

# TerraSky Co., Ltd.

**3915**

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## ■ Summary

### **Sales growing at over 30% per year thanks to the expansion of the cloud market, and there is a strong possibility that results exceed the Company's forecasts due to strong performance of products developed internally**

TerraSky Co., Ltd. <3915> is a cloud integration services company, providing support services for the installation of cloud-based systems and the development of related applications. The Company has a track record of more than 4,000 installations of cloud-based systems, most of which use the Salesforce platform. In FY2/19, 66% of sales came from Salesforce platform-related projects, while subsidiary BeeX Co., Ltd. provides cloud migration support for SAP systems, centered on the Amazon Web Services (AWS) related business. Also, the Company internally develops cloud services including cloud system development support tools and groupware.

#### 1. FY2/20 1Q Results Overview

In FY2/20 1Q (March–May 2019), TerraSky posted a large increase in sales, reporting consolidated sales of ¥2,124mn (+41.1% YoY) and operating income of ¥160mn (versus an operating loss of ¥27mn in the year-earlier period). Sales in the mainstay Solution segment were strong, rising 35.8% YoY on an increase in orders for cloud system installation projects as companies actively look to carry out digital transformation. Sales in the Product segment, which sells products that have been developed internally, grew a sharp 62.3% YoY thanks to large orders received. Despite the increase in personnel expenses associated with aggressive hiring, profit was recorded as a result of the increase in sales as well as the non-recurrence of one-time expenses posted in the year-earlier period in conjunction with the headquarters relocation and increase in floor space. In addition, extraordinary income of ¥558mn was recorded in conjunction with the partial sale of shares of Serverworks Co., Ltd. <4434>.

#### 2. Outlook for Results of FY2/20

For FY2/20, the Company has kept its initial forecasts for consolidated sales of ¥8,634mn (+31.7% YoY) and operating income of ¥246mn (+96.1%) unchanged. We think there is a strong possibility that results will surpass the Company's forecasts based on the fact that operating income in 1Q was 65.3% of the full-year forecast value, the fact that strong order flow in the Solution segment means full utilization will continue for at least the next three months, and the fact that significant increases in both sales and operating income can be expected from 2Q onward as a result of large orders received for DataSpiderCloud, which is a data coordination platform for cloud services and multiple systems in the Product segment.

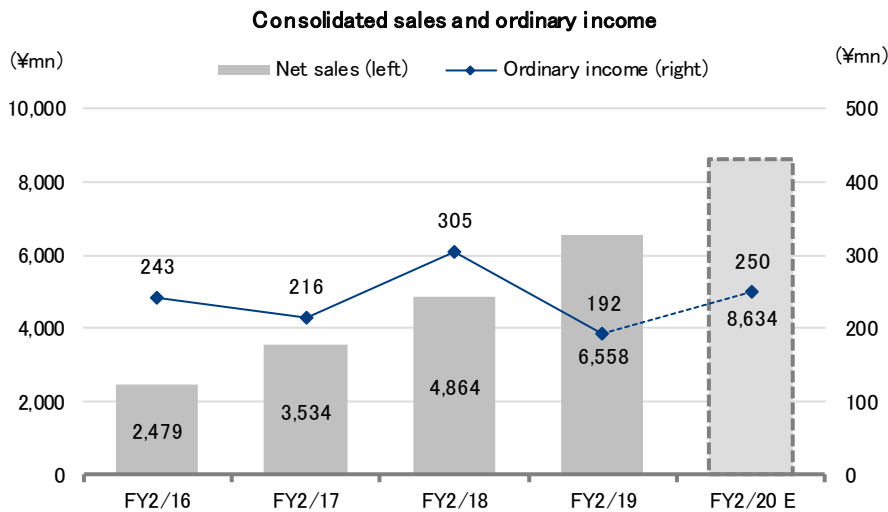
Summary

3. Growth Strategy

According to a research institute, the Japanese market for cloud computing services will enjoy strong growth, with an average growth rate of 20% per year over the five years through 2023. Amid this, the Company will leverage its strong technological capabilities and deep installation track record as strengths to provide installation support services for key cloud services such as Salesforce and AWS, and plans to aim for annual sales growth of 30% on an ongoing basis. With respect to the Product segment, which centers on the Company's mitoco service which is currently in the up-front investment stage for the expansion of functions, growth in profits is expected to accelerate due to the increase in contracts and the fact that the profit margin will start to rise in earnest from FY2/21 onward. In June 2019 the Company also established Quemix Inc., which conducts quantum computer research, and TSV Investment Limited Partnership No. 1 which invests in cloud services start-ups, as it lays a foundation for future earnings opportunities.

Key Points

- Expecting the cloud market to enjoy continued strong growth of around 20% per year as companies energetically pursue digital transformation.
- With orders remaining strong, there is a high likelihood that FY2/20 results will exceed the Company's forecasts.
- The Company is targeting ¥13.0bn in sales and ¥1.0bn in ordinary income in FY2/22



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

## ■ Company profile

### Japan's top-class cloud integrator

#### 1. Company profile

Since its founding in 2006, TerraSky has specialized in cloud computing services and, as the leading domestic cloud integration company, has been the driving force behind the growth of the cloud computing market in Japan. With more than 4,000 cloud system installations under its belt (as of May 2019), TerraSky has experience with a wide range of development projects for companies big and small and in all kinds of industries. The Company has seven consolidated subsidiaries as of August 2019: Sky365 Co. Ltd., BeeX Co., Ltd., Kitalive Inc., TerraSky Inc., TerraSky Ventures Co., Ltd., Cuon.inc., and Quemix Inc. As of the end of February 2019, there are 460 consolidated employees.

#### Consolidated subsidiaries and business descriptions

Company	Ownership ratio	Business segment	Business description
Sky365 Co., Ltd.	60%	Solution Business	Managed service provider (MSP)* specialized in cloud computing
BeeX Inc.	78%	Solution Business	AWS installation support, and support services for migration to cloud computing systems on SAP software platform
Kitalive Inc.	60%	Solution Business	Cloud system installation support centered in Hokkaido
TerraSky Inc.	100%	Product Business	Sell TerraSky cloud services in North America
Cuon.inc.	100%	Solution Business	Web system development
TerraSky Ventures Co., Ltd.	100%	Investment Business	Investment in, development of, and support for venture companies in the cloud-related domain
Quemix Inc.	100%	Other	Quantum computer research and provision of solutions for companies

\*MSP (Management Services Provider): A provider that contracts the operations, monitoring, and maintenance services for a company's servers and networks

Source: From the Company's results briefing materials

#### 2. History

Established under the name Head Inc. in 2006, the Company has specialized in cloud computing services since its inception. Company president Hideya Sato left IBM Japan to join the Japanese subsidiary of Salesforce.com, Inc. <CRM>, helping it get off the ground in Japan. In 2007, the fledgling operation adopted its current name, TerraSky Co., Ltd.

