

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

Recommendation rating (Sep21)

# Scala, Inc.

(4845.TSE 1st)

**Overweight**

| Stock Price      | Unit of Investment | Market Cap             | 52-Week High        | 52-Week Low         | PER(E)         |
|------------------|--------------------|------------------------|---------------------|---------------------|----------------|
| 759yen<br>(9/21) | 100Shares          | 13.36Bil yen<br>(9/21) | 883yen<br>(21/5/24) | 694yen<br>(21/5/13) | 24.3<br>(9/21) |

## Rolling out DX support business for public companies and local councils

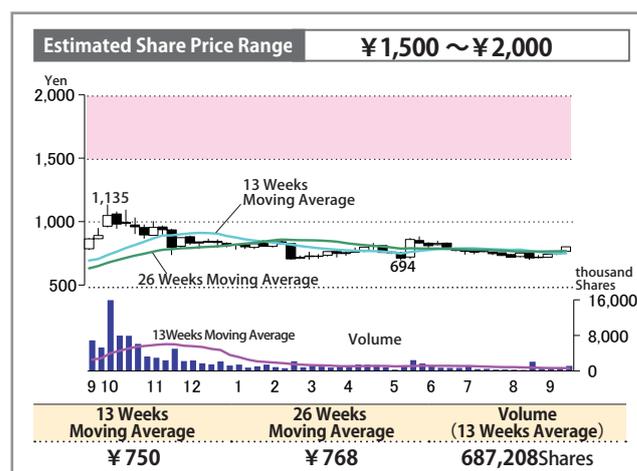
### ■ FY2021 saw the anticipated profit decline, as it pressed ahead with strategic investment

Scala, Inc. reported its consolidated business results (non-GAAP base) for the full fiscal year 2021, ended June 2021 (FY2021). In the period, sales revenue came to ¥8,734 million (up 14.6% year-on-year) and operating income was ¥282 million (down 16.2% y-o-y). The increase in sales revenue was driven by the growth of two newly incorporated businesses (in the scope of consolidation) - HR & Education Business and EC Business. However, sales revenue failed to deliver the target. The impact of the COVID-19 pandemic exceeded the company's predicted period and scale, which resulted in fewer events hosted by the HR & Education Business and softened demand for the call center service at the Customer Support Business. **Operating income came within its announced range, thanks mainly to steady performance of its mainstay IT/AI/IoT/DX Business, offsetting costs for strategic investment into the HR & Education as well as Incubation&Investment Businesses.**

### ■ Stimulating local council needs with 'Gyaku Propo' to capture new DX projects

In August 2019, Scala formulated its 'Mid-term Management Plan COMMIT5000' (details in 'Business Environment and Outlook' noted later). FY2021 ended June 2021 was the period to reshape management resources and lay the groundwork for the Mid-term Plan's success. In FY2022 ending June 2022, Scala continues with its strategic investment initiative centered on the Incubation & Investment Business. Meanwhile, the company has ample cash following its sale of shares in the former consolidated subsidiary SOFTBRAIN Co., Ltd., a marketing support system provider, therefore it is likely that some initiatives will shift into full gear. These include the development of business schemes (hereinafter 'scheme(s)') for public companies with annual sales of ¥100 ~ 200 million. For example, on behalf of Cookbiz Co., Ltd. (security code 6558), a job placement website operator specializing in the food industry, Scala formulated a 'scheme' comprising 'promotion of value-based management by supporting its IR activities', 'DX (digital transformation) support' and 'capital injection from the AI Engagement Fund (an investment limited partnership designated as Scala Co-creating Shared Value No.1, hereinafter 'SCSV'). Scala provides support to Cookbiz in its IR activities in an effort to create new value, aiming for gains from the sale of Cookbiz shares on a long-term basis. **As for the DX support, Scala collaborates with Cookbiz to develop the 'restaurant business DX platform', on which they promote reconstruction of restaurant operations faced with such challenges as low labor productivity and dependency on on-site sales/service as well as new customers. The company is to receive fees for a platform development service and loyal clientele-based income derived from this business.**

Meanwhile, the 'reversed publicly solicited proposal' (or 'Gyaku Propo'), a service platform combining public-private co-creation support with DX support, got off to a good start. The feature of



*Gyaku Propo* is that it calls on local councils to scheme public-private co-creation projects to address social issues such as SDG promotion, while private sector organizations that plan the actual development of those new projects make a budget and finance them. Among cases commenced in the previous year, business organizations sought local councils' ideas concerning issues such as assistance for senior drivers or implementation of the next-generation wheelchair. Five local councils regarding improvement of traffic environment as their pressing issue tendered for these reversed proposals; two of the local councils' ideas were adopted. Business organizations provide a budget amounting to a few million yen, part of which is donated to the successful local council. Scala not only receives a commission for driving the reverse proposal deal but also a service fee for the development of a DX support platform that fleshes out the local council's idea as well as receiving loyal clientele-based income derived from this business from the relevant council. **In this fiscal year, Scala is likely to leverage the municipality project to extend its local council client base, also obtain more opportunities from each successful local councils that tendered ideals.**

