, an in-house developed RPA tool
June 2021	Consolidated subsidiary IGLOOO formed a business alliance with ADARA, a U.S. company with over 1.7 billion digital IDs worldwide, to strengthen digital marketing support in the field of inbound tourism in Japan. Consolidated subsidiary Terilogy Worx signed a distribution contract with Singaporean company Uppsala Security, a provider of risk management solutions for crypto-asset AML and cyber-attacks. Signed a distribution contact with Focus Systems Corporation for ThreatSonar, from Taiwan’s TeamT5, a product handled by consolidated subsidiary Terilogy Worx.
July 2021	A Company engineer won the Grand Prize in the Network Division at the TREND MICRO Partner Engineer Award 2020.
Sep. 2021	Signed a capital and business tie-up with CBA Inc., an environmental DX venture, and underwrote share options to be issued by CBA.
Oct. 2021	Consolidated subsidiary Terilogy Worx began offering in-house-developed cyber threat hunting solution. Signed a distribution contract with Collabos Corporation for TechSee, a visual support tool handled by the Company that enables DX for support operations.
Nov. 2021	Consolidated subsidiary Terilogy Worx signed a sales partnership contract with Information Development Co., Ltd. for its in-house-developed THX product cyber-threat hunting. Capital and business tie-up partner CBA began offering CBA-wellfest, an industrial waste treatment cloud service.
Dec. 2021	Consolidated subsidiary Terilogy Serviceware signed a business tie-up agreement with WELL ROOM Co., Ltd., operator of a multilingual healthcare service site, and began offering its multi-lingual service for medical institutions.

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

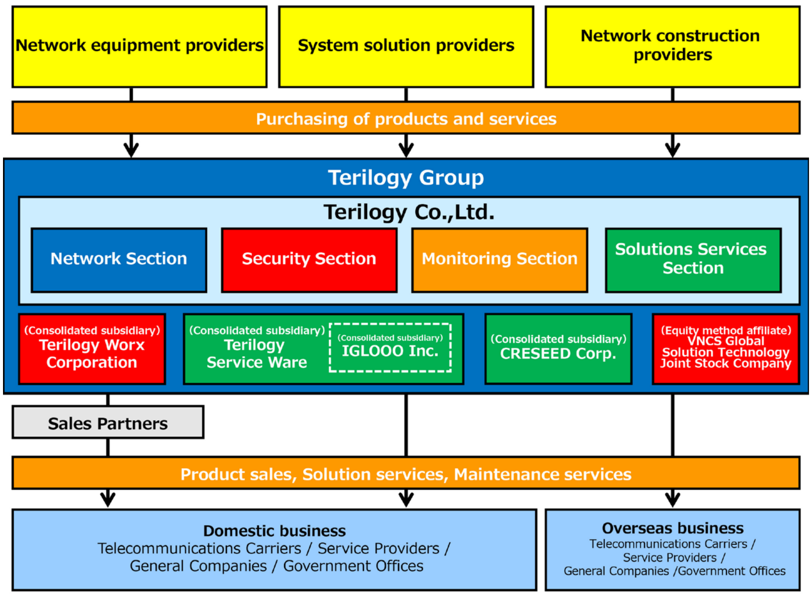
Business description

Engages in business in four sections: the Network Section, Security Section, Monitoring Section, and 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, Security Section, Monitoring Section, and Solutions Services Section.

Diagram of the business structure



Source: The Company materials

2. Network Section

In the Network Section in 1H of FY3/22, net sales were ¥708mn, which provided 30.1% of total net sales. The main products and services it handles are 1) network products (routers, switches, wireless LAN, and 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 and the accumulation of a strong track record over the 30 years since its foundation. In addition, it has a maintenance system operating 24 hours a day, 365 days a year to support the networks and other devices provided by this section.

Main products in the Network Section

radware

Network

Alteon ADC-vx

Up to a maximum of 28 virtual ADC (vADC) loaded on one dedicated ADC hardware unit. Able to consolidate and integrate multiple ADC

Infoblox CONTROL YOUR NETWORK

Network

Appliances

NonStop/distribution/ centralized management for identity-driven networks, such as DNS/DHCP/RUDIUS

Extreme networks

Network

Aerohive

Fully control-less, cloud-based next-generation WiFi solutions

Source: The Company's website

3. Security Section

In the Security Section in 1H of FY3/22, net sales were ¥752mn, which provided 32.0% of total net sales and solidifying it as 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 transactions (one-time password products). In addition, it has a maintenance system operating 24 hours a day, 365 days a year to support the security devices and software products provided by this section.

Main products in the Security Section

Security
Lastline
Protection from the latest threats in customers' public cloud environments (cloud infrastructure and cloud email) and in on-premises environments.

Security
Trend Micro TippingPoint
Has the leading track record for intrusion prevention systems as in-line type and network-type IPS appliances

Security
One Span (Former Vasco Data Security)
Secure user authentication that is more secure than fixed passwords by using a hard-software token to automatically generate a disposable, one-time password

Security
KERA
A consulting service that detects and collects information that threatens companies interacting with the Darknet, and then provides analysis results.

Security
Nozomi Networks
Provides asset management, real-time monitoring, abnormality detection, and vulnerability judgments for Industrial Control Systems (ICS)

Security
REDSEAL
Realizes proactive security by automatically generating an access map and attaching the results of a scan of the access map's vulnerabilities.

Security
Tempered Networks
Easily realize secure networks
– Secure Networking Made Simple –

Security
Cloud WAF Service
Provides the industry's best Web app security with a positive security model based on machine learning technologies.

Source: The Company's website

4. Monitoring Section

In the Monitoring Section in 1H of FY3/22, net sales were ¥161mn, which provided 6.9% of total net sales, and a feature of this section is the handling of Company-developed products. The main products and services it handles are 1) packet analysis using a Company-developed product (momentum), 2) monitoring services with cloud functions (CloudTriage), and 3) network operation, management, and monitoring devices. In addition, it has a maintenance system operating 24 hours a day, 365 days a year to support the Company-developed products (momentum); network operation, management, and monitoring devices; and software products provided by this section.

The Company's own brands include 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 uses a monthly billing model and forms part of the support business division. In momentum, data (packets) exchanged on a network are collected in a storage device, 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. Currently, it is working on developing new usage scenes, including network monitoring, security measures, and troubleshooting responses. 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.

Main products in the Monitoring Section

Source: The Company's website

5. Solutions Services Section

In the Solutions Services Section in 1H of FY3/22, net sales were ¥727mn, which provided 30.9% of total net sales. The section's main products and services encompass 1) a Company-developed software robotic process automation (RPA) tool (EzAvater), 2) a multilingual real-time video communication interpretation service (Mieru-Tsuyaku), 3) a cloud-based, managed VPN service (MORA VPN Zero-Con), 4) a corporate internet connection service (MORA Hikari), 5) a high-speed mobile data communication service (MORA Mobile), 6) web conference services (MVC and Zoom), 7) a visual contactless remote support service (TechSee) using artificial intelligence (AI) and augmented reality (AR), and 8) business involving pre-travel, on-travel, and post-travel services provided by second-tier subsidiary IGLOOO and 9) operational support and outsourcing business for information systems provided by consolidated subsidiary CRESEED Corp.