Company profile

In 2008, TerraSky started providing its SkyEditor\*<sup>1</sup> (now SkyVisualEditor) and SkyOnDemand\*<sup>2</sup>, currently mainstay services in the Product segment. Since then, the Company has been aggressively developing and providing cloud system development support tools. In 2016, the Company began providing mitoco\*<sup>3</sup>, a communication platform that is positioned as the next-generation version of groupware, and in 2017 the Company started offering the cloud-based data integration service DataSpiderCloud\*<sup>4</sup>. Both of these services are accumulating contracts and are in the process of developing into mainstay services. Most recently, as an omni-channel call center service linking Salesforce with LINE <3938>, in 2018 the Company launched OMLINE-I for inbound response, while in 2019 the Company launched OMLINE-O for outbound response.

\*1 SkyEditor, now called SkyVisualEditor, is a Salesforce screen development tool that allows companies to customize screens on Salesforce for easier use. By making it quick and easy for companies to develop desired screens, SkyVisualEditor outshines competing products to such an extent that is viewed as the de facto industry standard.

\*2 SkyOnDemand is an on-demand integration service that allows internal corporate systems to link to the data on Salesforce, AWS, Microsoft Azure, or other public cloud services as well as link the data on other cloud-based data with each other.

\*3 A communications platform developed for use on the Salesforce cloud platform. It can serve not only as an internal corporate communication tool (bulletin boards, talks, etc.), as well as workflow and document management along with a calendar function, but also makes it possible to connect with outside parties at partner companies. Connections with the IoT also allow it to be used to make reservations for intelligent conference rooms. It is also compatible with a mobile app.

\*4 A product jointly developed with Appresso K.K. (absorbed via merger into Saison Information Systems Co., Ltd. <9640> in April 2019). This service enables non-programming coordination linkage between various cloud services and in-house databases and applications.

TerraSky is also known for growing its business while actively promoting capital and business alliances over the years. In 2010, TerraSky entered into a capital and business alliance with NTT TechnoCross Corporation (formerly NTT Software Corporation) and in 2013 formed a similar alliance with Serverworks Co., Ltd. (whose primary business is AWS installation support services). In 2014, TerraSky entered into a capital alliance with US-based Salesforce.com, Inc. Also, in 2012 it established sales subsidiary TerraSky Inc. in the US to sell and market its cloud computing services in North America. In 2015, TerraSky listed on Tokyo Stock Exchange Mothers market (in November 2018 it moved to the 1st Section of the Tokyo Stock Exchange).

The Company has been aggressive in forming capital and business alliances even after its stock exchange listing. In 2016, the Company concluded a partnership agreement with Ecomott Inc. <3987> (IoT and mobile cloud solutions) and Cloudia Japan inc. (cloud integration service provider in the Kyushu region). In 2017, the Company entered into a capital and business alliance with IGUAZU Corporation, a distributor of IBM products, and in 2018 it entered into an alliance with Business Engineering Corp. <4828>.

With respect to developing subsidiaries, in 2014 the Company established Sky365 Co., Ltd. as a joint venture with Serverworks Co., Ltd., while in 2016 the Company established BeeX and Kitalive. In March 2019, the Company's AWS business was transferred to BeeX, thereby consolidating the AWS-related business in BeeX. The Company is aiming to list the shares of BeeX and Kitalive, but plans to own the majority of the shares of both companies even after the listings.

Company profile

**Company timeline**

Date	Major events
March 2006	Founded as Head Inc.
July 2008	Began offering screen development tool SkyEditor (now known as SkyVisualEditor)
October 2008	Began offering cloud integration tool SkyOnDemand
September 2010	Entered into capital and business alliance with NTT TechnoCross Corporation (formerly NTT Software Corporation)
August 2012	Established US-based subsidiary TerraSky Inc. (now a consolidated subsidiary)
September 2013	Entered into capital and business alliance with Serverworks Co., Ltd., making it an equity-method affiliate
May 2014	Established subsidiary Sky 365 Co., Ltd. (now a consolidated subsidiary) in Sapporo, Hokkaido, as joint venture with Serverworks Co., Ltd
October 2014	Entered into capital alliance with US-based Salesforce Inc.
April 2015	Listed shares on the Mothers market of the Tokyo Stock Exchange
January 2016	Entered into capital and business alliance with Ecomott Inc.
March 2016	Established subsidiary BeeX Co., Ltd. (now a consolidated subsidiary) to provide cloud integration services for SAP software-based systems Entered into capital and business alliance with Cloudia Japan inc., making it a consolidated subsidiary
July 2016	Started selling the mitoco socialware service
August 2016	Opened TerraSky Lab Established subsidiary Kitalive Inc. (now a consolidated subsidiary) as joint venture with Win Consult, Inc. to provide cloud integration services
March 2017	Entered into capital and business alliance with Phone Appli Inc.
May 2017	Entered into capital and business alliance with IGUAZU Corporation
March 2018	Entered into capital and business alliance with Business Engineering <4828>
November 2018	Moved listing to TSE 1st Section
March 2019	Transferred AWS business to BeeX Co., Ltd. Established TerraSky Ventures Co., Ltd., a corporate venture capital firm
May 2019	Acquired all shares of Web system developer Cuon.inc., making it a consolidated subsidiary
June 2019	Established Quemix Inc. for the purpose of quantum computer research and provision of solutions to companies Established TSV Investment Limited Partnership No. 1 for the purpose of investing in start-up companies in the cloud-related field

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

## Cloud computing market and TerraSky's businesses

### Company sees cloud computing market continuing to grow at more than 20% per year as companies ramp up digital transformation initiatives

