BRIDGE REPORT   Bridge Salon

	SAKURA Internet Co., Inc. (3778)
Kunihiro Tanaka, President	SAKURA internet

Company Information

Exchange	First Section, Tokyo Stock Exchange
Industry	Information, Telecommunication
President	Kunihiro Tanaka
HQ Address	Grand Front Osaka Tower A 35F 4-20 Ofukachou, Kita-ku, Osaka City, Japan
Year-end	March
Homepage	https://www.sakura.ad.jp/

Stock Information

Share Price	Number of shares issued (excluding treasury shares)	Total market cap	ROE(Act.)	Trading Unit
¥788	37,620,256 shares	29,645 million	4.5%	100 shares

DPS(Est.)	Dividend yield (Est.)	EPS(Est.)	PER(Est.)	BPS(Act.)	PBR(Act.)
¥2.50	0.3%	¥17.28	45.6 x	¥209.03	3.8 x

*The share price is the closing price on April 27.

*The number of shares issued was calculated by subtracting the treasury shares from the number of outstanding shares at the end of the latest quarter.

*ROE, BPS are actual results at the end of the previous term.

Consolidated Earnings

Fiscal Year	Net Sales	Operating Income	Ordinary Income	Net Income	EPS (¥)	DPS (¥)
March 2015(Act.)	10,576	964	857	516	59.52	10.00
March 2016(Act.)	12,086	978	822	443	15.95	2.50
March 2017(Act.)	13,961	1,018	804	548	15.74	2.50
March 2018(Act.)	17,033	745	574	349	9.29	2.50
March 2019(Est.)	20,400	1,200	1,000	650	17.28	2.50

*Unit: ¥mn

* Estimates are those of the company. As of March 2016, the definition of net profit has been changed to net profit attributed to parent company shareholders. (Same applies to the whole report.)

* Since Fiscal year March 2016 represents consolidated data. A four for one stock split was conducted in September 2015.

This Bridge Report presents Sakura Internet's earning results for the fiscal year March 2018, along with estimates for fiscal year March 2019.

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Key points

- **For the fiscal year March 2018, sales grew 22.0% year on year, while operating income dropped 26.7% year on year. While the sales of VPS and cloud services were healthy and grew 25.3% year on year, the sales of dedicated servers increased 28.2% year on year thanks to the transactions for koukaryoku (high-firepower) super computers. Sales rose, due to the M&A of BitStar Inc., etc. Due to the delay in the launch of IoT services, sales did not reach the initial estimate and investments decreased profit; however, the integration of data centers was finished in October 2017, and the third building of Ishikari Data Center (DC) started operation in November (Both of them incurred upfront expenditures), indicating the progress of development for the foundation for growth.**

- **For the fiscal year March 2019, sales and operating income are estimated to grow 19.8% and 60.9%, respectively, year on year. The number of subscriptions to major services is steadily increasing; that for VPS and cloud services rose 31.3% year on year, and that for dedicated servers grew 13.2% year on year. The company will try to shore up the business of rental servers, which has been stagnant in recent years. As for profit, the augmentation of depreciation and personnel expenses due to the year-round operation of the third building of Ishikari DC and the active recruitment of mainly engineers will be offset, and operating and ordinary incomes are expected to get closer to the record-high results in the fiscal year March 2011, and net income is projected to hit a record high. As for dividends, the company plans to pay a term-end dividend of 2.5 yen/share (estimated payout ratio: 14.5%).**

- **After the ages of "the first platform," which is based on main frames, and "the second platform," which is based on servers, clients, and the Internet, we are entering the age of "the third platform," which is based on cloud computing, social services, big data, and mobility. IDC Japan defined digital transformation (DX) as establishing competitive advantage by utilizing the third-platform technology. SAKURA Internet facilitates DX (enhancement of competitiveness) by offering "the third platform" as "a platformer supporting DX." In the fiscal year March 2019, the company will implement measures for developing "the third platform."**

1. Company Overview

Sakura Internet operates data centers located in Tokyo (Nishi Shinjuku, Higashi Shinjuku and Daikanyama, all using rented floor space), Osaka (Dojima, using rented floor space) and Hokkaido (Ishikari, owned land and buildings) to provide internet based hosting services for server environments (Computer resources), and server installation space for housing services, electrical and network circuits and other services.   While many hosting service companies tend to outsource their infrastructure (Data center facilities), Sakura Internet owns its own infrastructure, allowing them to pursue higher profitability (A source of price competitiveness) and utilization of this infrastructure for their housing services allows for reduced risk of fixed costs through the ability to increase utilization rates (Infrastructure possession risk).