Main products in the Solutions Services Section

Source: The Company's website

"EzAvater" is an RPA tool which is gaining attention as a way to achieve workstyle reform and improve efficiency. Its features include that it is extremely easy (robots for everyone = intuitive operations to enable the creation of scenarios to automate routine tasks), it makes stoppages 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. In fact, EzAvater has accumulated many positive reviews on ITreview, which is Japan's largest review site managed by ITcrowd Corp. for reviews by real users of corporate IT products and cloud services, and in the ITreview Grid Award 2021 Winter, it received the High Performer award.

Also, for sales of EzAvater, the Company is actively utilizing a partner strategy (it has introduced a gold partner system) from the aim of wanting to penetrate a wide range of user groups. During 2019, it concluded distribution contracts with NCXX Solutions Inc., Panasonic Solution Technologies Co., Ltd., Resona Gate Co., Ltd., Yamazakibuneidou, Inc., Nextage Co., Ltd., and UCHIDA ESCO Co., Ltd. <4699>. Since 2020 also, it has concluded distribution contracts with Hitachi Systems, Ltd., Computer Engineering & Consulting Ltd. <9692>, and Pebble Corporation, and it is working to expand sales channels.

Mieru-Tsuyaku is a video communication interpretation service that is available anytime, anywhere with one touch using a tablet or smartphone with a call operator providing support, such as for customer service. It provides interpretation services in English, Chinese, Korean, Thai, Russian, Portuguese, Spanish, Vietnamese, French, Tagalog, Indonesian, Nepalese, Hindi, and Japanese sign language for a flat rate (¥15,000 per month for the light plan, available from 9am to 9pm, and ¥25,000 per month for the standard plan, available 24 hours a day). The Company also offers a medical interpreting option (only in English, Chinese, Korean, Portuguese, Spanish and Vietnamese ¥35,000 per month).

Mieru-Tsuyaku was originally launched as a service targeting inbound visitors, but during the COVID-19 pandemic it has evolved into a service that can be utilized to respond to the needs of foreign residents in healthcare and other areas, and for web conferences that require interpreting. As of November 2021, Mieru-Tsuyaku had been introduced at 30 group vaccination sites in Saitama Prefecture and elsewhere (a total of 92 clients); by 4 government agencies and local governments, including the Ministry of Agriculture, Forestry and Fisheries, Shinagawa City, Nakano City, Ikeda City (a total of 21 clients); by 3 medical facilities including Yokohama Municipal Citizen's Hospital (a total of 4 clients); and by others including the Takasaki Foundation (a total of 7 clients).

Mieru-Tsuyaku is offered by Terilogy Serviceware (TSW). TSW is a consolidated subsidiary whose trade name was changed from that of the former corporate ICT services business of ITX Corporation, which was acquired from Nojima <7419> Group in December 2017. With this M&A strategy, the Company is acquiring new business domains and a customer base of medium-sized and SME enterprises, as well as retail stores such as nationwide chain stores and wholesale stores, both of which it had few in the past (TSW now has in excess of 1,000 customers, including major corporations).

In May 2020, Terilogy Serviceware made IGLOOO, which conducts an inbound media business, into a subsidiary. IGLOOO is a company that provides pre-travel and post-travel services, of businesses to produce content and promote overseas travel, centered on the operation of VOYAPON, an online media for inbound travel for people in Europe, the US, and Australia. Up until now, the Company has been providing the multilingual real-time video communication interpretation service Mieru-Tsuyaku in the "during travel" domain for foreign tourists visiting Japan. IGLOOO's services are highly complementary and synergistic with those of the Company that have established positions as industry leaders. Even during the "with COVID-19" era, it seems certain that the national policy aimed at making Japan a popular destination will be restarted in some way, so the Company's contrarian decision to make an offensive move even during this difficult time is worthy of praise.

Since joining the Terilogy Group, IGLOOO has conducted the following initiatives: 1) joined forces with MIKI TOURIST CO., LTD., and ITP INC., to launch the International Travel Showcase Online Exhibit Support Package of services to assist those wishing to take part in online travel exhibitions, particularly in Europe, the US, and Australia (August 2020); 2) updated its VOYAPON inbound media service for Europe, the US, and Australia (August 2020); 3) launched its VOYAPON STORE, a cross-border e-commerce website featuring narratives from the perspectives of foreign nationals (September 2020); 4) entered into a business alliance with unbot Inc., which engages in digital marketing business geared toward China, as an exclusive partner to promote tourism to Europe, the US, and Australia for the Chinese market (November 2020); 5) launched the first cross-border e-commerce project for Europe, the US, and Australia in collaboration with Yomitan Village, Okinawa Prefecture (April 2021), and 6) created a PR video and implemented promotions for Yamanashi Prefecture, targeting the Middle East (May 2021). In such ways, in terms of the future, it is accelerating business promotion and developing its presence to play a role for the Solutions Services Section.

Features and Strengths

The company has built a business model backed by its corporate philosophy. Its competence in "finding emerging technologies and marketable products" and its "ability to respond to the market" are the primary reasons it is chosen by its customers and partners.

1. Building the business value chain needed to practice its corporate philosophy of "focus on the customer."

The Company's business model shows the ingenuity it employs in putting its corporate philosophy "to respond to the needs of our customers and ensure their full satisfaction" into practice as a business. That, in short, is the creation of a business value chain centered around processes designed to meet the needs of the customer (technology, product research and discovery, etc.), and processes aimed at ensuring full customer satisfaction (offering solutions combining multiple products, having a maintenance structure in place, etc.), as well as the use of a partnering strategy in each of the processes along the value chain.

The Company's value chain

Source: The Company's website

To build a business model and value chain backed by a corporate philosophy, a company first needs to establish a mission and vision based on that philosophy, and then incorporate those in an action plan designed to achieve them. On a stand-alone basis, the Company has established as its mission "to provide unique, valuable security technology in a digital society to ensure safety and security in every business situation," and as its vision, "to become a technology solutions organizer that offers and implements unique, optimal solutions to customer issues by combining technologies of value." It has incorporated these into an action plan in a form fitted to the processes of its business value chain.

Specifics of that action plan include ongoing research and discovery activities regarding advanced, cutting-edge technology trends in Silicon Valley and Israel; ongoing research, inquiry and validation activities to determine the compatibility of technology discovered with the Japanese market and with issues faced by customers; development of solutions for market introduction by combining multiple technologies and through adaptive development arrangements, building of delivery and support systems, training in high-value proposal sales, and new market creation activities. All of these are indeed aligned with the corporate philosophy to "respond to the needs of our customers and ensure their full satisfaction"

2. The Company's competence in "finding emerging technologies and marketable products" and its "ability to respond to the market" are the basis for all of its strengths

The Company considers its strengths to be 1) its competence in "finding emerging technologies and marketable products" and its "ability to respond to the market" 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 security and safety solutions for varying applications, encompassing everything from network infrastructure to communication endpoints; 3) flexible provision of diverse services and products supported by a product lineup covering everything from products utilizing leading-edge technologies through to maintenance services, software products developed in-house, and new services; 4) stable and proven technical capabilities rooted in experience since its founding through three decades of reliable, customer-tailored service provision; and 5) global response capabilities, including the rapidly growing markets of emerging nations in Asia. Each of these strengths is backed by a track record of results, but in particular, the Company's ability to find "emerging technologies" and "marketable products" and its "ability to respond to the market" would seem to be its core competence on which all of the other strengths are based.