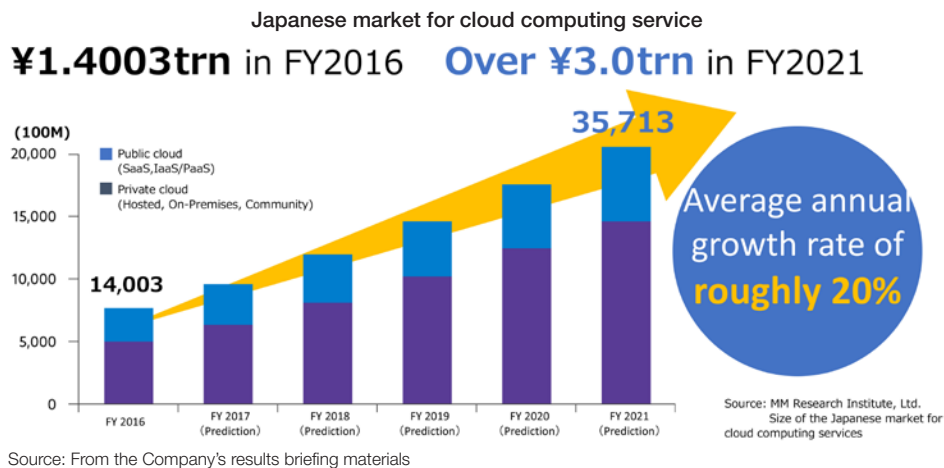
#### 1. Cloud service market

The history of the development of computers shows that in the first half of the 1960s, companies started adopting mainframe computers. Since the 1980s, mainframe computers have been replaced by desktop office computers and minicomputers. From the late 1990s, the form of information systems started changing to client-server systems together with the spread of computers, and from the late 2000s there have been increasingly high-speed communication networks along with progress being made in Internet technology. Against this background, cloud computing services appeared, IT applications have entered an era in which usage is considered more important than ownership.

Cloud computing market and TerraSky's businesses

Cloud computing is a service in which data and application software that users use and store on their computers are provided to users via networks by platformers such as Salesforce.com and Google. In the past, companies have had to construct, operate, and manage information systems on their own, but by using the cloud companies can avoid the time and effort required, and also improve operating efficiency and curb investment costs. Companies can shorten the development time required for constructing IT systems, which is a big advantage for them. In particular, with the improvements in the quality of communication networks and the enhanced cybersecurity measures being implemented by cloud service providers in recent years, more and more companies of all sizes are making the switch from existing systems to cloud computing.

According to a research company, in FY2016 the Japanese market for cloud computing services was worth ¥1.4003trn, a 38.5% increase over the previous year. The research company forecasts that Japan's cloud computing market will grow to ¥3.5713trn by FY2021; this represents a 2.5-fold increase over FY2016 or an average growth rate of roughly 20% per annum. The main battleground for the Company is the public cloud market, which in FY2016 was worth ¥388.3bn, a 40.9% increase over the previous year. The research company forecasts that the public cloud market will grow to ¥1.0556trn by FY2021; this represents a 2.7-fold increase over FY2016 or an average growth rate of approximately 22% per annum. As there are still many companies using client server systems, the number of companies moving to cloud computing appears likely to continue its high growth in the years ahead.



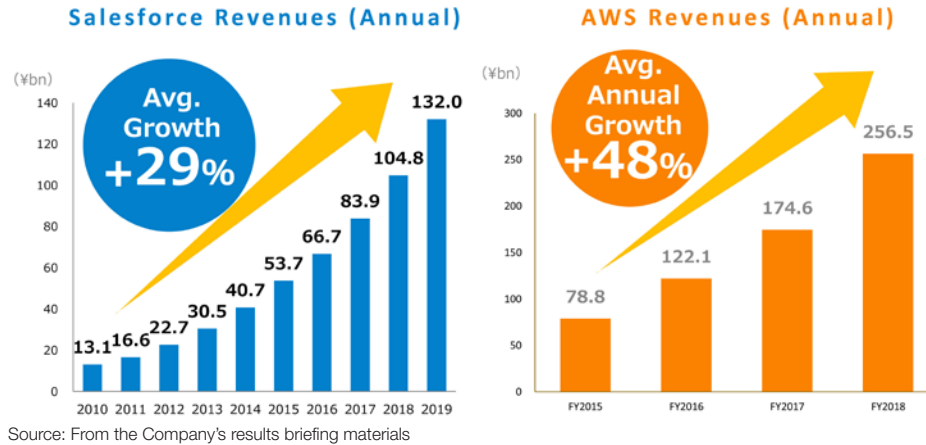
Public cloud service is broadly split into three different types: SaaS\*1, PaaS\*2, and IaaS\*3. Of these, PaaS and IaaS are used when companies create information systems. AWS and Salesforce.com, which are global leaders in terms of market share, continue to achieve high growth, with sales rising by 48% and 29% per year, respectively.

\*1 SaaS (Software as a Service) refers to online services that provide users access to software that had been available as a packaged product.  
 \*2 PaaS (Platform as a Service) refers to online services that provide a platform (hardware and operating system) that allows user to run applications.  
 \*3 IaaS (Infrastructure as a Service) refers to online services that provide the virtual servers, equipment, and all other network infrastructure needed to operate information systems



Cloud computing market and TerraSky's businesses

Salesforce and AWS Revenue Trend



## The Solution segment accounts for over 80% of sales

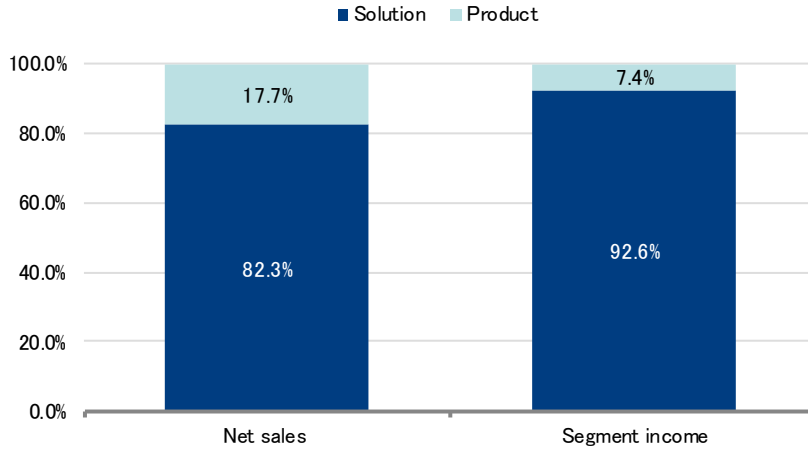
### 2. The Company's business

TerraSky has two segments, Solution and Product. In FY2/19 the Solution segment accounted for 82.3% of total sales and 92.6% of segment profit; the Product segment accounted 17.7% of sales and 7.4% of segment profit. The segment profit margin at the Solution segment is 14.0%. This is roughly in line with the 5.2% margin at the Product segment, but only because the Product segment bears a large burden of upfront investment spending such as the product development costs. Before depreciation and goodwill amortization, the segment profitability at the Product segment in FY2/19 was 26.3% versus 14.8% at the Solutions segment. Because the Product segment is a stock-type business, if sales continue to grow, profit margins should rise further in future years as development costs are fully depreciated. In contrast, the labor-intensive nature of the businesses under the Solution segment means that profitability improvement here will depend mainly on productivity gains.

