

A packaged service provider supporting business management, DX initiatives, etc.

Recommendation rating (Apr 15)

Scala, Inc.

(4845.TSE 1st)

Overweight

Stock Price	Unit of Investment	Market Cap	52-Week High	52-Week Low	PER(E)
782yen (4/15)	100Shares	13.74Bil yen (4/15)	857yen (21/1/26)	701yen (21/2/19)	5.1 (4/15)

Eyeing a sales expansion stage, Scala focuses on the formulation of 'schemes' for its Management and DX Support businesses

■ Upfront investment weighed down profits for 1H of FY21

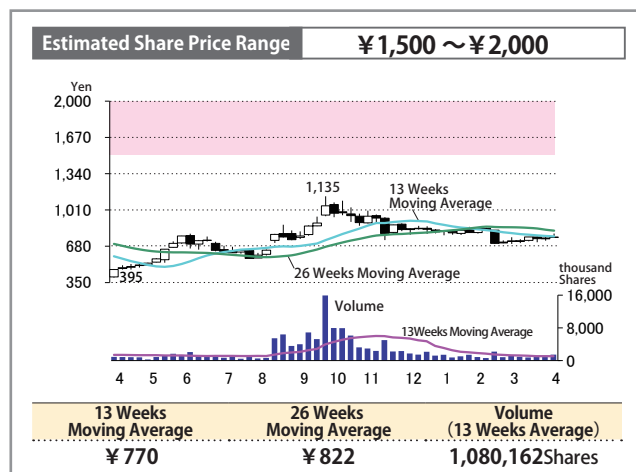
Scala, Inc. reported its consolidated business results (non-GAAP base) for the first six months (cumulative 2Q or 1H) of the fiscal year 2021, ending June 2021 (FY2021). In the period, sales revenue stood at Yen 4,285 million (up 17.5% year-on-year) and operating income was Yen 68 million (down 76.5% y-o-y). Although its mainstay IT/AI/IoT/DX business suffered a temporary surge in cancellations from the loyal client base amidst the COVID-19 pandemic ('the pandemic'), this was well offset by **fresh contributions from the newly established 'HR and Education' business and solid performance at the EC business, an operator of buying, selling and reusing matching game cards, as its digital marketing campaign led to an increased inflow of new users. On the profit front, the IT/AI/IoT/DX business delivered a double-digit decline in profit, but this was due to its proactive investment, mostly in newly launched businesses.** Two business segments - HR & Education and Investment & Incubation recorded a net loss. To cope with the pandemic, the former segment saw lower unit prices after the transition from face-to-face to the online platform of part of its new graduate recruiting programs, while the latter faced mostly up-front costs for development and employment programs.

Separately, by the end of 1Q, Scala transferred its entire shareholdings in Softbrain Co., Ltd., ('SB'). Consequently, from 2Q, businesses including SFA and Field Marketing that had been operated by SB have been reported as discontinued operations and excluded from the business segment. In conjunction with the change, there was a recomposition of its segment mix. (see Appendix)

■ Proceeds from sale of SB shares are to finance the Investment & Incubation business

In August 2019, Scala formulated its 'Medium-term Management Plan COMMIT5000' (details in 'Business Environment and Outlook' noted later). In this context, FY2021 that ends June 2021 may be regarded as the period to recompose management resources and lay the groundwork for the Med-term Plan's success. **In the wake of share sales, the company has ample cash to finance its Investment & Incubation business. However, rather than prioritizing capital injections in operations, it set out to develop schemes of business (hereinafter 'scheme(s)') that are expected to generate yearly revenue of Yen 100 ~ 200 million for offer to public companies.**