3. Refining the ability to find “emerging technologies” and “marketable products” to fulfill customer needs

The Company’s ability to find “emerging technologies” and “marketable products” lies in “accurately ascertaining and incorporating the trends of the times into its business areas, finding the latest technologies of overseas venture companies and concluding distributor and other contracts,” and it has no shortage of experience in this regard. Here, in addition to Wellfleet and Infoblox, in the broadband field, we can also mention TippingPoint (it was acquired by Hewlett-Packard <HPQ> of the US in 2010 and acquired by Trend Micro <4704> in 2015), Belgian company OneSpan, and American company Lastline (which was acquired by VMware of the US in 2020),) as examples in the security field.

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 (telecommunications equipment for relaying two or more different networks), which are one of the main products to build IP networks. Although Wellfleet does not exist today, in 1998, the company was acquired by Nortel (Canada), the world’s second largest computer network device company at the time, to compete against Cisco Systems <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 fulfilling its responsibility as a supplier by handling 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 products, it realized growth for DNS/DHCP appliances manufactured by Infoblox <BLOX> of the US (devices to issue an IP address) and Company-developed solutions for monitoring networks have become its core products following the spread of smartphones. In 2003, the Company was the first in Japan to conclude a distribution contract with Infoblox, 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 has provided wide-ranging solutions by concluding a domestic (Japan) master reseller contract with TippingPoint of the US, when it was independent in 2004 followed by concluding reseller contracts with OneSpan <OSPN> (formerly VASCO Data Security of Belgium) in 2007, Lastline of the US in 2012 (which was acquired by VMware <VMW> of the US in 2020), RedSeal of the US in 2015, Tempered Networks of the US and KELA of Israel in 2016, and Nozomi Networks of the US in 2018 (exclusive domestic (Japan) reseller contract with Tempered Networks), which is enabling it to provide solutions over a wide range.

TippingPoint is a cybersecurity company specializing in IPS (intrusion prevention systems) that was acquired by Trend Micro in 2015 for approximately US$0.3bn. However, the Company concluded a domestic (Japan) master reseller contract with TippingPoint 16 years before its acquisition and has accumulated a track record, so it continues to be 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 in recent years (2014: 1,723 cases→2015: 3,828 cases→2016: 4,046 cases→2017: 6,027 cases→2018: 6,740 cases cases→2019: 5,301 cases→2020: 4,119 cases), 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."

4. An ability to "ability to respond to the market" well-regarded by business partners

So why do overseas venture companies select the Company as their partner in Japanese business? The reason is its high ability "ability to respond to the market," which has been fine-tuned since its foundation by implementing a management strategy that is supported by its corporate philosophy of prioritizing the needs and satisfaction of customers.

The sources of the Company's "ability to respond to the market" 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 maintenance (in which the Company itself identifies problems and then outsources the actual maintenance work) and sales (using both direct and indirect agency network sales), and it is efficiently building an excellent customer base (more than 300 companies on a standalone base, which are 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 has become the deciding factor for overseas venture companies in choosing the Company as their partner in Japan.

In March 2020, the Company signed a distributor agreement with Israeli company Radware <RDWR>, which is one of the global leaders in areas such as network virtualization and cybersecurity solutions and is a publicly listed company on the NASDAQ market in the US. A press release from Nihon Radware K.K. stated, "Terilogy has a track record of creating Japanese markets by providing numerous overseas cutting-edge technologies to the Japanese market. Terilogy has achieved stable operation and management of technologies and products that previously had no track record in the Japanese market, and has earned the trust of Japanese customers for many years. Radware expects synergies between the strong solution proposal and support capabilities provided by Terilogy and the technical capabilities that have allowed Radware to be regarded as an industry leader, and has decided to conclude a distributor contract this time, judging that Radware can provide integrated security solutions to Japanese corporate customers, including main products such as Cloud WAF Service, Bot Manager and Cloud Workload Protection." We can view this as proof that the Company's ability to find "emerging technologies" and "marketable products" and "to respond to the market" are viewed positively by overseas technology companies.

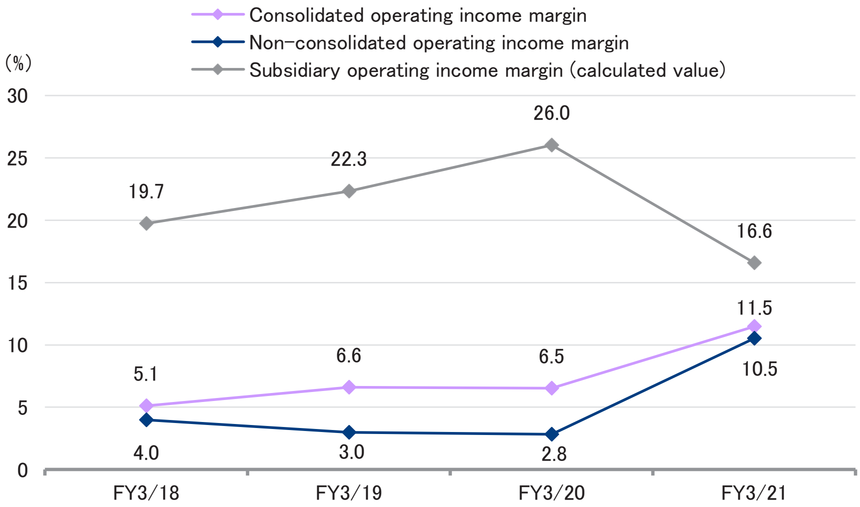
5. The Company's strengths are becoming evident in its business results as well

The Company can be highly evaluated for leveraging its ability to "find emerging technologies" and "respond to the market" while successfully strengthening its value chain through its partnering strategy and acquiring an outstanding customer base. That said, the Company's partnering strategy also involves incorporating trading company functions, which are generally less profitable, into the business model, and through FY3/17, the Company's operating income margin—a typical index of profitability that reflects the relative merits and demerits of corporate competitiveness—was flagging. Beginning in FY3/18, however, the Company's performance began to improve, and the strengths we have seen thus far seem to have become evident in its business results.

Looking at the change in the Company's operating income margin between FY3/18 and FY3/21, on a consolidated basis it went from 5.1%, to 6.6%, to 6.5%, to 11.5%; on a non-consolidated basis it went from 4.0%, to 3.0%, to 2.8%, to 10.5%; and as a total calculated value of subsidiaries, from 19.7%, to 22.3%, to 26.0%, to 16.6%. From this shift, we can see that, 1) the non-consolidated operating income margin, which had been flagging, has quickly jumped and has reached a level comparable to that of other companies in the industry; and 2) the operating income margin of the Company's group of subsidiaries, including those acquired through M&A, is not only higher than that of the Company on a stand-alone basis, but is also high in absolute terms.

The operating income margin for 1H of FY3/22 was 7.6%, lower than the previous year's level due to the application of revised Accounting Standard for Revenue Recognition revenue recognition standard and the impact of new consolidations resulting from M&As (making a company a subsidiary during the upfront investment phase is a factor in lowering the operating income margin). However, the decline on a non-consolidated basis seems to have been smaller than on a consolidated basis, and we will be watching future profitability trends with anticipation.

Change in operating income margin on a consolidated and non-consolidated basis



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

Results trends

The results in 1H of FY3/22 greatly exceeded the initial Company forecasts. The Company maintained its financial soundness while absorbing shareholder returns and the impact of M&A.