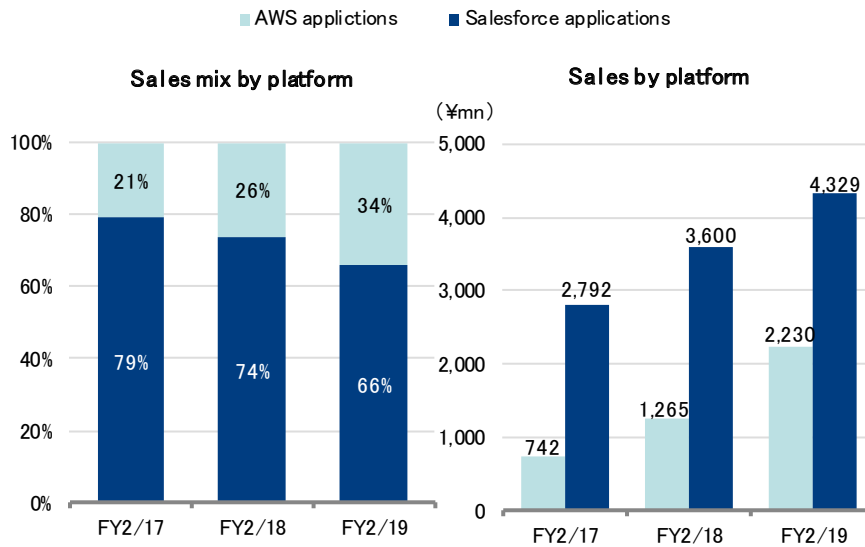
On a platform basis, Salesforce-related projects accounted for 66% of sales and AWS-related work accounted for 34% of sales in FY2/19. The proportion of sales coming from AWS-related work is on the increase over the past few years. AWS-related sales have been rapidly growing, roughly tripling over two years as the market has grown. Meanwhile, although the proportion of Salesforce-related sales declined, high sales growth in the 20-30% range continues.

Cloud computing market and TerraSky's businesses

**Sales and earnings by segment(FY2/19)**



\* Segment income is before the deduction of corporate expenses  
 Source: Prepared by FISCO from the Company's financial results



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

**(1) Solution Business**

The Solution Business provides support services for the installation of cloud-based systems designed to meet the needs of client companies. Solution services cover everything from defining business requirements for front-end or backbone systems, to design, development, testing, operations, validation of effectiveness, and planning improvement policies and systemization planning. As most of its front-end system development work is done on Salesforce, TerraSky has a licensing and sales agreement with Salesforce.com.

Cloud computing market and TerraSky's businesses

In the Solution business, the Company and Kitalive (primarily in the Hokkaido region) provide support services for the development and installation of Salesforce, while BeeX provides support services for the development and installation of AWS and transition to SAP cloud computing (migration to AWS). The Company has a top-class track record in Japan for both Salesforce installation support and SAP cloud migration. Sky365 provides MSP services related to cloud installation projects for Salesforce and AWS.

TerraSky has done more than 4,000 Salesforce installations for companies of all sizes and in many industries and business, with noteworthy clients including the Mizuho Financial Group, Inc. <8411>, Odakyu Electric Railway Co., Ltd. <9007>, and KDDI Corporation, <9433>. Reflecting the strength of Salesforce in customer relationship management (CRM) software, TerraSky also derives a large proportion of its sales from companies in the service industry and Bto2C businesses.

## (2) Product Business

TerraSky is developing and marketing cloud services as SaaS vendor, including Salesforce's screen development tools SkyVisualEditor and SuPICE, the data integration services SkyOnDemand and DataSpiderCloud, the socialware service mitoco, the IAS service for insurance agencies, and contact center solutions OMLINE-I and OMLINE-O. Among these, its biggest earners are SkyVisualEditor and DataSpiderCloud, which account for more than 60% of segment sales. Addressing the strong demand from users in Japan to customize screens and process logic to fit the needs of their own system operations, and also being extremely user friendly, SkyVisualEditor has become the de facto industry standard in Japan.

The Product Business is being developed by TerraSky Co., Ltd and US-based TerraSky Inc., though the US subsidiary is largely serving in a marketing capacity and is not generating enough sales to have a material impact on overall results. With regard to SkyOnDemand, the Company noted that it has contracted with NTT TechnoCross (with which it has a capital and business alliance) and general sales agents in Japan to handle sales, and most of the sales go through NTT TechnoCross.

## With largest number of Salesforce-certified engineers in Japan, strong in both cloud integration technology development and number of personnel

### 3. Strengths

TerraSky has three main strengths. The first is its expertise accumulated from abundant experience. With more than 4,000 installations under its belt as of May 2019, TerraSky has acquired substantial expertise in not only cloud integration, but also in project management and quality control that meet the needs of a wide range of client companies. Since there are only a limited number of companies that are capable of taking on large projects, this puts TerraSky in a strong position vis-à-vis competitors.

The second strength of TerraSky is the unmatched number and quality of its engineers possessing cloud expertise. The number of certified engineers attests to their high quality. According to materials released on August 1, 2019, Salesforce has presented MVP awards to only 13 engineers in Japan, and two of those engineers work for TerraSky. There are only 11 certified technical architects in Japan and four of them work for TerraSky. TerraSky also employs many AWS-certified engineers. Because the number of certified engineers corresponds closely to the Company's ability to receive orders for projects, it is not an exaggeration to say that TerraSky has more experience and more capacity to do development and installation work for Salesforce cloud systems than any other company in Japan. Thus, the extent to which the Company can increase the number of its certified engineers is the key to future growth.

Cloud computing market and TerraSky's businesses

After engineers join the Company, they spend roughly six months in classes and undergoing training to acquire technical certifications and they are sent to job sites as part of a project team. Employee trainings are necessary for TerraSky to establish its core competence, and are viewed as the driving force behind the growth of its business. For this reason, TerraSky makes sure it maintains the type of work environment that attracts and retains good employees, including competitive salaries and reasonable working hours and, as a result, has a better retention rate for engineering personnel than the industry average.

TerraSky's third strength is its ability to provide service for multiple platforms on the cloud, including Salesforce and AWS. Its ability to do development work for multiple platforms allows it to cover a wider range of customer needs, which in turn leads to more orders.

#### 4. Business risks

In terms of business risks, the Company must hire and retain enough engineers to respond to robust demand. The Company's hiring is centered on mid-career hires, not only at the headquarters but also at regional offices, but hiring is not keeping up with the increase in demand, and if the Company is not able to meet its hiring and retention goals its sales growth could fall short of its forecasts. There is also the risk of the Company taking on unprofitable projects. The department in charge of project management shares information and carefully monitors progress, and as a result there has only been approximately one unprofitable project per year since FY2/17, which is a very low number.

