

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

Recommendation rating (Mar 14)

Scala, Inc.

(4845.TSE Prime)

Overweight

Stock Price	Unit of Investment	Market Cap	52-Week High	52-Week Low	PER(E)
711yen (3/14)	100Shares	12.60Bil yen (3/14)	789yen (22/5/30)	628yen (22/1/20)	18.4times (3/14)

Ready to make great strides under DX and M&A strategies

■ IT/AI/IoT/DX business posted a surplus

Scala, Inc. reported its consolidated business results (IFRS base) for the first six months (July ~ December 2022) of fiscal year ending June 2023 (FY06/23). In the period, sales revenue came to ¥6,504 million (up 52.7% from the same period last year), but operating income fell by ¥78 million from a year ago period to ¥140 million. The IT/AI/IoT/DX business showed solid performance throughout the period, due in large part to a healthy contribution to its earnings from its subsidiary EGG Co., Ltd. (incorporated in February 2022), a developer of hometown taxation programs for local authorities. Also, the HR & Education business delivered higher revenue whilst the EC business continued to grow. The new Insurance business, launched in this period, added to overall earnings too. As for non-GAAP based segmental earnings, the IT/AI/IoT/DX business posted ¥556 million in profit (up 11.3% y-o-y). The business saw large growth in revenue sales from both spot and usage-based charging accounts, while monthly fees increased at a steady pace. The HR & Education business posted a segment profit of ¥134 million (up 3.5%). In an environment marked by the increasing resumption of corporate operations, more companies showed interest in hiring, retaining high-level corporate participants in the joint corporate recruiting sessions. The EC business posted a segment profit of ¥168 million (up 19.2%). Its online-based service 'Card shop - Yuyu-Tei -' increased registered members, which resulted in record high revenue and profit. Meanwhile, the Customer Support business suffered shrinking sales revenue and further segment deficits. The Incubation & Investment business saw larger up-front costs but managed to post a 15.2% increase in revenue sales and reduced the level of losses.

■ FY06/23 likely to see a marked P&L recovery

Concerning consolidated business results (IFRS base) for full-year FY06/23 ending June 2023, Scala forecasts that sales revenue will stand at ¥13,000 million (up 29.8% y-o-y) and operating income at ¥1,000 million (it posted a loss of ¥393 million for FY06/22). DX needs are very likely to continue for the year, serving as a tailwind to its mainstay IT/AI/IoT/DX business. The business has been working with other companies on the co-creative initiative. It has embarked on a collaboration with Otsuka Pharmaceutical Co., Ltd and Sompō Japan Insurance Inc., with a view to formulating a 'smart healthcare platform' to support the healthcare industry. Separately, the company completed the development of a dairy cattle genomic analysis system 'eG Plus' and commenced the service on January 6, 2023. Its hometown taxation operation is also making solid progress in various fields. It now works with a TIS INTEC Group firm and a subsidiary of USEN-NEXT Group to conduct demonstration tests for partially automated



or unmanned hometown taxation programs. Scala aims to keep an expansion plan for both the EC and HR & Education businesses. The Customer Support business suffered sluggish growth in this six-month period. However, the impact from a legal revision on its service for certain clients has run its course, so its earnings are expected to recover going forward. **The Incubation & Investment business pursues M&A deals and promotes business alliances with other companies. Of particular note is its 'Gyaku Propo' (reversed proposal) program, conducted by a subsidiary SOCIALX, Inc.** The program is a service that benefits both business and public interest by calling on local municipalities to suggest approaches or ideas for schemes designed to address social issues identified by private sector organizations. This program contrasts with normal publicly offered programs in which private sector organizations offer plans or approaches to public projects administered by local municipalities. There have already been several successful projects implemented. Scala supports those projects by offering its IT services.