For example, on behalf of Architects Studio Japan Inc. ('ASJ', security code 6085), an intermediary between registered architects and construction company members, Scala formulated a 'scheme' comprising 'value-based management (IR) support', 'DX (digital transformation) support' and 'AI Engagement Fund (an investment limited partnership designated as Scala Co-creating Shared Value No.1, hereinafter 'SCSV'). Scala provides ASJ with IR support to help the latter create new value, with the aim of posting gains from the sale of ASJ shares on a long-term basis. As for the DX support business, Scala collaborates with ASJ to develop the 'construction work DX platform'. Scala is to receive fees for a platform development service



and the loyal clientele-based income derived from this business. On the other hand, Scala provided no capital, only a 'scheme' to Shinoken Group Co., Ltd. (security code 8909) who engages in the sale of private condominiums and apartments for investment purposes. Scala is to help Shinoken formulate a value creation story (= IR support) while the two companies jointly develop the 'property trust DX platform' (= DX support). This platform will serve to convert conventional face-to-face property transactions, entailing documentation and signatures, to non-face-to-face, online-based transactions using digital IDs. Shinoken Group will be the first user of the platform, subsequently marketing the completed version to other companies.

Scala's share price flourished in response to the announcement of its business results for the cumulative 2Q of FY2021, but lately it has shown a sign of recovery. The company's approach to prospective businesses with various 'scheme' proposals is expected to progress further from this quarter into the next fiscal year ending June 2022. However, for some months ahead, we are expecting that the IT/AI/IoT/DX business will secure a solid revenue base which is large enough to absorb the cash to aggressively finance the Investment & Incubation business. Morningstar believes that Scala sold off shares in SB, which showed steady but mediocre growth, to shift its strategy of injecting cash in highly profitable projects; however, the market appears not to have factored this strategic change in the recent share price. Considering this, we have revised our previous estimated share price range (¥1,000 ~ ¥1,500). We have set the new high end price limit at ¥2,000. This was calculated by applying 13 times of forecast PER, undervaluing the average industry forecast, multiplied by the low end of its ESP guidance range at ¥154. The new estimated low-end price has been set at the nearest downside support at ¥1,500. Our valuation of the company shares remains unchanged with an 'Overweight' rating.

Financial Results (as of Apr 15, 2021)

		Revenue (Yen Mil)	YoY (%)	Operating Profit (Yen Mil)	YoY (%)	Income Before Income Taxes (Yen Mil)	YoY (%)	Net Profit (Yen Mil)	YoY (%)	EPS (Yen)
2019-6	Past Results	17,112	33.4	2,153	39.2	2,137	39.1	946	33.8	55.9
2020-6	Past Results	17,025	▲0.5	1,045	▲51.5	1,018	▲52.3	431	▲54.4	24.8
2021-6	Company est.	9,000 ~12,000	—	100 ~500	—	100 ~500	—	2,700 ~3,100	—	154.19 ~177.04
	MS est.	10,500	▲38.3	300	▲71.3	300	▲70.5	2,900	6.7	165.1
2022-6	MS est.	17,050	1.6	1,705	5.7	1,705	5.7	720	▲75.2	41.0

※ Scala, Inc. has prepared its financial statements under IFRS (International Financial Reporting Standards) from the fiscal year ended June 2016, but figures in the table (adjusted items that arose after the adoption of IFRS were excluded) are restated in line with non-GAAP.

In addition, the share price is highly likely to make major leaps forward when Scala newly launches No.2 and No.3 SCSVs and the achievement of its Med-term Management Plan comes into sight on the back of a growth in 'scheme' proposal adoptions.

(Takahiro Arimura)