## Results trends

### Aided by the growing cloud computing services market, both sales and profit increased significantly in FY2/20 1Q, setting new record highs for the second straight quarter

#### 1. FY2/20 1Q results

For FY2/20 1Q, TerraSky reported consolidated sales of ¥2,124mn (+41.1% YoY), operating income of ¥160mn (versus an operating loss of ¥27mn in the year-earlier period), ordinary income of ¥192mn (versus ordinary loss of ¥13mn in the year-earlier period), and net income attributable to owners of parent of ¥513mn (versus a net loss of ¥17mn in the year-earlier period), as the Company posted a significant increase in both sales and profits, and set record-high quarterly results for the second straight quarter. Sales in 1Q were 24.6% of the Company's forecast for the full fiscal year, while operating income was 65.3% of the full fiscal year forecast. Progress on the profits side was significant.

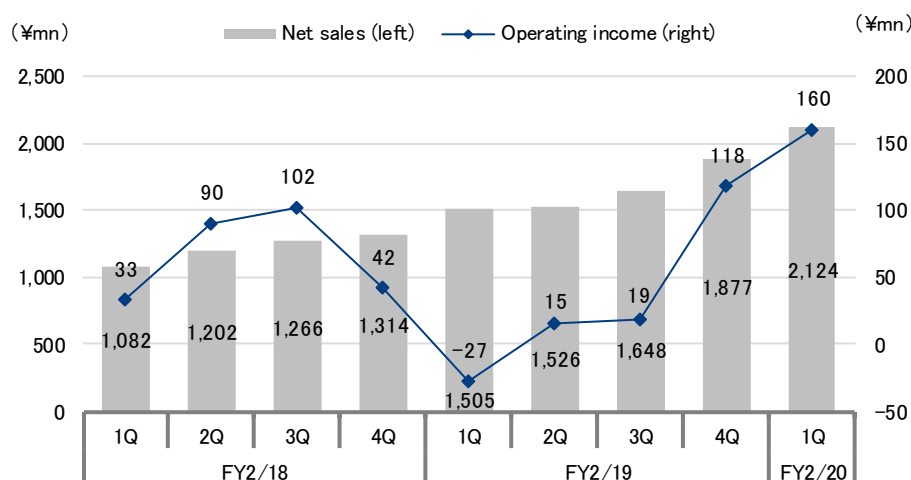
## Results trends

## FY2/20 1Q results

	FY2/19 1Q		FY2/20 1Q		YoY	% of the full fiscal year forecast
	Results	% of sales	Results	% of sales		
Net sales	1,505	-	2,124	-	41.1%	24.6%
Cost of sales	1,084	72.1%	1,504	70.8%	38.7%	-
SG&A expenses	448	29.8%	459	21.6%	2.4%	-
Operating income	-27	-1.8%	160	7.6%	-	65.3%
Ordinary income	-13	-0.9%	192	9.1%	-	76.9%
Extraordinary income (loss)	-2	-	558	-	-	-
Net income attributable to owners of parent	-17	-1.2%	513	24.2%	-	118.3%

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

## Quarterly results trends



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

An increasing number of companies are considering introducing cloud systems as a part of their digital transformation initiatives, and both the Solution business and the Product business saw significant increases in sales and profits compared to the same period of the previous year. The operating margin rose 9.4 percentage points year-on-year. Looking at the breakdown, the cost of sales ratio declined 1.3 percentage points and the SG&A expense ratio fell 8.2 percentage points. Despite an increase in personnel expenses and recruitment expenses, SG&A expenses increased by only 2.4% year-on-year on an amount basis due to the non-recurrence of one-time expenses posted in the year-earlier period associated with the headquarters relocation and floor space expansion.

Net income attributable to owners of parent was increased partly due to extraordinary income of ¥558mn associated with a gain on the sale of investment securities (some shares of Serverworks). As a result of this sale of shares, the Company's ownership ratio in Serverworks declined to 19.9% and Serverworks is no longer an equity-method affiliate.

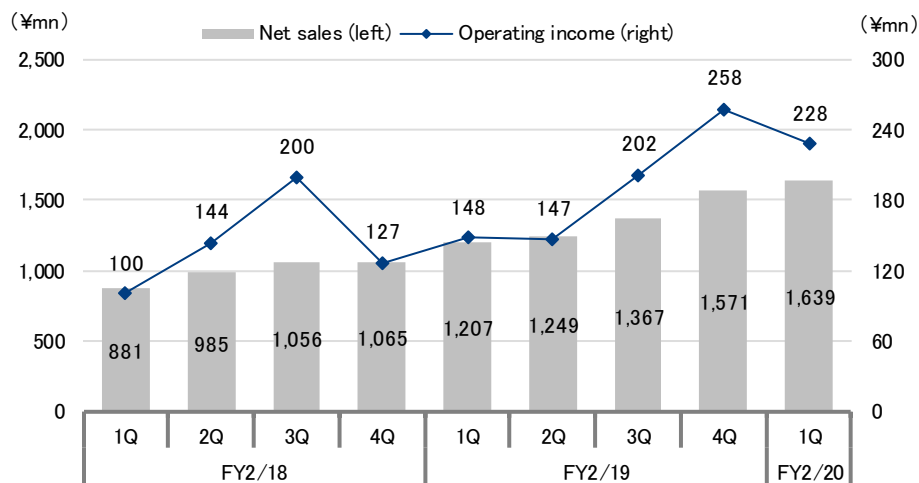
Results trends

**(1) Results by business segment**

Looking at results by segment, the Solution segment posted strong gains in both sales and profit, with FY2/20 1Q sales rising 35.8% YoY to ¥1,639mn and segment profit (operating income) rising 54.2% to ¥228mn. The growth in both sales and profit was driven by strength in orders received for both development and maintenance projects for cloud systems such as Salesforce and AWS, mainly from large companies. The Company’s installation track record now exceeds 4,000 installations. Sales increased while profit declined on a quarter-on-quarter basis, but this was mainly the result of an increase in personnel-related expenses associated with an increase in employees. On a standalone basis, 18 new graduates joined the Company in April 2019.

Meanwhile, the Product segment saw higher sales and profits, with sales rising 62.3% YoY to ¥484mn, while segment profit (operating income) increased 324.5% to ¥103mn. One factor for the increase in sales was progress with the adoption of DataSpiderCloud as a data-linking platform connecting on-premise data (such as core systems) and cloud systems for many purposes as needs increased, while Hoken Minaoshi Honpo Co., Ltd. began using strategic product mitoco in January 2019. These factors led to a steady increase in the number of companies signing contracts. In May 2019, an upgraded version of mitoco was released with enhanced calendar and workflow functions, thereby improving its user-friendliness.