Business Description

Sakura Internet's business is divided into housing, hosting, other services including domain and SSL acquisition (Certification for unique domain acquisition outsourcing), with each these services accounting for 15%, 68% (Exclusive servers, rental servers and VPS Cloud accounting for 23%, 18% and 27% respectively) and 17% respectively.

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Housing Service Business

Within their data center, Sakura Internet provides space for customers to freely install their own telecommunication equipment, together with rental of necessary circuits and power supplies for Internet connections.   The renting of installation space for "rental rack" units (Also offering circuits, power supply and other equipment) is the core service of this business.   However, the Company also began providing a "rental space" (Large-scale housing) services with the start of operations of their Ishikari Data Center, where real estate is owned by the Company.

Hosting Service Business

The hosting service is divided into the physical hosting of dedicated server services, rental server services, virtual hosting of virtual private server (VPS) and cloud service.

Dedicated Server Service

This service offers the exclusive use of Sakura Internet's own physical servers ('Sakura's Dedicated Server').   While burdens associated with the specialized knowledge required for server maintenance and other tasks arise, the ability to establish the customers' own servers, unlimited restrictions on software installation and other features allow for greater flexibility compared to rental server services.   Sales of dedicated servers have decreased along with the spread of virtual servers for cloud and VPS services.   However, functional merits of stable performance, ability to use high-performance database storage, cost advantage of being able to limit cost increases with expansion in scale compared to cloud service, and renewed interest in utilization of high-speed processing required in the artificial intelligence (AI) realm made possible by the implementation of new services have contributed to increases in customers using cloud (virtual servers) and dedicated servers (physical servers).
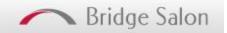
Furthermore, Sakura Internet started a new service in February 2012 as a competing product to cloud service.   Physical servers can be utilized just like the cloud, while performance and security associated with the use of virtualization technologies is far superior to the normal cloud in every way (While the pricing for the smallest service plan remains unchanged, service specification has been increased to over double previous levels).   There are no limits to the number of units, multiple unit construction is possible and the application process can be completed in as little as 10 minutes.

Rental Server Service

This service provides the use of Sakura Internet's own physical servers and abundant functions, which are maintenance free.   They offer services for the use of one physical servers ('Sakura's Managed Server'), as well as the shared use of one physical server with a number of customers ('Sakura's Rental Server').   While there are set conditions on the server set-up and the installation of software, Sakura Internet is able to considerably decrease the burden of work required of users as the specialized knowledge needed for maintenance of the servers is handed by Sakura Internet.

Virtual Private Server, Cloud Service

A service that leverages virtualization technologies that allows customers to establish multiple virtual servers on a physical server, allowing them to be used individually like dedicated servers.   Sakura Internet offers a basic virtual server service with a single contract ("Sakura's VPS"), as well as a contract that allows for the application and set-up of numerous servers that can be charged by the day or by the hour ("Sakura's Cloud").   They offer greater flexibility and excel in cost performance compared to physical servers. (Dedicated server services or rental server services.)

2.Fiscal Year ended March 2018 Earnings Results

【Consolidated Earnings】

	FY 3/17	Ratio to sales	FY 3/18	Ratio to sales	YoY	Forecast	Compared with the initial forecasts
Sales	13,961	100.0%	17,033	100.0%	+22.0%	19,300	-11.7%
Gross profit	4,177	29.9%	4,818	28.3%	+15.3%	-	-
SG&A	3,159	22.6%	4,072	23.9%	+28.9%	-	-
Operating profit	1,018	7.3%	745	4.4%	-26.7%	1,050	-29.0%
Ordinary profit	804	5.8%	574	3.4%	-28.6%	870	-34.0%
Net profit	548	3.9%	349	2.0%	-36.3%	530	-34.1%

*Unit: ¥mn

*Figures include reference figures calculated by Investment Bridge Co., Ltd. Actual results may differ (same applies to all tables in this report).