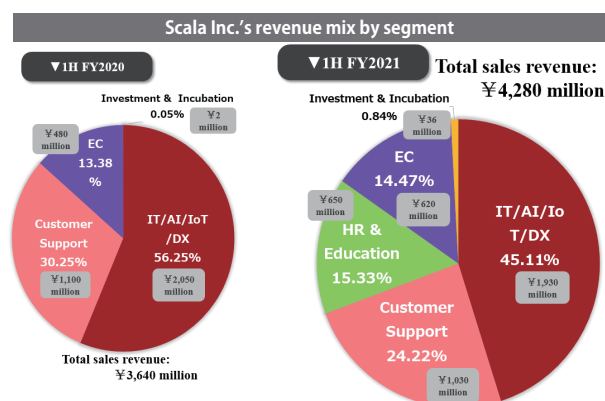
Company Overview

Scala, Inc. embarked on an enterprise with the SaaS/ASP business. In July 2016, the company incorporated a marketing support system provider Softbrain Co., Ltd., as its consolidated subsidiary. In March and November 2018, Scala incorporated both Leoconnect, Inc., then a subsidiary of Hikari Tsushin, Inc. (security code 9435), and Connect Agency Inc., a sub-subsidiary of Hikari Tsushin, as its consolidated subsidiaries. In August 2019, in line with its mid-term plan, Scala announced that it had consolidated J-Phoenix Research Inc. which engaged primarily in support and consultation for the implementation of AI/IoT technology. At the same time, it established Scala Partners, Inc., an enterprise that provides financial assistance and develops companies within the AI and other fields. In April 2020, the company incorporated Grid Group Holdings Co., Ltd., a facilitator of regional revitalization and regeneration programs among other services, as its wholly owned subsidiary. Then following a successful takeover bid by C5-8 Holdings Co., Ltd. for Softbrain Co., Ltd. in November 2020, Softbrain Co., Ltd. and its subsidiaries became discontinued operations from 2Q FY2021. In November 2020, Scala launched a 'Reversed Publicly Solicited Proposal' service (or 'Reversed Proposals' for short). The company developed the service in collaboration with Public dots & Company, an operator of public-private co-creation projects. The Reversed Proposal focuses on SDG initiatives. The service has garnered attention for its innovative method - it looks to local municipalities to plan for public-private co-creation projects, while private sector organizations that plan the actual development the new projects budget and finance them.

Business Environment and Outlook

According to the '2020 WHITE PAPER: Information and Communications' released by the Japanese Ministry of Internal Affairs and Communications, the penetration of AI and IoT has shown marked progress, with the number of IoT devices in use worldwide estimated to increase from roughly 25.4 billion units in 2019 to 34.8 billion units by the end of 2022. On the back of mounting needs for further efficiency and labor saving across the board, the speed of adoption of AI technology appears to accelerate going forward.

Meanwhile, Scala, Inc. has formulated its 'Medium-term Management Plan COMMIT5000'. The plan outlines the company's three 'capabilities' that have been acquired through the operation of SaaS/ASP services (1. The capability of discovering real issues; 2. The capability of revealing the hidden value of resources; and 3. The capability of proposing and executing an optimal combination of issues and resources to maximize value.) With an eye to effectively implementing the three capabilities, the company has newly established the following segments that will assume the objective: 1. An added value-based management support business; 2. An IT/AI/IoT-related business; 3. A social issue solution-oriented business. In line with the Medium-term Management Plan, Scala is set to rearrange the existing and new businesses into the three Business domains, with a view to generating an organic alliance between them and three capabilities to maximize customer value. With the fulfillment of this vision, the plan has set dual-period earnings projections. One is to achieve Yen 100 billion in sales revenue (operating income of Yen 10 billion) by FY2025 and the other Yen 500 billion in sales revenue (operating income of Yen 50 billion) by FY2030. To date, the company has developed and commercialized projects or programs building on its three capabilities, aimed mainly at listed companies in Japan. However, it now plans to expand its markets to target government-affiliated enterprises, local authorities and overseas companies.



※ Following the recognition of discontinued operations of Softbrain Group companies, Scala reorganized its line of business into five segments.
(Source) Created by Morningstar Japan, based on the company's data.

Business segment overview

When Softbrain Group companies discontinued, Scala reorganized its businesses into five segments.

Reportable segment	Group company	Description of business	
IT/AI/IoT/DX	Scala Communications, Inc. Scala Service, Inc.	Provision of SaaS/ASP services	
	Scala Next Inc.	Development of SaaS/ASP services and offshore development	
	Connect Agency, Inc.	Cloud based PBX service	
	Retool, Inc.	Planning, development and sale of cloud activity management tools	
	Social Studio Inc.	Support administrative bodies and local municipalities in their promotion of DX programs	
Customer Support	Leoconnect, Inc.	Consulting of customer support (call center operation, etc.)	
HR & Education	Grit Group Holdings, Inc. Athlete Planning, Inc. Sports Stories, Inc. FourHands, Inc.	Recruiting agency, child education, physical education, support for recruiting overseas human resources	
	EC	Scala PLAYce, Inc.	Operation of EC sites to trade matching game cards
	Investment & Incubation	Scala, Inc. Scala Partners, Inc.	Group headquarters, holding company and investment business Innovation, incubation and investment
		J-Phoenix Research Inc. (JPR)	Support for value based management (preparation of analyst and integration reports; fund management support)
SCL Capital LLC		Investment fund management	
SCSV-1 Investment Limited Liability Partnership		Investment fund	

(Source) Created by Morningstar Japan, based on the company's data.