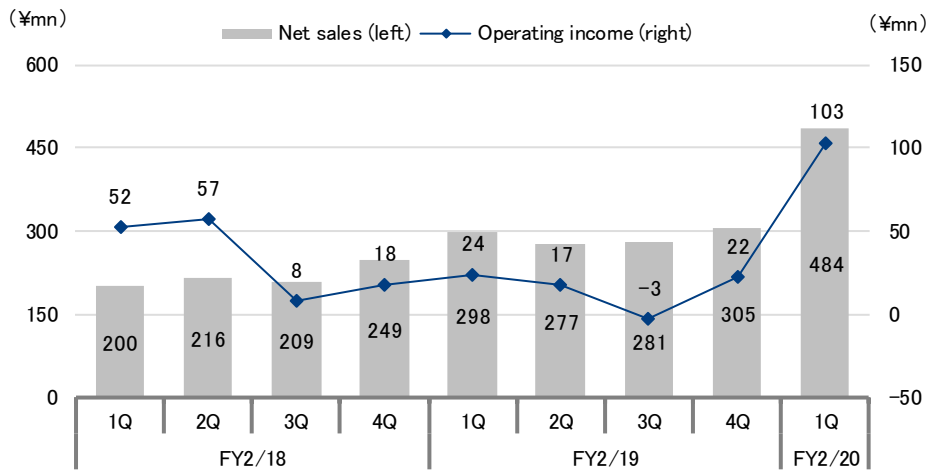
**Results of Solution Business**



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

Results trends

Results of Product Business



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

(2) Initiatives undertaken during FY2/20 1Q

The major initiatives undertaken by the Company during FY2/20 1Q are as follows.

- a) As an internal reorganization effort for the Group, in March 2019 the Company's AWS business division was integrated into subsidiary BeeX. The aim of this move is to further grow the AWS business by consolidating resources.
- b) TerraSky Ventures was established in March 2019 as a subsidiary in order to start an investment and development business targeting cloud-related venture companies.
- c) In April 2019, the Company relocated and increased the floor space of its Osaka Office in the West Japan Branch. The number of engineers had increased with the expansion of business in the Kansai area, and the office had become cramped. The old office was near Shin-Osaka Station, and the new office is an office building directly connected to the Yodoyabashi Station in central Osaka, which is much more convenient in terms of transportation. This is expected to help when it comes to recruiting. At the end of February 2019, the Osaka Office had 18 employees, which was double that of two years ago.
- d) In May 2019, the Company acquired all of the shares of Cuon, which excels in Web system development using Ruby on Rails,\* making Cuon a subsidiary. Bringing Cuon's technological and development capabilities into the Group allow the Group to propose projects that include the development of portal sites and mobile applications, and further strengthened the business foundation. Cuon has annual sales of approximately ¥300mn and approximately 20 employees. Cuon's results will be brought into the Company's consolidated results from FY2/20 1Q, and the Company expects ¥186mn in goodwill which it plans to amortize using the straight-line method over six years.

\* An open source Web application framework using the Ruby programming language developed by a Japanese person. This framework has recently become a trend, as it was designed to make development easy with less code than other frameworks.

## Results trends

## Net assets increased considerably due to the strong earnings as well as higher latent gains in conjunction with Serverworks' stock market listing

### 2. Financial position and management indicators

At the end of FY2/20 1Q, the Company's balance sheet showed total assets of ¥11,860mn, up ¥6,230mn from the end of the previous fiscal year. Behind the jump in assets, in current assets cash and deposits increased ¥757mn in conjunction with the expansion of revenue. In non-current assets, goodwill increased ¥185mn with the move to make Cuon a subsidiary, while investment securities rose ¥5,181mn in association with the listing of Serverworks' shares.

Total liabilities of ¥4,514mn were up ¥2,096mn from the end of the previous fiscal year. In current liabilities, this increase was driven by a ¥192mn increase in income taxes payable and a ¥198mn increase in advances received. In non-current liabilities, this increase was driven by a ¥1,662mn increase in deferred tax liabilities in conjunction with the increase in latent gains on Serverworks. Net assets of ¥7,345mn were up ¥4,133mn, due to a ¥362mn increase in retained earnings, and a ¥3,786mn rise in valuation difference on available-for-sale securities due to the change in market valuation in conjunction with Serverworks' stock market listing.

With respect to key management indicators, there were major improvements, as the shareholders equity ratio increased from 52.5% at the end of FY2/19 to 60.1% at the end of FY2/20 1Q due to the increase in net assets, while the interest-bearing debt ratio declined from 29.4% to 10.9%. The Company's net cash position (cash and deposits minus interest-bearing debt) also increased by ¥846mn to ¥1,879mn, an indication that the Company's financial position became stronger during the period.

#### Consolidated balance sheet

	(¥mn)				
	FY2/17	FY2/18	FY2/19	FY2/20 1Q	Change
<b>Current assets</b>	1,772	2,320	3,581	4,469	888
(Cash and deposits)	814	1,089	1,900	2,658	757
<b>Non-current assets</b>	777	1,495	2,048	7,390	5,341
<b>Total assets</b>	2,552	3,817	5,630	11,860	6,230
<b>Total liabilities</b>	1,314	2,155	2,417	4,514	2,096
(Interest-bearing debt)	723	1,049	868	779	-88
<b>Net assets</b>	1,238	1,661	3,212	7,345	4,133
<b>Management indicators</b>					
(Stability)					
Equity ratio	45.0%	38.5%	52.5%	60.1%	7.6pt
Interest-bearing debt ratio	63.0%	71.4%	29.4%	10.9%	-18.5pt
Net cash	90	39	1,032	1,879	846

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



## ■ Outlook

### With orders remaining strong, there is a high likelihood that FY2/20 earnings will exceed Company forecasts

#### 1. Forecast for FY2/20

For FY2/20, the Company has kept its initial forecasts for consolidated sales of ¥8,634mn (+31.7% YoY), operating income of ¥246mn (+96.1%), ordinary income of ¥250mn (+29.8%) and net income attributable to owners of parent of ¥434mn (+178.6%). However, we think there is a strong possibility that results will surpass the Company's forecasts based on the fact that operating income in 1Q was 65.3% of the full-year forecast value, the fact that strong order flow in the Solution segment means full utilization of engineers will continue for at least the next three months, and the fact that in the Product segment strong performance is expected from 2Q onward based on the increase in sales of DataSpiderCloud and the increase in contracts for in-house products with high profit margins, including mitoco.