Sales and operating income grew 22.0% and 26.7%, respectively, year on year.

Sales were 17,033 million yen, up 22.0% year on year. While the sales of VPS and cloud services were healthy and grew 25.3% year on year, the sales of dedicated servers increased 28.2% year on year thanks to the transactions for koukaryoku (high-firepower) super computers. In addition, the sales of rental servers were healthy and increased 5.0% year on year, and the sales of other services rose 61.7% year on year, as the company acquired ITM Co., Ltd., which serves as a management service provider (MSP, undertaking the monitoring, operation, and maintenance of servers and networks) for large corporations, and BitStar Inc., which serves as an MSP or the like for small and medium-sized enterprises in Sapporo, Hokkaido.

Operating income was 745 million yen, down 26.7% year on year. Gross profit rate declined 1.6 points, due to the augmentation of depreciation, lease fees, etc. for the start of operation of the third building of Ishikari Data Center and the investment in servers and network equipment, as well as the increase in outsourcing cost for data center operation and after the inclusion of subsidiaries in the scope of consolidation, etc. SG&A expenses augmented, due to the rise in personnel expenses through the increase of engineers for in-company system development and sales staff of subsidiaries, the augmentation of rents for the new headquarters in Osaka, etc.

The number of employees as of the end of the term increased by 68 to 563, mainly because 43 employees of BitStar joined the corporate group. The company recruited about 100 people in the second preceding term and the previous term, but the number of its employees, mainly engineers and sales staff, increased by only 19.

As for comparison with the initial estimates, sales fell below the estimate due to the stagnant start of IoT services, which were launched in the current term, and the company incurred costs for investments, including the investment for human resources made till the previous term.

Service Segment Sales

	FY 3/17	Share	FY 3/18	Share	YoY
Housing	2,467	17.7%	2,486	14.6%	+0.8%
Dedicated Servers	2,995	21.5%	3,841	22.6%	+28.2%
Rental Servers	2,990	21.4%	3,138	18.4%	+5.0%
VPS, Cloud	3,683	26.4%	4,615	27.1%	+25.3%
Others	1,825	13.1%	2,951	17.3%	+61.7%
Total	13,961	100.0%	17,033	100.0%	+22.0%

*Unit: ¥mn

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3. Fiscal Year March 2019 Earnings Estimates

1)Consolidated Earnings

	FY 3/18 Act	Ratio to sales	FY 3/19 Est.	Ratio to sales	YoY
Sales	17,033	100.0%	20,400	100.0%	+19.8%
Operating profit	745	4.4%	1,200	5.9%	+60.9%
Ordinary profit	574	3.4%	1,000	4.9%	+74.1%
Net profit	349	2.0%	650	3.2%	+86.0%

*Unit: ¥mn

It is estimated that sales and operating income will rise 19.8% and 60.9%, respectively, year on year.

Sales are projected to grow 19.8% year on year to 20.4 billion yen. While the sales of VPS and cloud services, which are the mainstay services of the company, are forecasted to rise as steeply as 31.3% year on year, the sales of dedicated servers are estimated to increase 13.2% year on year, due to the growth of demand for high-performance, low-cost computers through the increase of koukaryoku (high-firepower) computing, etc. In addition, the sales of rental servers are estimated to increase 22.0% year on year due to the enhancement of services (which will be described later), and the sales of other businesses are projected to rise 24.7% year on year, due to the acceleration of service development with increased engineers. The performance of housing is expected to be at the same level as that in the previous term.

As for profit, cost of sales, including depreciation, lease fees, personnel expenses for engineers, and cost for equipment for sales, is estimated to increase slightly less than 12% year on year, and SG&A expenses, including personnel cost, advertisement expenses, and the expenditure for installing communication tools and developing IoT, is projected to rise 17-18% year on year, but it will be offset by sales growth and the improvement in gross profit rate. Operating income is forecasted to rise 60.9% year on year to 1.2 billion yen. Operating and ordinary incomes are expected to get closer to the record-high results in the fiscal year March 2011, and net income is projected to hit a record high.