Risk Factors

Scala commits to a service level agreement (SLA) with clients of SaaS/AS services. SLA defines a certain level of assurances for server operations, care for service failures, notice concerning scheduled maintenance, among others. This indicates that the company may face a large amount of indemnity should its service fails, for whatever reason, to comply with the levels of assurance defined by SLA. Separately, in November 2018 the company established Scala Next, Inc., with the aim of planning and developing SaaS/ASP businesses and services. The subsidiary develops part of the cost-reduction projects in its Mandalay branch in Myanmar. In February 2021, the Myanmar national army launched a coup d'état, then in March, six districts in Yangon (the country's largest city) were placed under martial law. Although the Mandalay branch of Scala Next, Inc. has incurred no actual damage, it is necessary to keep a close watch on the heightening geopolitical risk in the country.

Shareholder Return (As of Apr 15)

Dividends

		Dividend Per Share		
		First half	Second half	Annual
2019-6	Past Results	¥12	¥12	¥24
2020-6	Past Results	¥14	¥14	¥28
2021-6	Company est.	¥16	¥16	¥32

Shareholder Special Benefits

None

Competitor Comparison (If the number is better than rivals, it's highlighted by red character) (As of Apr 15)

	Scala, Inc. (4845•TSE 1st)	PiPEDO HD, Inc. (3919•TSE 1st)	Cybozu, Inc. (4776•TSE 1st)	
Basic Point	Stock Price	¥782	¥1,680	¥2,512
	Unit of Investment	100Shares	100Shares	100Shares
	Minimum Investment Amount	¥78,200	¥168,000	¥251,200
	Fiscal Year End	June	February	December
Share Price Indicator	PER (E)	5.1	15.6	1059.9
	PBR	1.8	2.9	18.0
	Dividend Yield (E)	4.1%	—	0.5%
Growth	Revenue Growth Rate (E)	▲47.1%	7.3%	17.0%
	Operating Profit Growth Rate (E)	▲90.4%	▲1.9%	▲54.4%
	EPS Growth Rate (E)	743.5%	▲30.5%	▲92.4%
Profitability	Operating Margin (E)	1.1%	20.0%	5.6%
	ROE	4.5%	29.3%	27.6%
	ROA (Ordinary income/Total assets)	4.2%	19.1%	21.5%
Financial Health	Equity ratio	29.7%	55.6%	52.4%
	Debt-Equity Ratio	155.8%	39.1%	0.0%
	Current Ratio	145.5%	221.3%	119.8%

We selected PiPEDO HD, Inc. (security code: 3919) and Cybozu, Inc. (security code: 4776) as industry peers. Scala competes with these on some operations of the Site Assistant and CRM Services in the SaaS/ASP business field.

※ Scala's estimated data shown above represent the low end of its guidance ranges for FY2021.

■ Growth Potential

The consolidated earnings for the full FY2021, ending June 2021, are expected to show declines in both revenue and profit in real terms. This is due to the discontinuation of the SB business from 2Q (between October 2021 ~ June 2021). On the other hand, the year has recognized a gain from the sale of SB shares and the gain is expected to finance the development of the Investment & Incubation business. From a medium- and long-term strategic perspective, these moves can be regarded as a recomposition of Scala's management resources, not impediments to its growth potential. By holding SB shares, in time, the shareholder value may double, but based on management's judgement and estimation, Scala resolved to invest the proceeds from the sale of SB shares in highly profitable projects, resulting in an increase in shareholder value at least four times that of the former case.

Of industry peers, we note the revenue growth and negative operating income growth outlooks by Cybozu, Inc. The company expects solid growth in revenue from the cloud business for FY2021, ending December 2021, and plans to implement an aggressive investment strategy to boost profitability.