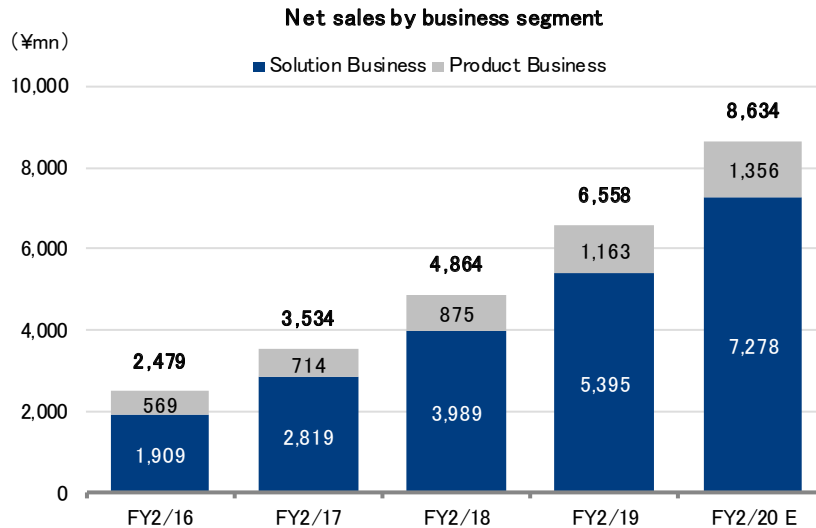
#### Forecast for FY2/20 consolidated results

	FY2/18		FY2/19		FY2/20 E		YoY
	Results	% of sales	Results	% of sales	Forecast	% of sales	
Net sales	4,864	-	6,558	-	8,634	-	31.7%
Operating income	268	5.5%	125	1.9%	246	2.8%	96.1%
Ordinary income	305	6.3%	192	2.9%	250	2.9%	29.8%
Net income attributable to owners of parent	171	3.5%	156	2.4%	434	5.0%	178.6%
Net income per share (¥)	30.64		26.76		35.66		

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

In terms of sales by segment, the Company expects sales in the Solution segment to increase 35% YoY to ¥7,278mn, and expects sales in the Product segment to increase 17% YoY to ¥1,356mn. In 1Q, Solution segment sales were 22.5% of the full-year forecast, which was basically just as planned, while the progress rate in the Product business was a high 35.7%. This seems to be due to the big contribution of large DataSpider Cloud projects as discussed above in 1Q. The fee structure of the DataSpiderCloud service is divided into an initial installation fee and a monthly usage fee, so sales inflate at the time of introduction. Still, the Product segment seems to be performing well even excluding this factor.

Outlook



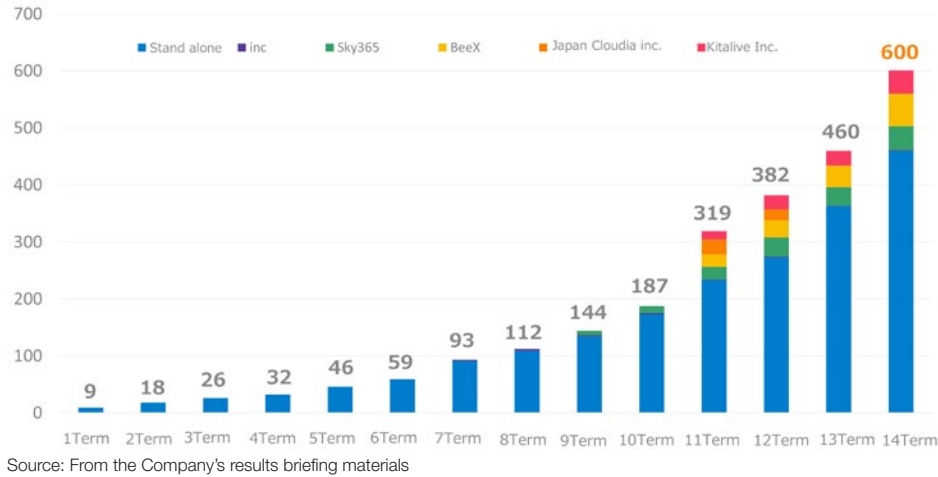
Source: Prepared by FISCO from the Company's results briefing materials

For FY2/20, the Company's plans call for hiring 78 people on a standalone basis (18 of these will be new graduates), and 150 people on a consolidated basis. The Company plans to increase its number of employees by 140 people at the end of FY2/20 to 600 employees. At subsidiaries, the hiring plan calls for increasing employees mainly at BeeX and Kit Alive, where the shortage of human resources is increasing due to an increase in orders. In FY2/20 1Q, hiring progressed as planned, but the pace has slowed somewhat in 2Q. The Company is working to strengthen recruitment through various measures, such as hiring at regional offices and using headhunting companies, as it strives to achieve its plan.

Both new grads and mid-career hires undergo roughly six months of classes and training to get technical certifications (with new grads typically requiring more than a year of training). The total cost of paying and training this year's batch of new employees for FY2/20 is expected to come to several hundred millions of yen by the time they are ready to go out into field and contribute to earnings, and this comes on top of the tens of millions of yen the Company expects to spend just in hiring costs. Since the number of new employees the Company expects to hire in FY2/20 is roughly twice the number hired last year, we estimate that all the related annual costs will be nearly ¥200mn-300mn more than last year. Currently, there is a bottleneck in human resources with respect to cloud system introduction inquiries and this continues to invite losing opportunities for receiving orders, and it seems like the Company will continue to proactively invest in personnel until its manpower becomes in line with demand.

Outlook

FY2/20 forecast for consolidated employees



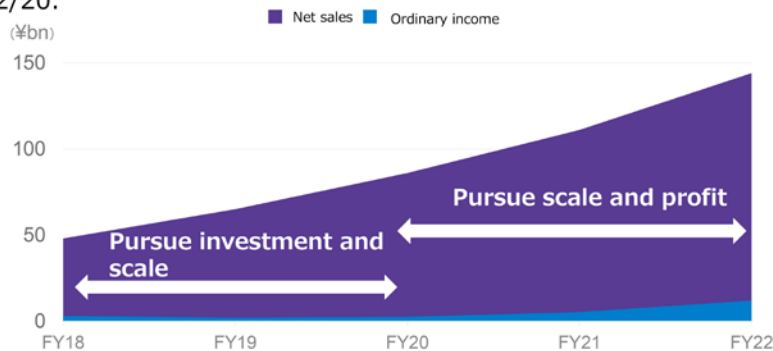
## Aiming for 30% annual growth due to the growth of the Solution business and expansion of the DX business by the new BeeX

### 2. Medium-term forecast and growth strategy

The Company is aiming for 30% annual sales growth in the medium-term by expanding the Solution business and the new BeeX digital transformation (DX) business against the backdrop of the expansion of the cloud market. In terms of profits, the strategic product mitoco is expected to start contributing to profits from FY2/21, and the Company plans to speed up overall profit growth by increasing the profit margin of the Product segment.