The corporate group plans to recruit 83 new graduates (4 for SAKURA Internet) as active recruitment activities.

Equipment investment is estimated to amount to 8.4 billion yen, including 3.1 billion yen for data centers (2 billion yen for the third building of Ishikari DC) and 4.8 billion yen for servers and network equipment. Although Ishikari DC No. 3 has a capacity of 1,900 racks, only 1 room (equivalent to 120 racks) is currently available, and some racks are used. In the fiscal year March 2019, the company is preparing for the operation of 2 rooms (equivalent to 240 racks).

Service Segment Sales

	FY 3/18 Act	Share	FY 3/19 Est.	Share	YoY
Housing	2,487	14.6%	2,480	12.2%	-0.3%
Dedicated Servers	3,841	22.6%	4,350	21.3%	+13.2%
Rental Servers	3,139	18.4%	3,830	18.8%	+22.0%
VPS, Cloud	4,615	27.1%	6,060	29.7%	+31.3%
Others	2,951	17.3%	3,680	18.0%	+24.7%

*Unit: ¥mn

The sales of dedicated servers amounting to 4,550 million yen include the sales of koukaryoku (high-firepower) computing amounting to about 800 million yen (up 100 million yen). Among the sales of VPS and cloud services amounting to 6,060 million-yen, cloud services account for about 3.8 billion yen (up 1.1 billion yen). Other sales amounting to 3,680 million yen include the sales of IoT services amounting to about 500 million yen.

2) Measures in FY 3/19

The basic policies are "business activities in the growing environment" and "intensive investment in growing fields." For "business activities in the growing environment," the company will implement some measures for hosting and cloud services, IoT, AI, and data distribution fields. For "intensive investment in growing fields," the company will recruit more engineers and cement the cooperation

with subsidiaries, to improve and increase added value.

"Business activities in the growing environment"
For hosting and cloud services, the company will continue the enhancement and improvement of functions of VPS and cloud services and bolster rental servers, which has been stagnant in recent years. As part of these efforts, the company released the management window function exclusively for cloud servers in March for VPS and cloud services. As for rental servers, the company made all plans compatible with HTTP/2 in March, and sped up PHP apps, including WordPress, in April. It plans to renew the control panel in May. In addition, it launched "Arukas," a new hosting service using "Docker," a container-based virtualization technology, as a new service in March.

In the IoT field, the company will concentrate on the sale of "sakura.io," a necessary platform for IoT, in the license format and the sale of "Secure Mobile Connect," a necessary communications function for IoT. The company has already offered "sakura.io" to "Merchari," a bicycle sharing service launched in February 2018 (in the protocol license format). It also has offered communications modules using "LoRa," etc. for demonstrative experiments using 3 kinds of LPWA formats (SIGFOX, LoRa, and Wi-SUN), which are conducted by National Institute of Information and Communications Technology (NICT), etc. in Yokosuka City, Kanagawa Prefecture.
Here, LPWA stands for a low power wide area, which means a wireless network covering a wide area with low power consumption. Representative standards include LoRa, SIGFOX, and NB-IoT. Merchari is a bicycle sharing service launched in February by Souzoh, Inc., which is a company of the Mercari Group, and with this service, it is possible to borrow a bicycle parked in a bicycle-parking area or the like by using a smartphone. The communications module of "sakura.io" was incorporated into the connected lock for shared bicycles.
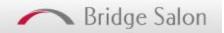
In the AI field, the company targets AI, machine learning (go and shogi software, etc.), measurement (research into new materials), video production (CG movies, etc.), cryptocurrencies, etc. The business layers of the AI domain can be divided into application data (utilization), data analysis (analysis), algorithms (solutions), and hardware (a system base). The company conducts business while focusing on hardware (provision of koukaryoku [high-firepower] computing).

