

	Sakura Internet Inc. (3778)
	

President Kunihiro Tanaka

Company Information

Market	TSE 1st Section
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
Website	https://www.sakura.ad.jp/

Stock Information

Share Price	Number of shares issued (excluding treasury shares)	Total market cap	ROE Act.	Trading Unit	
¥640	36,480,056 shares	¥23,347 million	1.2%	100 shares	
DPS Est.	Dividend yield Est.	EPS Est.	PER Est.	BPS Act.	PBR Act.
¥2.50	0.4%	¥5.48	116.8 x	¥199.06	3.2 x

*The share price is the closing price on October 31st 2019.

*The number of shares issued is obtained by subtracting the number of treasury shares from the number of shares issued as of the end of the latest quarter. ROE and BPS are the values as of the end of the previous term.

Earnings Trend

Fiscal Year	Sales	Operating Income	Ordinary Income	Net profit attributed to parent company shareholders	EPS	DPS
March 2016 Act.	12,086	976	822	553	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 Act.	19,501	567	395	91	2.44	2.50
March 2020 Est.	22,900	720	480	200	5.48	2.50

*Estimates are provided by the company.

*Units: million yen, yen

This Bridge Report presents Sakura Internet's earning results for the first half of fiscal year ending March 2020, along with estimates for the term ending March 2020.

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Key Points

- For the first half of the fiscal year March 2020, sales and operating income grew 14.6% and 43.7%, respectively, year on year. The sales of dedicated server services increased 36.3% year on year thanks to Koukaryoku (high firepower) computing for national research institutes, etc. and the sales of other services rose 30.8% year on year due to the growth of sales of transactions for government satellite data. Like this, recent activities produced good results, and VPS and cloud services expanded 9.4% year on year in parallel. As for profit, the company secured an estimated profit by offsetting the unexpected decrease in book values of IoT modules due to failures.
- There is no revision to the full-year forecast, and it is estimated that sales and operating income will increase 17.4% and 26.9%, respectively, year on year. IoT-related sales are estimated to fall below the initial estimate due to conventional dedicated server services and defects, but it will be covered by the favorable performance of cloud services and Koukaryoku services (dedicated server services), and total sales are expected to reach the initial estimate. As for IoT-related services, the company plans to promote a new model developed by eliminating defects from 4Q (Jan. to Mar.), but it was not taken into account in the sales forecast.
- The progress rate toward the full-year estimate is 45.1% for sales (the progress rate toward the actual result in the same period of the previous year: 46.2%), 56.6% for operating income (the progress rate toward the actual result in the same period of the previous year: 50.0%), 67.9% for ordinary income (the progress rate toward the actual result in the same period of the previous year: 52.7%), and 88.6% for net income (the progress rate toward the actual result in the same period of the previous year: 118.3%). The progress rates of profits are high, but it is forecasted that the company will increase investments and expenses for securing competitiveness by renewing services, renovating existing data centers, etc. in the second half, so the earnings forecast was left conservative.

1. Company Overview

Sakura Internet operates data centers located in Tokyo (Nishi Shinjuku, Higashi Shinjuku and Daikanyama, 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. Sakura Internet owns its own infrastructure, allowing them to pursue higher profitability and utilization of this infrastructure for their housing services allows for reduced risk of fixed costs through the ability to increase utilization rates.

1-1 Business Description

Sakura Internet's business is divided into housing, hosting (Dedicated servers, rental servers, VPS, and cloud), domain and SSL acquisition (Certification for unique domain acquisition outsourcing), and others including subsidiary business. The composition ratio of sales of fiscal year March 2019 is 13.6%, 64.5% (of which exclusive servers, rental servers and VPS Cloud accounting for 20.5%, 16.8% and 27.2% respectively), and 21.9%.

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’). Physical servers can be utilized just like the cloud, but the performance and security are far superior to those of the normal cloud with the use of virtualization technologies. 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 great flexibility compared to rental server services.

After applying to this service, the servers will be available in 10 minutes at the fastest, and you can use some of them at once since the number of them is unlimited. 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 have contributed to increases in customers using cloud (virtual servers) and dedicated servers (physical servers).