1. Steady results in 1H of FY3/22

In the consolidated results for 1H of FY3/22, net sales increase 21.0% YoY to ¥2,349mn, operating income grew 5.2% to ¥178mn, and ordinary income fell by 2.0% to ¥174mn. The operating income margin was lower by 1.2 pp YoY at 7.6%, while orders received during the period increased 34.5% to ¥2,710mn, while outstanding orders at the end of the period rose by 277.4% to ¥1,416mn. Starting this fiscal year, the Company has begun applying the revised Accounting Standard for Revenue Recognition and the Implementation Guidance on revised Accounting Standard for Revenue Recognition, making a straight year-on-year comparison impossible, but in 1H alone operating income surpassed the initial full-year forecast (¥170mn), and the Company's financial results appear to be strong.

The decline in operating income margin was primarily due to an increase in the cost of sales ratio associated with the new consolidation of IGLOOO and CRESEED, and there are no problems with profitability trends on an organic basis. Meanwhile, in terms of orders and sales, the significant YoY increase includes both the effect of new consolidations as well as the impact of application of the revised Accounting Standard for Revenue Recognition. Looking at the YoY change by quarter, in net sales in 1Q of FY3/22 declined 30.5% but increased by 19.3% in 2Q; orders received fell by 16.8% in 1Q but increased by 26.0% in 2Q; and outstanding orders increased by 12.1% in 1Q and by 19.7% in 2Q, putting all of these figures on a rising trend. The YoY declines in 1Q, which straddles the fiscal year end, are within the range of normal seasonality, and all of these figures are judged to be performing well.

Simplified income statement

(¥mn)

	FY3/17	FY3/18	FY3/19	FY3/20	FY3/21	FY3/22 1H
Net sales	2,434	3,221	3,660	4,051	4,701	2,349
YoY	-7.7%	-	13.6%	10.7%	16.1%	21.0%
Cost of sales	1,709	2,197	2,256	2,537	2,757	1,391
YoY	-9.6%	-	2.7%	12.5%	8.7%	24.0%
Gross profit	725	1,024	1,403	1,513	1,944	958
YoY	-3.0%	-	37.0%	7.8%	28.5%	17.0%
SG&A expenses	831	858	1,159	1,249	1,404	779
YoY	15.2%	-	35.0%	7.8%	12.4%	20.0%
Operating income	-105	166	244	263	540	178
YoY	-	-	47.0%	8.0%	104.7%	5.2%
Ordinary income	-97	173	229	288	543	174
YoY	-	-	32.3%	25.4%	88.5%	-2.0%
Net income	-99	154	207	214	437	81
YoY	-	-	34.6%	3.5%	103.9%	-30.5%

Note: Results are non-consolidated up to FY3/17, and from FY3/18 onwards, they are consolidated and include net income attributable to owners of parent., with the application of revised Accounting Standard for Revenue Recognition from 1H of FY3/22.
Source: Prepared by FISCO from the Company's securities report and financial results

Looking at net sales by business section in 1H of FY3/22, they increased 36.7% YoY in the Network Section, increased 9.0% in the Security Section, declined 53.2% in the Monitoring Section, and increased 87.7% in the Solutions Services Section. The net sales distribution ratio for subscription and maintenance services, which are impacted by the application of the revised Accounting Standard for Revenue Recognition, was 59.6% in the Network Section, 68.7% in the Security Section, 91.6% in the Monitoring Section, 24.1% in the Solutions Services Section, and 53.7% on a Company-wide basis.

The factors in the background to the strong performance of the Network Section include 1) DHCP/DNS appliances manufactured by Infoblox of the US (Infoblox IP address management servers) have entered a phase of replacement purchases, and within Japan, demand has continued, mainly from major domestic manufacturers, for replacement purchases for new models, which have increased added-value from the addition of security functions, from the current model, for which around 500 units have already been shipped; 2) that customer take-up of Radware products sold via sales partners since FY3/21 has been strong.

The main Radware products which the Company handles in this business are 1) DDoS-fighting equipment and services that autonomously protect against Dos/DDoS attacks, also known as "service stop attacks"; 2) Load Balancer (a product that distributes the load on a server allowing it to operate stably), which boasts a large track record in the Japanese market; 3) multihoming equipment, which is the de facto standard for line load balancing; 4) Cloud WAF Service that achieves the highest level of web application security in the industry; 5) Bot Manager that protects all channels, such as web applications, mobile applications, and API, from automated threats (bots); and 6) Cloud Workload Protection that comprehensively protects cloud assets. Products 2 and 3 are network related, while the rest are security related.

The Company became the primary distributor for Israeli company Radware in Japan following the conclusion of a distributor contract in March 2020, and it seems that the handover from the company that was previously in that position was smooth. Due to good customer acquisitions, it is highly probable that the Company will achieve annual sales of about ¥600mn (including maintenance contracts) within a few years. In addition, due to the fact that the previous primary distributor mainly handled network-related products, the Company (which can distinguish the products from existing products in the security-related field) is expected to develop the business scale even larger through cross-selling and up-selling. In actuality, for Radware-related orders, it achieved ¥217mn in orders received and ¥55 million in sales of maintenance service in FY3/21. Order activities are continuing to go well in 1H of FY3/22 as well.

The Security Section also performed well with an increase in the threat of cyber-attacks, as internet dependence in public life and economic activity rose with the hosting of the Tokyo Olympics and Paralympics and in the midst of the COVID-19 pandemic. Specific products delivering strong performance included, among others, 1) Nozomi Networks products designed to respond to a demand for security measures in critical infrastructure such as electric power systems and industrial control systems such as factory and building management, stimulated by the spread of OT and IoT; 2) Network intrusion prevention security and targeted attack countermeasure cloud services to combat threats such as cyber-attacks and unauthorized access, which are becoming more sophisticated and complex by the day; and 3) The KELA cyber threat intelligence service, which collects and analyzes information on cyber-crime and terrorism, etc., and BitSight, an automated cyber risk assessment service that visualizes supply chain risks. In addition, the Company has won an order from a government agency for a service that uses AI to analyze social media sites to identify hidden relationships and undercover accounts between criminal groups, and has successfully deployed a service to address software supply chain risks—the next theme the Company is working on—at a major telecommunications carrier.

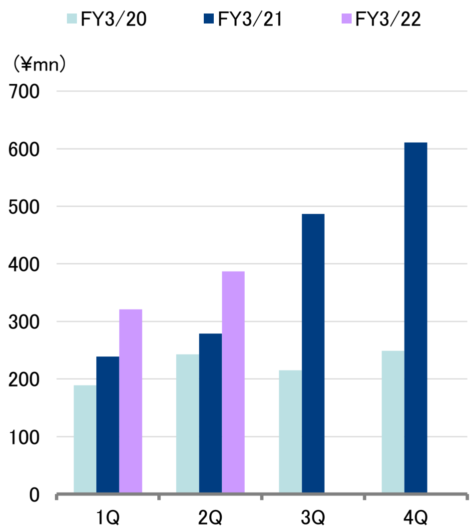
Sales declined significantly in the Monitoring Section. This was because, despite acquiring orders from electric power-related internet service providers and domestic financial institutions, large-scale projects for momentum, the packet capture product for government agencies, booked in the previous fiscal year, dissipated. As both momentum and the CloudTriage operation monitoring cloud service are proprietary products and are expected to be highly profitable, it will be interesting to see if the Company will be able to cultivate demand centered on its existing major customers.

