

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

Recommendation rating (Oct 3)

Scala, Inc.

(4845.TSE Prime)

Overweight

Stock Price	Unit of Investment	Market Cap	52-Week High	52-Week Low	PER(E)
671yen (10/3)	100Shares	11.88Bil yen (10/3)	789yen (22/5/30)	628yen (22/1/20)	17.4times (10/3)

Accelerating its M&A strategy to achieve targets

Business results for FY6/22 were driven by the IT/AI/IoT/DX and EC businesses

Scala, Inc. reported its consolidated business results (Non-GAAP) for full fiscal 2021 ended June 2022 (FY6/22). In the period, sales revenue came to ¥10,015 million (up 15.0% year-on-year) and operating profit was ¥99 million (down 78.9% y-o-y). The Customer Support Business that saw a large account cancellation in 1H (July 2021 ~ December 2021) suffered a fall in revenue, posting a segment deficit for the year. The Incubation & Investment Business continued its strategic investment initiative. It reported higher revenue but widened segment deficit on the year, while the newly launched Insurance Business remained in deficit, despite that it began to record revenue from marketing insurance products. Meanwhile, its mainstay IT/AI/IoT/DX Business, alongside HR & Education and EC Businesses, showed a strong performance, securing revenue growth and operating profit overall.

FY6/23 likely to see a marked earnings recovery

Scala's consolidated business results forecast for fiscal 2022 ending June 2023 (FY6/23) are shown in the appended table on Page 1. In this, the company anticipates a sharp earnings recovery, bolstered by strong sales revenue growth. Earnings at the IT/AI/IoT/DX and HR & Education Businesses are expected to improve significantly, also the highly profitable EC Business is likely to sustain a solid performance. The money-losing Customer Support Business is forecast to break even, thanks in large part to an accelerated shift towards labor-saving and high profit-oriented call center projects. Consequently, the running deficits from strategic businesses are to be absorbed across the company.

With regard to the performance of strategic businesses for FY6/23, the Insurance Business is likely to see revenue growth, but it is expected to post a larger net loss due to heavy insurance claim payments (NB. Scala forecasts that the business will post a surplus on a monthly basis during FY6/24). Going forward, the business plans to broaden and enhance healthcare-related services and engage in an operation that focuses on the capability of transferring insurance risks (i.e. a financial function). Meanwhile, the Incubation & Investment Business is projected increasingly to achieve revenue growth and cut down on net losses. These trends are supported principally by two factors, comprising the winning of more projects on the back of the enhanced service of 'Reversed Public Offering Proposal' (a private-public co-creation-oriented matching platform; hereinafter referred to as its Japanese abbreviated name 'Gyaku Propo'), and the launch of two new services related to M&As (mergers and acquisitions). One is a 'Co-creation-oriented M&A Advisory' service in which Scala provides counselling to its partners in line with the 'co-creation concept' and the other is the 'Special Appointed Task Force for M&A' that provides on-site supports to its M&A partners.



Start-up undertakings and projects operated by these strategic businesses are unlikely to generate a profit in the short to medium-term. However, Scala often secures orders for system development projects related to its services, contributing to higher earnings for the mainstay IT/AI/IoT/DX Business. Scala intends the M&A initiative as its medium to long-term growth strategy, thus it conducts research and due diligence on potential M&A deals on a routine basis. Although it is inevitable for the Incubation & Investment Business to incur up-front investment expenses to some degree, it holds the key to the company's future consolidated earnings growth.

In August 2019, Scala formulated its 'Medium-term Management Plan COMMIT5000' (for details, see 'Business Environment and Outlook' shown later); It now eyes to achieve ¥100 billion in sales revenue and ¥10 billion operating profit by FY6/25. Morningstar adheres to the company's forecasts for FY6/23, but in the succeeding FY6/24 we believe that the company will step up its growth strategy that leverages M&A deals to accomplish its targets. Our estimated share prices have been kept as they were reported on April 22nd, in the range of ¥900 ~ ¥1,200. The lower limit of the range is on a par with the number calculated by multiplying the company's forecast EPS (earnings per share) by the industry's estimated PER which is in the 23 times range. Scala plans to pay increased full-year dividends for 14 years in succession, making the expected dividend yield for this fiscal year at an attractively high-level of 5.5%. Our valuation of the company shares remains unchanged with an 'Overweight' rating.