Scala now aims to achieve ¥100 billion in sales revenue and ¥10 billion operating income by FY06/25. Although these goals appear to be rather audacious, given the level of its current earnings, the company will proactively aim to deliver them through M&A deals and business alliances alongside existing business growth. Our forecast EPS for FY06/24 is ¥46. This does not factor in new M&A deals. By applying 19 times PER to this number, we have estimated the lower end of the target price range at ¥870. The upper end of the range is set at ¥1,130. This was calculated by adding a positive M&A effect (i.e. premium) of around 30%

Financial Results (as of Mar 14, 2023)

	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
WA est.	13,000	29.8	1,000	10.1times	970	12.0times	650	14.8times	38.6
2024-6 WA est.	16,250	25.0	1,280	28.0	1,220	25.8	810	24.6	45.8

※ 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.

to the lower end price. We believe that the company shares are undervalued, therefore we maintain our valuation of the company shares with an 'Overweight' rating.

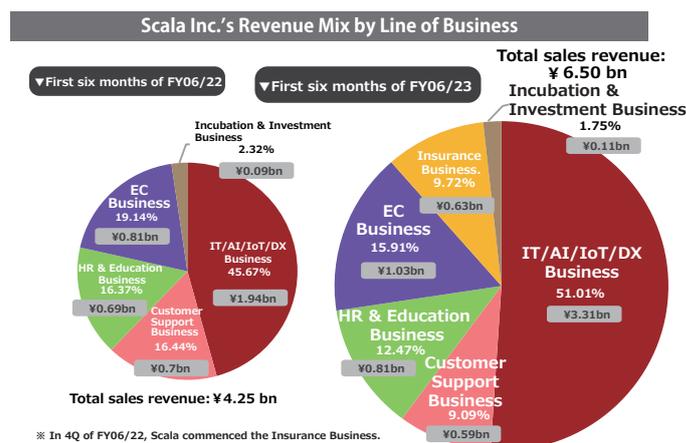
(written by Souta Suzuki)

Company Overview

Scala, Inc. embarked on an enterprise with the SaaS/ASP Service. The company strives to solve social issues and personal matters by promoting DX that draws upon IT, AI and IoT capabilities. It manages various services. These include the search engine within websites 'i-search' which have been adopted by more than 450 major companies and 'interactive voice response' (IVR). The IT/AI/IoT/DX business makes roughly half of its consolidated total sales revenue (48.7% in FY06/22 final). The business provides DX-related services to major companies, local governments, central government, and other public offices. It also proposes and provides support for the implementation of SaaS/APS services. Other businesses include 'Customer Support' (13.6%) which engages in a call center service, 'HR & Education' (14.7%) offering specialized new graduate employment support and 'EC' (16.5%), an operator of second-hand e-commerce sites in which users reuse trading card games. Scala regards direct/indirect investments along with IT services as its pivotal growth drivers. In light of this, its 'Incubation & Investment' business (2.1%) pursues M&A opportunities and promotes business alliances with other companies. In addition, SOCIALX, Inc., a subsidiary of the Incubation & Investment business, focuses on the 'Gyaku Propo' (reversed proposal) program, a service platform combining public-private co-creation projects (details of 'Gyaku Propo' are described in another section). In 2022, Scala incorporated as its subsidiary Nihon Pet Small-amount Short-term Insurance Company, and commenced the 'Insurance' business (4.5%).

Business Environment and Outlook

According to the '2022 WHITE PAPER: Information and Communications' released by the Japanese Ministry of Internal Affairs and Communications, the penetration of AI and IoT has been showing marked progress, with the number of IoT devices in use worldwide estimated to increase from 25.3 billion units in 2020 to 39.85 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 objectives: 1. Creation of a value-based management support business; 2. An IT/AI/IoT-related business; and 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



※ In 4Q of FY06/22, Scala commenced the Insurance Business.

(Source) company's data.