In the Solutions Services Section, there was a significant impact from new consolidations on YoY sales growth. Comparing net sales in FY3/22 2Q with 1Q, there was a significant increase of 20.3%, confirming that organic growth is also steady. The features of Mieru-Tsuyaku—a multilingual, real-time, video communication interpretation service that includes sign language—the Section's mainstay product, have been well-received, and demand has expanded at vaccination sites and elsewhere as a means of communicating with foreign residents and the hearing impaired.

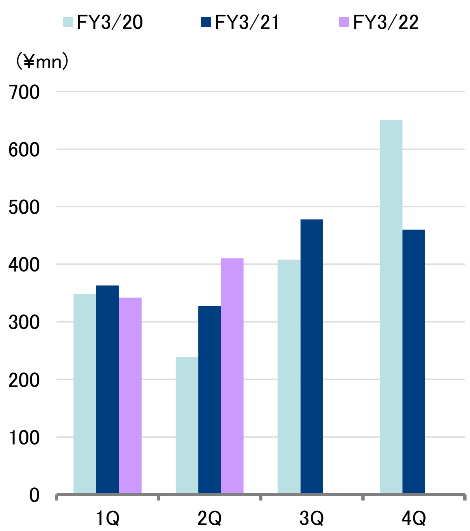
In addition to conventional license and webinar contracts, demand for ancillary products such as video and audio equipment also expanded as web conferencing services have become more commonplace during the COVID-19 pandemic. Due to its simplicity and affordability, the easy-connecting, cloud-based managed VPN service has also contributed, with inquiries from cloud-based PBX services and retail distribution including beauty salons, as well as from medium-sized companies and others. EzAvater, the Company's in-house developed RPA tool, is currently in the process of expanding its distributor network and focusing on marketing activities to raise brand recognition, while the sales activities of CRESEED, a newly consolidated subsidiary, are for the most part proceeding as planned.

Trends in quarterly net sales by business section

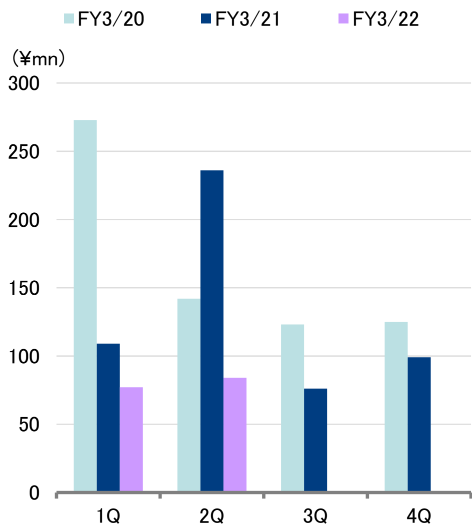
Network Section quarterly sales



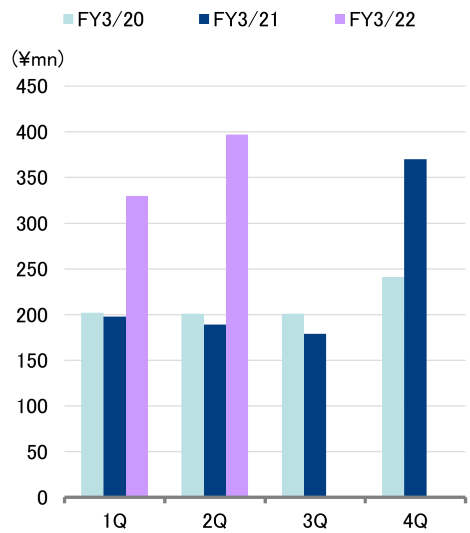
Security Section quarterly sales



Monitoring Section quarterly sales



Solutions Services Section quarterly sales

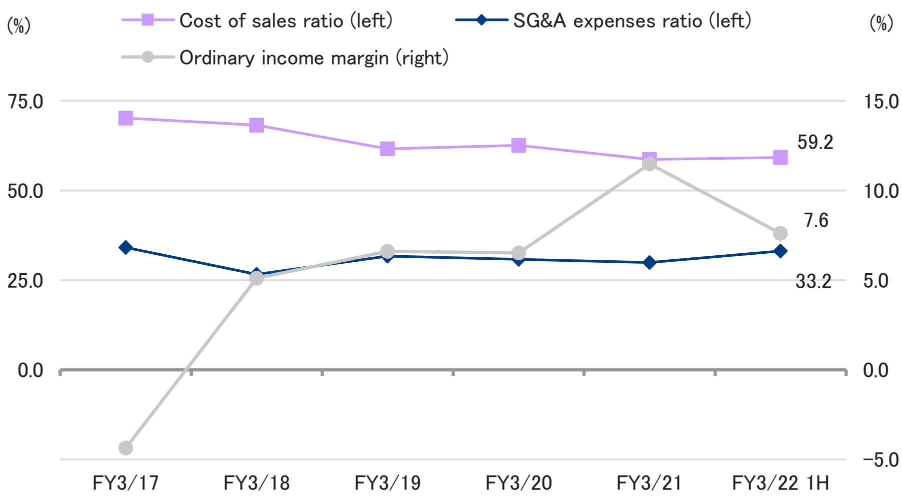


Source: Prepared by FISCO from the Company's securities report, quarterly securities report, and financial results

The cost of sales ratio in 1H of FY3/22 was 59.2%, a YoY increase of 1.4 pp, and a direct result of the new consolidation of IGLOOO and CRESEED.

Conversely, the SG&A expenses ratio in 1H of FY3/22 declined 0.2 pp YoY to 33.2%. While the increase in sales likely had a significant effect, it is commendable that the Company has absorbed the cost-cutting effects of the COVID-19 pandemic and its continued upfront investment in the hiring of new graduates and mid-career recruits. As a result, the operating income margin in 1H of FY3/22 was 7.6%, a decline of 1.2% pp YoY. However, looking at the trend during the period, it jumped from 3.4% in 1Q to 11.1% in 2Q, which is also higher than the 9.9% in FY3/21 2Q. To date, given the Company's business model—which involves low-margin hardware sales—we have assumed that the operating income ratio the Company is actually capable of is currently around 7%, but we will be keeping a close watch on future trends, keeping in mind that a further rise is possible.

Trends in the profit margin, 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 and financial results

2. Is maintaining a sound financial structure that can absorb cash outflows from shareholder returns and M&A

The Company is also maintaining the soundness of its financial structure. The equity ratio was 41.4% at the end of 1H of FY3/22 (46.6% at the end of FY3/21), while the current ratio was lower at 150.1% (versus 169.9% at the end of FY3/21). Looking at the shift in recent years, the equity ratio has risen significantly from 24.4% at the end of FY3/18 to 53.9% at the end of FY3/20, while the current ratio has exceeded 200%, from 99.0% at the end of FY3/18 to 209.4% at the end of FY3/20, indicating sufficient solvency, with some attention being given to near-term movements.

However, the deterioration in these financial indicators does not need to be viewed as particularly problematic, as they are the result of share buybacks (¥234mn in 1H of FY3/22) and an increase in advances received (current liabilities), from ¥787mn at the end of FY3/20 to ¥2,452mn at the end of 1H of FY3/22, including orders for large projects from the National Police Agency. In fact, the D/E ratio (interest-bearing debt / shareholders' equity) was 0.14 times (0.13 times at the end of the previous period) and net cash (cash and deposits – interest-bearing debt) was ¥1,952mn (¥2,070mn), both maintaining the levels at the end of the previous period, and the Company is maintaining a sound financial structure while absorbing cash outflows due to dividend payments and M&A.