(written by Takahiro Arimura)

Financial Results (as of Oct 3, 2022)

	Revenue (Yen Mil)	YoY (%)	Operating Profit (Yen Mil)	YoY (%)	Income Before Income Taxes (Yen Mil)	YoY (%)	Net Profit (Yen Mil)	YoY (%)	EPS (Yen)
2021-6 Past Results	8,712	—	471	—	440	—	387	—	22.1
2022-6 Past Results	10,015	15.0	99	▲78.9	81	▲81.6	44	▲88.5	2.5
2023-6 Company est.	13,000	29.8	1,000	—	970	—	650	—	38.6
MS est.	13,000	29.8	1,000	10.1times	970	12.0times	650	14.8times	38.6
2024-6 MS est.	50,000	3.8times	5,000	5.0times	4,850	5.0times	3,250	5.0times	183.6

※ 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.

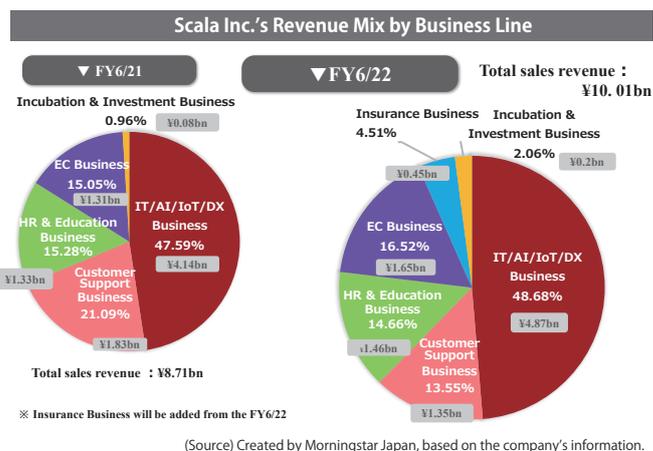
Company Overview

Scala, Inc. embarked on an enterprise with the SaaS/ASP (currently IT/AI/IoT/DX) business. It has rigorously executed its growth strategy through M&As. In 2018, it incorporated two firms as its consolidated subsidiaries. The first, in March, was Leoconnect, Inc., at that time a subsidiary of Hikari Tsushin, Inc. (security code 9435); the next, in November, was Connect Agency Inc., a sub-subsidiary of Hikari Tsushin. In August 2019, in line with its medium-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 to and develops companies in the AI and other fields. In August 2021, the company incorporated readytowork Co., Ltd. as its wholly owned subsidiary. The subsidiary supports Japanese clients based in Nepal in their new business developments and DX changeovers, primarily concerning website systems. The Nepal subsidiary 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. In November 2021, the company set up a subsidiary SOCIALX, Inc. to operate 'Gyaku Propo' programs. In 2022, Scala consolidated two companies as its subsidiary - Nihon Pet Small-amount Short-term Insurance Company and EGG CO., LTD. The former is a provider of low-premium, short-term pet insurance plans and the latter is a firm particularly excelling in the development of hometown taxation schemes.

Business Environment and Outlook

According to the '2021 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 25.3 billion units in 2020 to 39.8 billion units by the end of 2024. 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 '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 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 Medium-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.



Reportable segment	Group company	Description of business
IT/AI/IoT/DX	•Scala Communications, Inc.	Provision of SaaS/ASP services
	•Scala Service, Inc.	Provision of SaaS/ASP services
	•Scala Next Inc.	Development of SaaS/ASP services and offshore development
	•readytowork Co., Ltd.	Cloud-based PBX service
	•Connect Agency, Inc.	Cloud-based PBX service
Customer Support	•Retool, Inc.	Planning, development and sale of cloud activity management tools
	•Social Studio Inc.	Support for administrative bodies and local municipalities in their DX programs
	•EGG CO., LTD.	System development/system maintenance/network establishment
HR & Education	•Leoconnect, Inc.	Consulting of customer support (call center operation, etc.)
	•Athletic Planning, Inc.	Provides support for personnel employment (new graduates and mid-career recruitment) and other services
EC	•FourHands, Inc.	Provides support for child education, community development etc.
	•Sports Stories, Inc.	Operates physical education, sports lessons and others
Insurance	•Broncos20 Co., Ltd.	Management of basketball club team
	•Scala PLAYce, Inc.	Operation of EC sites to trade matching game cards
Incubation & Investment	•Nihon Pet Small-amount Short-term Insurance Company New	Provision of low-premium, short-term insurance plans
	•Scala, Inc.	Group headquarters, holding company and investment business
	•Scala Partners, Inc.	Innovation, incubation and investment
	•J-Phoenix Research Inc.	Support for value-based management (preparation of analyst and integration reports, fund management support)
	•SCL Capital LLC	Investment fund management