The company's approach to prospective businesses with various 'scheme' proposals is expected to progress further from this fiscal year into the next, ending June 2023. For some time ahead, we expect that the IT/AI/IoT/DX Business will secure a solid revenue base which is large enough to absorb the cost of substantially financing the Incubation & Investment Business. In addition, Scala's midterm management plan is highly likely to be achieved once it newly launches No.2 and No.3 SCSVs and its business growth trajectory rises on the back of increased

### Financial Results (as of Sep 21, 2021)

|                     | Revenue (Yen Mil) | YoY (%)      | Operating Profit (Yen Mil) | YoY (%)      | Income Before Income Taxes (Yen Mil) | YoY (%)      | Net Profit (Yen Mil) | YoY (%)      | EPS (Yen)     |
|---------------------|-------------------|--------------|----------------------------|--------------|--------------------------------------|--------------|----------------------|--------------|---------------|
| 2020-6 Past Results | 7,624             | —            | 337                        | —            | 313                                  | —            | 218                  | —            | 12.6          |
| 2021-6 Past Results | 8,734             | 14.6         | 282                        | ▲16.2        | 251                                  | ▲19.9        | 121                  | ▲44.3        | 6.9           |
| 2022-6 Company est. | 12,000<br>~20,000 | 1.4<br>~2.3倍 | 450<br>~1,200              | 1.6<br>~4.3倍 | 400<br>~1,150                        | 1.6<br>~4.6倍 | 300<br>~800          | 2.5<br>~6.6倍 | 17.1<br>~45.5 |
| MS est.             | 16,000            | 1.8倍         | 825                        | 2.9倍         | 775                                  | 3.1倍         | 550                  | 4.5倍         | 31.3          |
| 2023-6 MS est.      | 29,500            | 1.8倍         | 2,150                      | 2.6倍         | 2,100                                | 2.7倍         | 1,570                | 2.9倍         | 89.2          |

※ The company prepares its financial information under the IFRS (International Financial Reporting Standards), but the above figures have been reconciled to non-GAAP measures (actual figures) by excluding adjustments and other items made on adoption of the IFRS.

※ Sales revenue, operating income and income before taxes for FY2020 and FY2021 are from continuing operations, while net income for these years represents actual figures excluding those from non-continuing operations.

※ Year-on-year changes for FY2020 have not been disclosed.

adoption of 'scheme' proposals.

Morningstar (MS) believes that recent share prices appear not to have duly evaluated Scala's medium to long-term strategies yet. Our estimated share price is in the range of ¥1,500 ~ ¥2,000 (unchanged from previous estimates). We have set the upward end price at around ¥2,000. This was calculated by multiplying the industry average PER of 29 times by MS's forecast EPS for FY2023 (ending June 2023) at ¥89. The downward end price has been set at its support level of ¥1,500. Our valuation of the company shares remains unchanged with an 'Overweight' rating. (Takahiro Arimura)

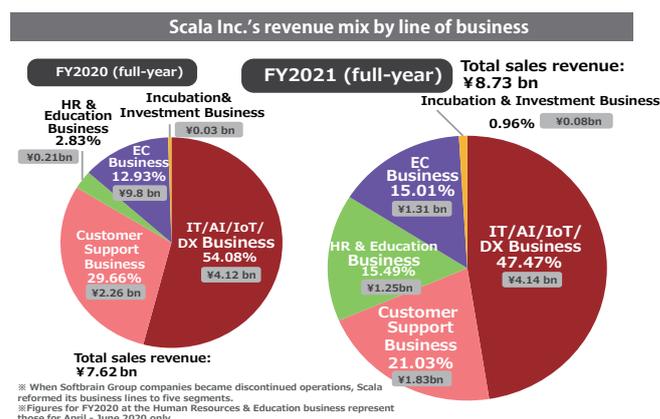
**Company Overview**

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 midterm 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 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 August 2021, the company incorporated readytowork, Inc. as its 100% subsidiary. readytowork supports domestic clients in Nepal in their new business development and DX changeovers, primarily concerning web systems. This is Scala's second offshore technology development base, following the first Scala Next Inc. Mandalay branch (Myanmar) established in December 2018. Combined with the base in Japan, the company now deploys three technology bases with a view to shortening DX development time and accumulating expertise.

**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.

Scala, Inc. has formulated its 'Mid-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 the purpose of effectively proposing these 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 Mid-term Management Plan, Scala is set to organically coordinate the three capabilities with the three business segments to maximize customer value. With the fulfillment of this vision, the plan has set dual-period earnings projections. One is to achieve ¥100 billion in sales revenue (operating income of ¥10 billion) by FY2025 and the other ¥500 billion in sales revenue (operating income of ¥50 billion) by FY2030. The company plans to develop and commercialize the three capabilities for public companies and others in Japan. It is also set to expand its markets targeting government-affiliated enterprises, local authorities and overseas companies.