Moreover, the Company's non-consolidated retained earnings, which normally serve as the source of its dividend payments, were ¥301mn at the end of 1H of FY3/22 (versus ¥502mn). The Company has already secured approximately a little under three years' worth of dividend capital given that it needs about ¥82mn to cover its dividend of ¥5 per share.

At the end of the 1H of FY3/21, total assets were down ¥293mn from the end of the previous period to ¥5,331mn, while net assets increased ¥407mn to ¥2,235mn. Looking at a breakdown of the changes versus the end of the previous period, it is notable that in assets, notes and accounts receivable fell by ¥564mn, while in liabilities, accounts payable (current liabilities) rose by ¥721mn. While the former may be attributable to seasonality, the latter is due to the large project for the National Police Agency.

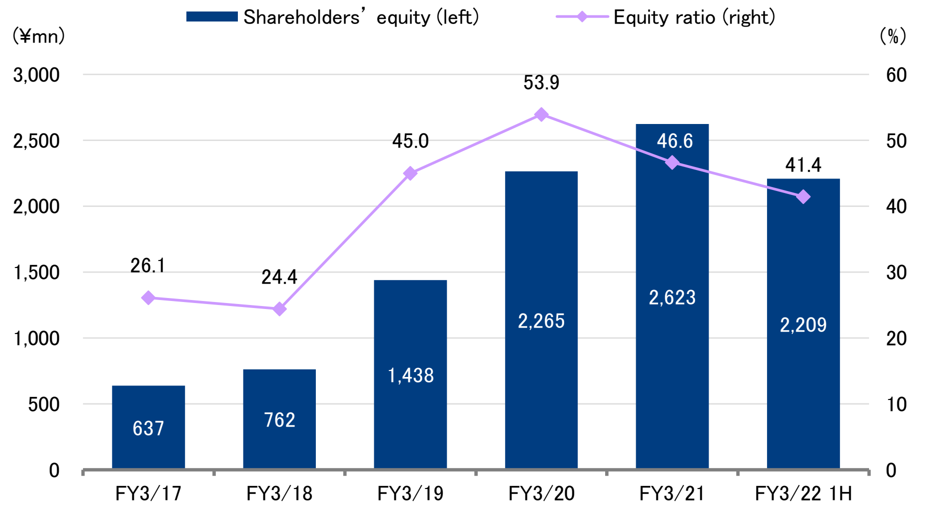
Simplified balance sheet

(¥mn)

	End of FY3/17	End of FY3/18	End of FY3/19	End of FY3/20	End of FY3/21	End of FY3/22 1H	YoY
Current assets	2,063	2,288	2,355	3,404	4,515	4,209	-306
Cash and deposits	1,098	972	1,064	1,895	2,418	2,271	-147
Notes and accounts receivable - trade	494	863	742	871	965	401	-564
Inventory assets	24	35	56	102	180	226	46
Non-current assets	375	806	839	798	1,109	1,122	12
Property, plant and equipment	93	131	148	147	208	191	-17
Intangible non-current assets	63	381	353	339	526	514	-11
Investments and other assets	218	321	337	311	374	415	41
Total assets	2,439	3,123	3,194	4,203	5,625	5,331	-293
Current liabilities	1,752	2,312	1,314	1,626	2,657	2,803	146
Accounts payable - trade	315	252	243	451	378	97	-281
Short-term borrowings	750	1,177	137	130	57	58	0
Non-current liabilities	49	48	439	307	324	291	-32
Long-term borrowings	-	-	386	256	290	260	-29
Lease obligations	35	9	11	7	6	-	-
Total liabilities	1,802	2,361	1,753	1,934	2,981	3,095	113
Interest-bearing debt	750	1,177	524	386	347	319	-28
Total net assets	637	762	1,441	2,269	2,643	2,235	-407

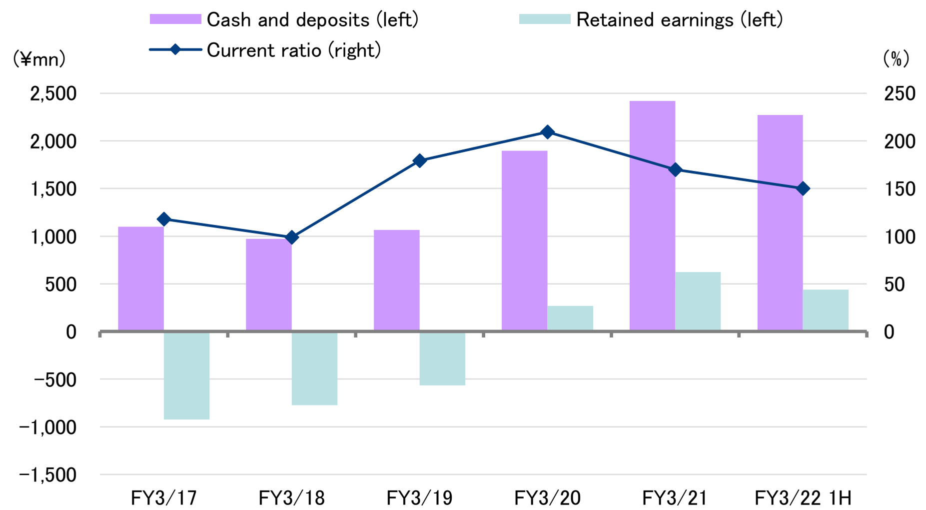
Note: Results are non-consolidated up to FY3/17 and consolidated from FY3/18 onwards.
Notes and accounts receivable - trade for 1H of FY3/22 and beyond include contract assets.
Source: Prepared by FISCO from the Company's securities report and financial results

Trends in shareholders' equity and the equity ratio



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

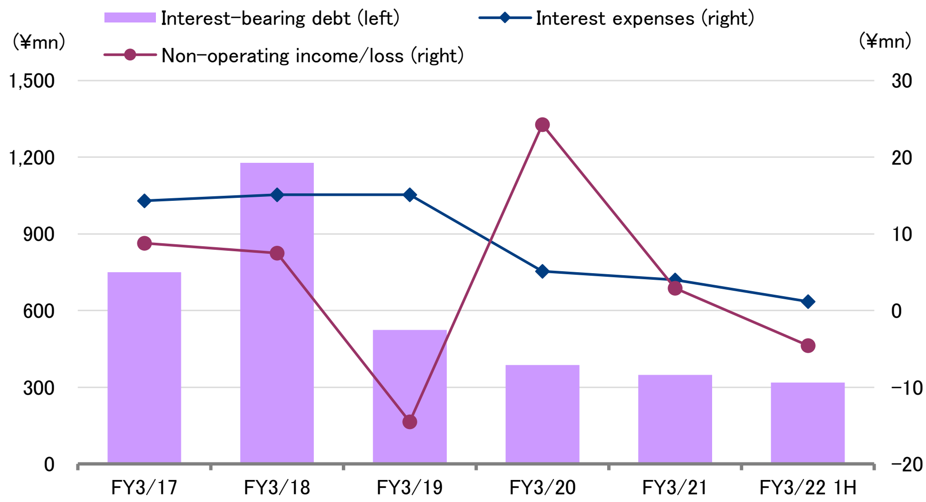
Trends in the current ratio, cash and deposits, and retained earnings



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

Also, the greater soundness of the financial structure has led to an improvement in non-operating income/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. Despite this, interest expenses in 1H of FY3/22 decreased 46.6% YoY, and reductions on interest-bearing debt continue to be effective.