Illustration of medium-term consolidated earnings

- Aiming for continued average annual sales growth of 30% based on growth of the Solution business and the new BeeX's DX business with a backdrop of the expanding cloud market.
- Pursue profits over the medium term by expanding sales of mitoco from FY2/20.



#### Outlook

To achieve the high growth, the Company plans to undertake the following initiatives.

##### **(1) Promote digital transformation (DX)**

As companies have become more active in digital transformation, TerraSky plans to expand its business by building a system that supports digital transformation efforts as a Group. With the evolution of cloud system technology and improved security, companies are increasingly switching their core information systems to the cloud. In addition, new markets created through innovations such as VR, robotics, IoT, and next-generation security are developing on a cloud platform. Thus, the Company aims for sales growth exceeding the overall market growth rate while deepening its knowledge of advanced technologies.

##### **(2) mitoco**

The Company's product mitoco is being introduced as a communication platform that realizes "workstyle reform" for companies of all sizes. In 2018, mitoco started to be used by major financial institutions such as Mizuho Bank, Ltd. and Resona Bank, Limited. As groupware provided on Salesforce, it is effectively unchallenged in Japan, and is expected to contribute to profits from FY2/21 by continuing to grow sales while expanding functions.

##### **(3) Omnichannel**

In the omnichannel domain, in 2018 the Company started providing OMLINE-I, a service that links Salesforce Service Cloud\* and LINE Customer Connect. Inquiries from customers coming into a contact center via LINE can be centrally managed together with inquiries from various channels such as telephone and SNS, thereby improving the operational efficiency of call center operators and improving customer satisfaction. This service is already being adopted by the contact center of the internet service provider So-net operated by Sony Network Communications Inc. and LINE Pay Corporation's LINE Pay customer support center.

| \* A customer service support system provided by Salesforce.com |

In addition, in August 2019 the Company began offering OMLINE-O which supports outbound services. This service connects Salesforce and LINE's corporate service LINE Official Account, and allows the user to centrally manage marketing and customer service using LINE, from message delivery to user management, on Salesforce. Connecting LINE users with Salesforce customer information makes it possible to deliver one-to-one optimal LINE messages matching customer attributes. Companies that introduce this service can improve customer unit prices as well as customer satisfaction.

Along with the spread of social networking services, the way in which companies contact their customer is constantly evolving, with contact methods moving from email and telephones to social networking services such as LINE, and even making use of chatbots. With Salesforce already widely used by retailers, service companies, and other BtoC companies, services offered by TerraSky that connect to LINE can be expected to draw a lot of attention and contribute to sales and earnings going forward. Here, too, there are already companies that offer similar services over Salesforce, but we believe that TerraSky, which excels in developing applications for Salesforce, is offering a superior service in terms of functionality and convenience. The Company's target is for this service to contribute to profits three years after its launch.

Outlook

**(4) AWS business reorganization**

In order to strengthen the AWS business, which is the fastest growing in the public cloud market, in March 2019 the Company transferred its AWS business division to BeeX with the aim of merging the strengths of both companies to expand sales. BeeX is developing services based on the two themes of data center transformation and hybrid cloud/multi-cloud, and mainly engages in supporting SAP cloud migration, AWS and Azure cloud infrastructure construction, and cloud operation and maintenance services, and has accumulated know-how in the SoR (System of Record)\* domain. Meanwhile, in the Company's AWS business, the Company possesses know-how in the field of SoE (System of Engagement)\* including AWS cloud infrastructure construction and migration support. By merging these, the Company aims to strengthen its proposal capabilities and increase orders.

\* SoR refers to a legacy operation system (a core system such as ERP) designed with an emphasis on accurate recording. It is a static system in which the data structure will not change significantly from the initial design stage. On the other hand, SoE refers to a system designed with emphasis on the connection with users. SoEs are designed not only to record and share inputted information, but also to be actually utilized by users and to strengthen the relationship between users and the system. Since the relationship with the user is constantly changing, it is necessary to design the system based on the assumption that the defined data structure will also dynamically change.

**(5) Corporate venture capital**

As discussed above, in March 2019 the Company established TerraSky Ventures for the purpose of investment and business development. TerraSky Ventures aims to invest in cloud-related B-to-B startups with the goal of adding value to companies and generating profits. In June 2019, TerraSky Ventures formed the TSV Investment Limited Partnership No. 1 as an investment fund. In addition to a ¥110mn investment from TerraSky and TerraSky Ventures, Japan Asia Investment Co., Ltd. invested ¥100mn in the fund. The plan is to increase the total size of the fund to ¥1.0bn by the end of 2019.

**(6) Quantum computers**

Quemix was established in June 2019 for the purpose of researching quantum computers and proposing solutions for companies. The Company plans to acquire priority access rights to use the state-of-the-art "IBM Q" quantum computer developed by IBM and develop algorithms and libraries for use. In addition, in order to stimulate discussions and research on quantum computers, the Company plans to launch a "Quantum Computing Lab" which will be used to support the development of researchers and R&D activities at participating companies. A specific example could be a case of working with a chemicals manufacturer to jointly develop an optimal algorithm for molecular structure analysis. Although they will be in the research and development stage for the time being, it is said that in the future quantum computers will solve problems with computational performance surpassing that of current supercomputers. The initiative is currently in the up-front investment stage.

## ■ Shareholder return policy

### Implementing a shareholder benefits plan, may consider paying dividend in near future

The Company has introduced a shareholder benefit plan as a measure to provide returns to shareholders. Specifically, the Company gives a ¥1,000 QUO Card to shareholders at the end of February each year. With regard to dividends, the Company continues not to pay dividends because it is prioritizing strengthening its financial base in anticipation of future business expansion as well as growing its business. However, the Company intends to start paying dividends when it has the extra ability to distribute profits, based on a comprehensive consideration of its financial condition, business results and other factors. Thus, if earnings continue to grow, there is a possibility that the Company will make its first dividend payment in the near future.

## ■ Information security policy

The TerraSky group has an established information security policy, provides management personnel regular training on information security, has been certified as meeting the ISO27001 information security management standards, and is constantly striving to strengthen its information management structure.



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