Business segment overview		
Reportable segment	Group company	Description of business
IT/AI/IoT/DX	•Scala Communications, Inc.	Provision of SaaS/ASP services
	•Scala Service, Inc.	Development of SaaS/ASP services and offshore development
	•Scala Next Inc.	Development of SaaS/ASP services and offshore development
	•readytowork Co., Ltd.	Cloud-based PBX service
	•Connect Agency, Inc.	Planning, development and sale of cloud activity management tools
	•Retool, Inc.	Support for administrative bodies and local municipalities in their DX programs
Customer Support	•Social Studio Inc.	System development system maintenance/network establishment
	•EGG CO., LTD.	Consulting of customer support (call center operation, etc.)
HR & Education	•Livconnect, Inc.	Provides support for personal 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
	•Broncos20 Co., Ltd.	Management of basketball club team
EC	•Scala PLAYee, Inc.	Operation of EC sites to trade matching game cards
Insurance	•Nihon Pet Small-amount Short-term Insurance Company	Provision of low-premium, short-term insurance plans
	•Scala, Inc.	Group headquarters, holding company and investment business
Incubation & Investment	•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
	•SCSV-1 Investment Limited Liability Partnership	Investment fund
	•SOCIALX, Inc.	Planning and operating a public-private co-creation platform 'Gyaku Propo'

(Source) company's data.

Risk Factors

Scala's operations potentially run some risks including – Faced with weakening business conditions, its major clients may hold down their IT investments; the growth in size and complexity of projects may cause delays in project development or additional costs; the SaaS/ASP services may face difficulties arising from server down issues and other challenges; and the Incubation & Investment business is at risk of making a loss.

Shareholder Return (as of Mar 14, 2023)

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 Mar 14, 2023)

	Scala, Inc. (4845•TSE Prime)	PIPEDO HD, Inc. (3919•TSE Standard)	Cybozu, Inc. (4776•TSE Prime)	
Basic Point	Stock Price	¥711	¥1,419	¥3,020
	Unit of Investment	100Shares	100Shares	100Shares
	Minimum Investment Amount	¥71,100	¥141,900	¥302,000
	Fiscal Year End	June	March	December
Share Price Indicator	PER (E)	18.4times	22.3times	—
	PBR	1.4times	3.3times	29.9times
	Dividend Yield (E)	5.2%	1.5%	0.5%
Growth	Revenue Growth Rate (E)	29.8%	17.8%	15.5%
	Operating Profit Growth Rate (E)	910.1%	7.1%	288.9%
	EPS Growth Rate (E)	1,448.6%	6.7%	—
Profitability	Operating Margin (E)	7.7%	9.3%	9.3%
	ROE	—	14.9%	1.2%
	ROA (Ordinary income/Total assets)	—	8.0%	6.6%
Financial Health	Equity ratio	41.5%	28.2%	29.1%
	Debt-Equity Ratio	81.4%	5.3%	101.1%
	Current Ratio	185.2%	139.7%	83.1%

We have chosen Techmatrix Corporation (stock code: 3762) and Cybozu, Inc. (4776) as industry peers.

※ 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

Consolidated business results for FY06/23 are expected to show a substantial improvement in P&L, thanks to a 30% growth in sales revenue. The mainstay IT/AI/IoT/DX business is likely to increase revenue from DX projects for local governments at an accelerated pace. The HR & Education business is expected to post higher revenue from the new graduate employment support service and the operation of a professional basketball team 'The Saitama Broncos' among others are all prospective contributors to Scala's earnings growth.

Meanwhile, the ongoing 'Medium Term Management Plan COM-MIT5000' has set targets for FY06/25, the halfway point of the Plan, of achieving consolidated sales revenue of ¥100 billion and operating income 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 income margin for FY06/23 is expected to be 7.7%. In the company projection, the IT/AI/IoT/DX, HR & Education and EC businesses are to maintain a double-digit segment operating income 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 position

At the end of December 2022, Scala's equity ratio stood at 41.5%. Interest-bearing debts total at the same date was ¥6,826 million, a decrease from the ¥7,377 million logged at the end of September of the year. Retained earnings was ¥5,792 million. The company projects to pay increased full-year dividends for 14 years in succession.

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How to Read Wealth Advisor Equity Research Report

Our Uniqueness

(1) Emphasize Its Position as an Independent Evaluation Organization

Wealth Advisor emphasizes its position as an independent evaluation organization and is committed to providing objective comparison and assessment in the Wealth Advisor 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 Wealth Advisor 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.