(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 Oct 3, 2022)

Dividends

		Dividend Per Share		
		First half	Second half	Annual
2021-6	Past Results	¥16	¥18	¥34
2022-6	Past Results	¥18	¥18	¥36
2023-6	Company est.	¥18.5	¥18.5	¥37

※ 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 Oct 3, 2022)

	Scala, Inc. (4845•TSE Prime)	PIPEDO HD, Inc. (3919•TSE Standard)	Cybozu, Inc. (4776•TSE Prime)	
Basic Point	Stock Price	¥671	¥2,797	¥1,477
	Unit of Investment	100Shares	100Shares	100Shares
	Minimum Investment Amount	¥67,100	¥279,700	¥147,700
	Fiscal Year End	June	February	December
Share Price Indicator	PER (E)	17.4times	24.5times	—
	PBR	1.3times	4.0times	10.6times
	Dividend Yield (E)	5.5%	0.0%	0.9%
Growth	Revenue Growth Rate (E)	29.8%	2.5%	18.1%
	Operating Profit Growth Rate (E)	910.1%	▲9.6%	▲120.8%
	EPS Growth Rate (E)	1,448.6%	▲19.0%	—
Profitability	Operating Margin (E)	7.7%	18.8%	-1.4%
	ROE	▲5.5%	22.1%	8.6%
	ROA (Ordinary income/Total assets)	▲2.0%	19.5%	11.2%
Financial Health	Equity ratio	41.7%	58.7%	45.4%
	Debt-Equity Ratio	106.5%	27.7%	34.5%
	Current Ratio	264.5%	223.3%	111.1%

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 assistance service in the SaaS/ASP business field.

※ Estimated data for Scala shown above were calculated by using the actual results (Non-GAAP base) for FY6/22 and MS's earnings forecasts for FY6/23 (in reference to those announced by the company).

■ Growth Potential

Consolidated business results for FY6/23 are expected to show a marked recovery on the back of an approximately 30% growth in revenue. The mainstay IT/AI/IoT/DX Business is expected to increase revenue from DX projects for local governments at an accelerated pace. Also, the HR & Education Business is likely to be posting higher revenue from the new graduate employment support service and the operation of a professional basketball team 'THE SAITAMA BRONCOS' among others.

Meanwhile, the ongoing Medium-term Management Plan COMMIT5000, formulated in August 2019, sets targets for FY6/25, the halfway point of the Plan, to achieve consolidated revenue of ¥100 billion and operating profit of ¥10 billion. That said, the company is implementing its management policy under which it promotes the diversification of its business portfolio, investment in new businesses and rigorous pursuit of M&A deals, evolving around the core IT/AI/IoT/DX Business which descended from the founding business. Consequently, in our view, M&A and other strategies are critical factors for the accomplishment of its Midterm Plan.

■ Profitability

Operating profit margin for FY6/23 is expected to come to 7.7%. In the company projection, the IT/AI/IoT/DX, HR & Education and EC Businesses are to maintain a double-digit segment operating profit margin. Their profits are expected to absorb up-front investment expenses incurred by the Insurance and Incubation & Investment Businesses whilst the Customer Support Business is slated to emerge from deficit.

■ Financial Stability

Scala's equity ratio at the end of FY6/22 fell 8.3 points from the end of the previous year to 41.7%. The fall in equity ratio reflected the recognition of an IFRS-base net loss and decreased retained earnings from the level logged in FY6/21. Separately, the company recorded higher long-term debts than those in FY6/21, this led to its debt to equity ratio (D/E ratio) at 106.5%. We note that the company's debts now exceed its equity. Nevertheless, its liquidity ratio stood at 264.5%, with a large proportion of current assets, demonstrating that we should not be much concerned about its financial standing.

Morningstar Japan K.K.

Research & Analysis Department
Analyst Takahiro Arimura

+81-3-6229-0078
tarimura@morningstar.co.jp

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.