Trends in interest-bearing debt, interest expenses, and 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 and financial results

At the end of 1H of FY3/22, the balance of cash and cash equivalents was ¥1,981mn. Looking at each of the cash flow conditions, net cash provided by operating activities was ¥320mn, mainly because net income before income taxes was ¥174mn and advances received increased ¥184mn. Net cash used in investing activities was ¥113mn, mainly due to the acquisition of tangible and intangible assets and investment securities. Net cash used in financing activities was ¥350mn overall, including ¥28mn for repayment of long-term borrowings, ¥82mn in dividend payments, and ¥249mn for the repurchase of shares.

Simplified cash flow statement

(¥mn)

	FY3/17	FY3/18	FY3/19	FY3/20	FY3/21	FY3/22 1H
Net cash provided by (used in) operating activities (a)	291	-55	374	484	1,131	320
Net cash provided by (used in) investing activities (b)	0	-440	-55	-24	-256	-113
Net cash provided by (used in) financing activities	-219	391	-218	464	-237	-350
Free cash flow (a) + (b)	291	-495	318	459	874	206
Cash and cash equivalents at end of period	535	462	569	1,500	2,128	1,981

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

Outlook

Another upward revision to FY3/22 full-year consolidated results is expected, with attention also on business development driven by increased customer needs in the areas of DX and SDGs.

1. The FY3/22 results forecasts remain conservative

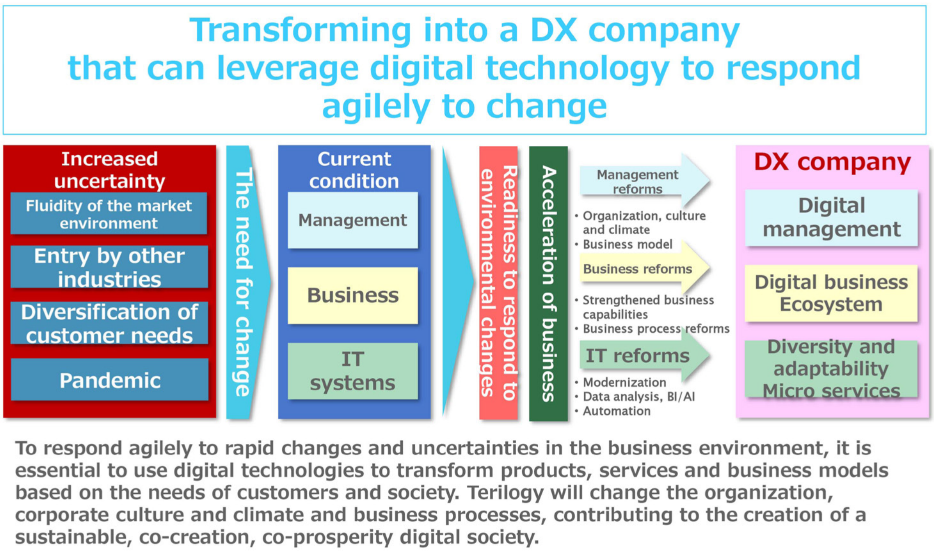
With regard to initial forecasts for the consolidated results for 1H of FY3/22, based on factors such as results in 1H of FY3/22, the Company upwardly revised its forecast for net sales to increase 10.6% YoY to ¥5,200mn operating income to decrease 68.5% to ¥170mn, ordinary income to decrease 68.7% to ¥170mn, and net income attributable to owners of parent to decline 70.3% to ¥130mn. The Company raised its revised consolidated forecasts for operating income to ¥250mn, down 53.7% YoY, ordinary income to ¥250mn, down 54.0%, and net income attributable to owners of parent to ¥135mn, down 69.2%, but left its initial forecast for net sales unchanged.

The Company's forecast of a 2.5% operating income margin in 2H would seem too conservative for the Company's actual ability (around 7%), given the strong impact application of the revised Accounting Standard for Revenue Recognition will have in 2H. It is highly likely that the Company will announce another upward revision when it releases its financial results for 3Q of FY3/22. Note also that under the Company's policy for returns to shareholders of targeting a dividend payout ratio of at least 50%, it plans to once again pay a period-end dividend per share of ¥5.

2. Full-scale business development based on embracing customer needs in the areas of DX and SDGs

In December 2020, the Company announced its "Digital Transformation Strategy," and described its reasons for engaging in DX in a flowchart that noted "Increasing uncertainty→Need for change→Strengthen readiness to respond to environmental changes and accelerate business→DX company." In March 2021, it also acquired certification as a DX certified business operator under a national DX certification program. The Company is working to transform not only itself, but to develop business based on embracing customer needs in the area of DX.

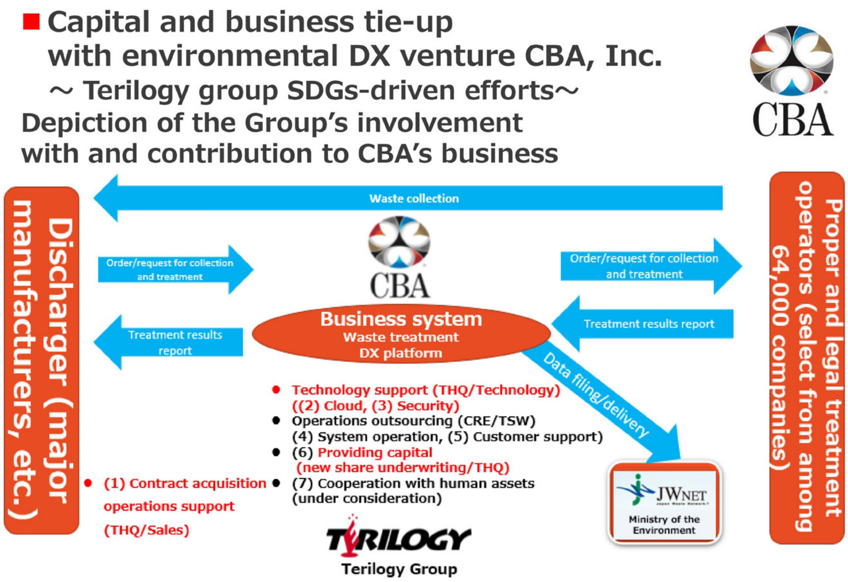
Why Terilogy is engaged in DX



Source: The Company materials

In this context, in September 2021 the Company signed a capital and business tie-up with CBA Inc., an environmental DX venture, and took the step of underwriting stock options to be issued by CBA. The Company describes the purpose of this capital and business tie-up as follows: "We will provide a highly secure, state-of-the-art cloud service to the still-outdated waste treatment industry, streamline and optimize the operations required for waste treatment, and make active use of the data accumulated through this service to sort waste that has traditionally been incinerated into recyclable materials and waste for disposal". By using the power of digital technology to implement optimal waste treatment, we will promote resource recycling and contribute to solving social issues toward the realization of a sustainable society as advocated in the SDGs. This too is nothing less than another business development aimed at putting the corporate philosophy of "focus on the customer" into practice. The Company can also be highly commended for using its partnering strategy to quickly build its business model. While they are still at the stage of having responded to growing customer needs in DX and the SDGs, it will be interesting to see what direction the Company takes as a business in nurturing those opportunities.