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

**Business segment overview**

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

| Reportable segment      | Group company                                     | Description of business  |
|-------------------------|---|--|
| IT/AI/IoT/DX            | Scala Communications, Inc.<br>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 for administrative bodies and local municipalities in their DX and SDGs programs                     |
| Customer Support        | Leoconnect, Inc.                                  | Consulting of customer support (call center operation, etc.)   |
| HR & Education          | Athlete Planning, Inc.                            | Provides support for personnel employment (new graduates and mid-career recruitment) and other services      |
|                         | FourHands, Inc.                                   | Provides support for child education, community development etc.   |
|                         | Sports Stories, Inc.                              | Operates physical education, sports lessons and others   |
| EC                      | Scala PLAYce, Inc.                                | Operation of EC sites to trade matching game cards   |
| Incubation & Investment | Scala, Inc.                                       | Group headquarters, holding company and investment business  |
|                         | Scala Partners, Inc.                              | 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 fail, 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 March 2021, the Myanmar national army launched a coup d'etat and 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 Sep 21)**

**Dividends**

|        |              | Dividend Per Share |             |        |
|--------|--------------|--------------------|-------------|--------|
|        |              | First half         | Second half | Annual |
| 2020-6 | Past Results | ¥14                | ¥14         | ¥28    |
| 2021-6 | Past Results | ¥16                | ¥18         | ¥34    |
| 2022-6 | Company est. | ¥16                | ¥16         | ¥32    |

※ Dividends for FY2021 included a ¥2.00 special dividend to commemorate its 30th anniversary.

**Shareholder Special Benefits**

None

## Competitor Comparison (If the number is better than rivals, it's highlighted by red character) (As of Sep 21)

|                       | Scala, Inc.<br>(4845•TSE 1st)      | PiPEDO HD, Inc.<br>(3919•TSE 1st) | Cybozu, Inc.<br>(4776•TSE 1st) |               |
|-----------------------|------------------------------------|-----------------------------------|--------------------------------|---------------|
| Basic Point           | Stock Price                        | ¥759                              | ¥2,524                         | ¥2,544        |
|                       | Unit of Investment                 | 100Shares                         | 100Shares                      | 100Shares     |
|                       | Minimum Investment Amount          | ¥75,900                           | ¥252,400                       | ¥254,400      |
|                       | Fiscal Year End                    | June                              | February                       | December      |
| Share Price Indicator | PER (E)                            | 24.3                              | <b>21.9</b>                    | —             |
|                       | PBR                                | <b>1.3</b>                        | 4.4                            | 18.2          |
|                       | Dividend Yield (E)                 | <b>4.7%</b>                       | 1.0%                           | 0.5%          |
| Growth                | Revenue Growth Rate (E)            | <b>83.2%</b>                      | 11.9%                          | 17.0%         |
|                       | Operating Profit Growth Rate (E)   | <b>275.0%</b>                     | 5.1%                           | <b>▲85.5%</b> |
|                       | EPS Growth Rate (E)                | <b>▲82.1%</b>                     | <b>▲25.5%</b>                  | —             |
| Profitability         | Operating Margin (E)               | 5.2%                              | <b>20.5%</b>                   | 1.8%          |
|                       | ROE                                | <b>34.9%</b>                      | 29.3%                          | 27.6%         |
|                       | ROA (Ordinary income/Total assets) | 0.8%                              | 19.1%                          | <b>21.5%</b>  |
| Financial Health      | Equity ratio                       | 50.0%                             | <b>55.6%</b>                   | 52.3%         |
|                       | Debt-Equity Ratio                  | 84.4%                             | 39.1%                          | <b>0.0%</b>   |
|                       | Current Ratio                      | <b>264.5%</b>                     | 221.3%                         | 119.8%        |

Note: 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 service in the SaaS/ASP business field.

※ Scala's estimates for FY2021, shown above, represent the median of its guidance ranges.

### ■ Growth Potential

The consolidated financial results forecast for the year ending June 2022 shows that Scala will outperform competitors in terms of growth rate of revenue and operating income margin. Scala approaches top management of public companies through Engagement Funds (SCSV) and proposes support services concerning DX, business management, among others. This method is expected to dramatically drive growth of its IT/AI/IoT/DX and Incubation & Investment Businesses.

Of industry peers, we note Cybozu, Inc.'s forecast of solid revenue growth from its cloud business for FY2021, ending December 2021. At the same time, it expects that its operating income growth will slide deeply into contracting territory as it plans to aggressively invest in advertising and general publicity programs to drive future profitability.

### ■ Profitability

Scala forecasts that its operating income margin for FY2022 will be in the range of 3.8% ~ 6.0%. 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 Incubation & Investment Businesses as well as new businesses and business scheme development projects. On the other hand, its ROE is expected to improve significantly to 34.9% (a 30.4-point increase from last year). This is probably due to a sharp rise in net profit thanks to the recognition of a profit from a non-continuing operation in FY2021.

### ■ Financial Stability

Scala's equity ratio at the end of FY2021 showed a marked recovery to 50.0% (a 20.3-point increase from last year). In the year, its cash position soared after it posted an income from a non-continuing operation. Its debt equity ratio is relatively high, but 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 being at the highest position in the competition. We believe that Scala's balance sheet is well controlled overall, with no particular concerns 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.