Each of the above earnings figures for comparison represents the low end of its company guideline range.

■ Profitability

Scala forecasts that its operating income margin for FY2021 will be in the range of 1.1% ~ 4.2%. Its profitability is likely to be under downward pressure from up-front investment in its operations, with particular focus on IT/AI/IoT/DX and Investment & Incubation businesses as well as new businesses and business scheme development projects. Meanwhile, its proactive investment in growth and development programs implemented in FY2020 lowered levels of operating income as well as the other income items presented under it, thereby its ROE and ROA are relatively lower than those of its peers.

■ Financial Stability

At the end of FY2020, Scala's equity ratio was relatively lower than those of its peers. Its debt equity ratio was greater than 100%, meaning its debt, including borrowings, was in excess of its equity capital. Nevertheless, the company management regards M&A (corporate mergers and acquisitions) as an important business issue therefore, the effective use of interest-bearing debt can be viewed as its strategic intent. On the other hand, the company owns a large proportion of current assets, with its liquidity ratio in the mid-position in the competition table. We believe that Scala's balance sheet is well controlled overall, with no particular concern about its financial standing.

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How to Read Morningstar Equity Research Report

Our Uniqueness

(1) Emphasize Its Position as an Independent Evaluation Organization

Morningstar emphasizes its position as an independent evaluation organization and is committed to providing objective comparison and assessment in the Morningstar Equity Research Report. For all stocks covered by us, we determine investment decisions, estimated share price range and earnings forecasts based on expertise of an individual analyst as well as the stock assessment committee consisting of several analysts.

(2) Universe of Covered Stocks

The stock assessment committee selects covered stocks based on the following criteria.

[Stock Selection Criteria]

- Domestic emerging companies that are rarely covered by analysts
- Stocks that are popular among retail investors (refer to data from online security brokers)
- Size of market capitalization (over about 5 billion yen)
- Exclude stocks which are liquidated or trade control, or stocks with going concern and excessive debt

(3) Investment Decisions Classified into Three Groups

We determine investment decisions for covered stocks after consultation with the stock assessment committee based on research, interview and analysis by each Morningstar analyst.

Each stock is classified into either of three groups according to the following criteria.

Overweight

: Forecasted to go beyond the current stock price level by 15% or more in the next 6 months.

Neutral

: Forecasted to fall into the range of -15% ~+15% of the current stock price level in the next 6 months.

Underweight

: Forecasted to go below the current stock price level by 15% or more in the next 6 months.

We flexibly respond to any changes of observations regarding earnings forecasts, financial situations and stock price trends, and change investment decisions accordingly. "Under Review" status may be applied if any new information comes out and extra time is needed to determine investment decisions. Also we don't change investment decisions during trading hours. "Suspension" status may be applied when an analyst leaves our company.

(4) Estimated Share Price Range in the Medium Term

It shows the price range for a stock price in the next 6 months. We determine upper and lower range of stock price based on fair value estimates from share price indicator, technical factors such as chart points, most recent high and low prices, trend line and moving average, trading volume in each price range and such.

Analysis Points

■ Analyst Comment

Each analyst reports and evaluates the most recent earnings trend and business environment. It shows the most important information for stock investment such as evidence for investment decisions, perspectives on earnings forecasts and business prospects. Also to make sure it is easy to comprehend, we write in 2-4 paragraphs and use bold to emphasize important texts.

■ Revenue and Earnings Trend

It reports earnings in past two fiscal years, company forecasts and our forecasts for the current and next fiscal year. We predict earnings based on research as well as past quarterly earnings trend and analysis by segments.

■ Company Overview

It explains in detail what businesses the company is engaged in and how revenue sources are defined. Also on the basis of our research, it discusses what businesses the company will focus on in years to come and how it carries out mid-term business plan.

■ Business Environment and Outlook

It discusses current circumstances and growth potential of the industry to which the company belongs. A comprehensive report on the industry from different perspectives is provided through research interviews to competitors. Specific figures of the industry data are also introduced.

■ Risk factors

It shows the company's risk factors and describes various aspects of risks such as business, earnings and financials. Typical stock market risks are also taken into consideration.