The first in Terilogy to develop SDGs-related business



Source: The Company's results briefing materials

3. The new medium-term management plan shows the path to achieve net sales of ¥10bn

For FY3/22, the plan's first fiscal year, the new medium-term management plan incorporates "numerical targets for organic growth," "the basic strategy and priority measures to achieve the targets" and "the basic approach for implementing the M&A and business alliance strategy." More specifically, it shows the path toward achieving net sales of ¥10bn.

First, for the "numerical targets for organic growth," which are net sales of ¥7.4bn and operating income of ¥560mn in the plan's final fiscal year (FY3/24), based on the FY3/21 operating income of ¥540mn, the sense is that the results left something to be desired. However, there is no need to overreact to the absolute level for the final fiscal year starting from FY3/22, which conservatively incorporates the impact of the application of the revised Accounting Standard for Revenue Recognition. The message of the new medium-term management plan to achieve a sales growth rate of 20% and an operating income margin of 8% should be accepted. We can also expect that the numerical targets may be incorporated into a rolling forecast based on the fact that FY3/22 is trending upward from the initial plan.

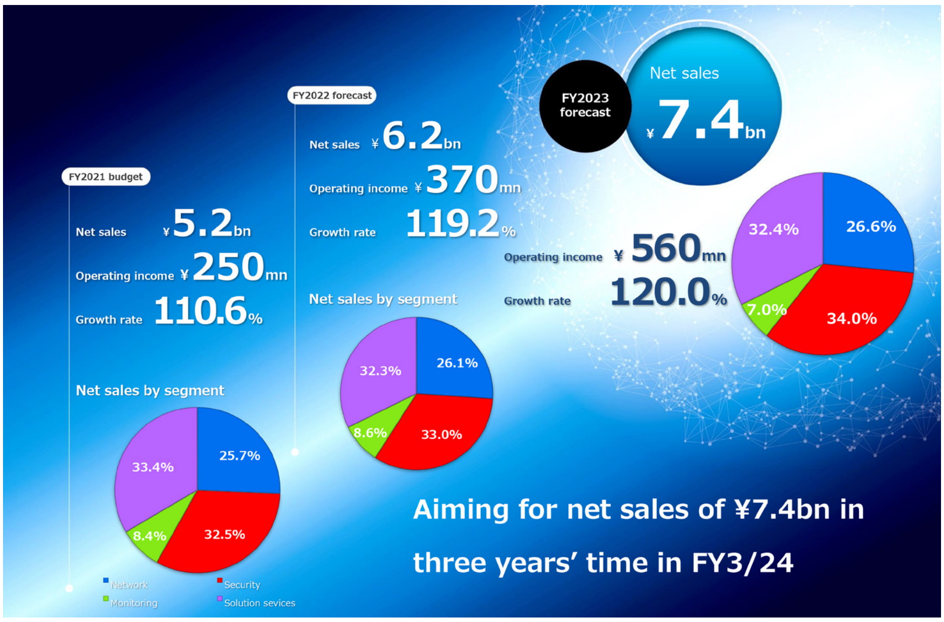
For “the basic strategy and priority measures to achieve the targets” the key messages can be read to be 1) strengthening the recurring income-type business model 2) dynamic expansion of the Group’s businesses, and 3) global business development. Whatever the case, the key will be the alliance strategy, including M&A, so the fact that the current new medium-term management plan incorporates a “basic approach for implementing an M&A and business alliance strategy” is considered to have an important meaning. In particular, based on the perceived image of an investment scale of around ¥1bn to ¥2bn, we shall be focusing on the Company clearly indicating the scale of the investment budget per project (¥300mn to ¥500mn) and the scale of acquired annual sales (¥500mn to ¥1bn).

On this point, the case of CRESEED being made a subsidiary in March 2021 appears rich in suggestions. CRESEED was founded in 1990 from a company split from the information systems department of KANEDA Co, Ltd., a trading company specializing in oil and chemical products. It seems its core business is an information systems operational support and outsourcing business for the information systems departments and systems personnel of customers. It provides IT services, such as work solutions and systems and network construction, centered on its group of in-house concept products that realize flexibility equivalent to scratch development and ease of application equivalent to package software.

By making CRESEED a subsidiary, the Company’s strategy is to aim to 1) expand business opportunities in the medium- to small-scale enterprise markets, in which it has had little experience up to the present time, and 2) introduce an asset-type business model of an information systems operational support and outsourcing business. This can be said to be consistent with the basic strategy and priority measures in the new medium-term management plan. Also, in relation to the investment scale, including costs, of ¥302mn, as the FY3/22 forecasts are for net sales and operating income of ¥700mn and ¥50mn respectively, and an operating income margin of 7.1%, it is also an acquisition that obeys the Company’s own rules for M&A.

From the above points, based on the net sales target of ¥7.4bn through organic growth, the Company is aiming to accumulate net sales on a scale of ¥2bn to ¥4bn through its M&A strategy. In other words, the new medium-term management plan can be highly evaluated for ambitiously showing the path toward achieving net sales of ¥10bn, and we shall be paying attention to it taking this direction.

2021 to 2023 Three-year medium-term management plan (numerical targets)

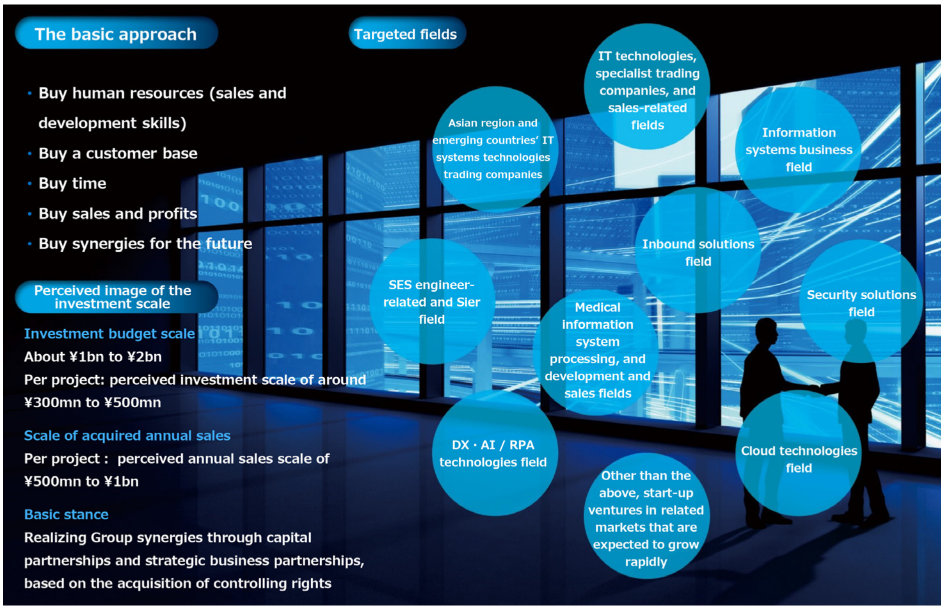


Source: The Company’s results briefing materials

2021 to 2023 Three-year medium-term management plan (basic strategy and priority measures)

Source: The Company's results briefing materials

2021 to 2023 Three-year medium-term management plan



Source: The Company's results briefing materials

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■ For inquiry, please contact: ■
FISCO Ltd.
5-13-3 Minami Aoyama, Minato-ku, Tokyo, Japan 107-0062
Phone: 03-5774-2443 (IR Consulting Business Division)
Email: support@fisco.co.jp