In the data distribution field, the company will concentrate on the acquisition of big data, while expecting that this field will grow. As part of the demonstrative experiment of a data distribution system for smart cities and buildings, the company started gathering and disclosing building-related data at the properties of Fukuoka Jisho (Fukuoka City, Fukuoka Prefecture, representative director: Ichiro Enomoto) in February, and was designated as an outsourcer of the project for making the data of governmental satellites open and developing an environment for using the data in fiscal 2018 in March. In addition, the company concluded an agreement for comprehensive cooperation in regional vitalization utilizing information technologies, including IoT, with Ishikari City, Hokkaido at the end of March, and started the trial operation of a system for measuring the water level of the river using LoRa in April. There will be no compensation for them, but the company will be able to use collected and accumulated data freely.

"Intensive investment in growing fields"
The number of employees of SAKURA Internet increased from 236 at the end of FY 3/14 to 563 at the end of FY 3/18, through the active recruitment of mainly engineers. From FY 3/19, too, the company will actively recruit mainly engineers.
In addition, the company will seize business chances by increasing the range and quality of value it offers to keep up with the changes of the times. The company has offered the basic value and the value demanded by many clients through its standard services as an IT platform, including cloud and hosting services, big data collection and distribution, and IoT platforms, but from now on, it will also increase customers and transactions, which could not be dealt with by a single company, by offering IT solutions, including SI and MSP, for meeting individual needs based on the cooperation among group companies. The company will cement the cooperation with ITM Inc. and BitStar Inc., which serve as MSPs, and establish a subsidiary named Prunus Solutions Inc., which specializes in the proposals for solutions for large projects, in May. Prunus Solutions Inc. is a SIer that offers services, including the design, development, sale, operation, and maintenance of IT infrastructure. Rather than dealing with conventional on-premises systems, it will offer integration services in the field of high-performance cloud computing (large-scale, high-speed computing resources + one-stop services including the design, operation, and maintenance of systems). Major target clients are the R&D, information system, and service sections of governmental offices, universities, public organizations, research institutes, and private organizations.

In addition to the above-mentioned basic policies, the company will make continuous efforts to make their working environment comfortable and make employees' jobs meaningful.

3) Envisioned growth

The company will grow in both the existing domains and the new growing domains. The existing domains are composed of the stably growing one, including rental servers and dedicated servers, and the promising one, including VPS and cloud services. On the other hand, the new growing domains include AI and IoT. As for the stably growing domain, including rental servers and dedicated servers, the company will pursue the economies of scale through M&A and streamline business operation, to earn profit stably. By increasing new customers and raising unit prices, it will accelerate the growth of VPS and cloud services in the promising domain. Then, it will expand its market share by supporting clients in practical application, establish its position in the IoT and AI fields early, and add revenue from them to the revenue of the existing domain.

After such growth, SAKURA Internet aims to become an indispensable platformer for accessing data, such as a data exchange site.

4. Conclusion

After the ages of "the first platform," which is based on main frames, and "the second platform," which is based on servers, clients, and the Internet, we are entering the age of "the third platform," which is based on cloud computing, social services, big data, and mobility. According to the reference material of SAKURA Internet, IDC Japan defined digital transformation (DX) as creating value of enterprises through new products, services, business models, and relations and establishing competitive advantage by utilizing the third-platform technology. In other words, DX is vital for surviving the competition among enterprises, and the utilization of the third-platform technology is a key.

The company assists each enterprise in strengthening its competitiveness by offering the third platform as a platformer supporting DX. In detail, it will establish a cloud platform (which has been already established and is to be upgraded), an IoT platform, and a data platform, which will become the base for the third platform, integrate them, and offer them to users (The efforts to become a platformer supporting DX would lead to the growth in both the existing domain and the new growing domain).

The company has already started concrete measures, including the enhancement and improvement of the functions of VPS and cloud services for upgrading the cloud platform, the bolstering of rental servers, the full-scale sale of the IoT platform "sakura.io" and "Secure Mobile Connect," the alliances with enterprises and municipalities for developing a data platform, and the establishment of a subsidiary named Prunus Solutions Inc. In FY 3/19, the sales of dedicated servers, rental servers, VPS and cloud services, and other services are estimated to grow, while taking into account the outcomes of the above-mentioned measures. We would like to pay attention to the progress of their performance or activities.