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. First Half of Fiscal Year ending March 2020 Earnings Results

2-1 Earnings Overview

	1H FY 3/19	Ratio to sales	1H FY 3/20	Ratio to sales	YoY	1Q Revised forecasts	Difference from the forecast
Sales	9,014	100.0%	10,329	100.0%	+14.6%	10,680	-3.3%
Gross profit	2,545	28.2%	2,803	27.1%	+10.2%	-	-
SG&A	2,261	25.1%	2,396	23.2%	+6.0%	-	-
Operating Income	283	3.1%	407	3.9%	+43.7%	400	+1.8%
Ordinary Income	208	2.3%	326	3.2%	+56.3%	310	+5.2%
Net profit attributed to parent company shareholders	108	1.2%	177	1.7%	+63.5%	160	+10.6%

*Unit: million yen

Sales and operating income grew 14.6% and 43.7%, respectively, year on year.

Sales were 10,329 million yen, up 14.6% year on year. Although the sales of housing services decreased gradually, the sales of Koukaryoku computing for national research institutes, etc. contributed, so the sales of dedicated server services increased 36.3% year on year. The sales of other services grew 30.8% year on year thanks to the rise in sales from transactions for governmental satellite data. The sales of VPS and cloud services increased 9.4% year on year, due to the increase of new customers and the use by existing customers through the addition of new functions, etc.

Operating income was 407 million yen, up 43.7% year on year. Cost of sales augmented 16.3% year on year to 7,525 million yen, due to the rise in depreciation and lease payments (up 377 million yen) caused by the increase of servers and network equipment, etc., the write-down of book values of IoT modules^{Note}, etc., but the increase rate of SGA was as low as 6.0% (The main reason for the augmentation of SGA is that personnel cost rose 113 million yen due to the increase of engineers for in-company system development, sales staff of subsidiaries, etc.). Net income grew 63.5% year on year to 177 million yen, as the loss on sale and retirement of fixed assets was posted as an extraordinary loss, but tax burden ratio declined.

Note: Write-down of book values of IoT modules

Since IoT modules had defects, sale was suspended, and they were repaired at the expense of the manufacturer. In the fourth quarter, sale will be resumed, but considering the effect of the suspension of sale, the company wrote down the book values (increasing cost by 130 million yen).

The defects mean those of the flash memory inside the modem. Some products showed abnormalities and communications modules became disabled when a certain period of time elapsed after manufacturing. When all products in stock were checked, defects were found in a small number of modems, but it was anticipated that the communications modules in service would not work, so the company took the above described measure.

2-2 Earnings Overview for the first half of fiscal year

	1Q FY 3/19	2Q	3Q	4Q	1Q FY 3/20	2Q
Sales	4,399	4,614	4,928	5,558	5,122	5,206
Gross profit	1,212	1,332	1,354	1,446	1,518	1,285
Operating Income	112	171	154	129	312	95
Ordinary Income	63	144	97	89	273	52
Net Income	39	69	37	-53	159	17
EBITDA	726	808	771	810	1069	853
Sales profit ratio	27.6%	28.9%	27.5%	26.0%	29.6%	24.7%
Operating profit ratio	2.6%	3.7%	3.1%	2.3%	6.1%	1.8%

*Unit: million yen

Sales grew 1.7% from the previous quarter, while operating income dropped 69.5% from the previous quarter.

The sales of dedicated server services declined due to the recoil from the posting of sales equivalent to the initial cost for a large-scale project in the previous quarter, but the sales growth of VPS and cloud services and the transactions for governmental satellite data contributed, and the sales of products of subsidiaries were posted. Consequently, consolidated sales rose 1.7% from the previous quarter to 5,206 million yen. As for profit, operating income decreased 69.5% from the previous quarter to 95 million yen, due to the write-down of book values of IoT modules (augmenting cost of sales by 132 million yen), the rise in depreciation and lease payments (augmenting cost of sales 32 million yen), the rise in personnel expenses (augmenting cost of sales by 16 million yen), and the increase in electric power cost caused by a seasonal factor (rise in air-conditioning cost in the summer) (augmenting cost of sales by 18 million yen).

3. Fiscal Year ending March 2020 Earnings Forecasts

3-1. Earnings Estimates

	FY 3/19 Act.	Ratio to sales	FY 3/20 Est.	Ratio to sales	YoY
Sales	19,501	100.0%	22,900	100.0%	+17.4%
Gross profit	5,345	27.4%	5,965	26.1%	+11.6%
SG&A	4,778	24.5%	5,245	22.9%	+9.8%
Operating Income	567	2.9%	720	3.1%	+26.9%
Ordinary Income	395	2.0%	480	2.1%	+21.3%
Net profit attributed to parent company shareholders	91	0.5%	200	0.9%	+118.2%

* Unit: million yen

There is no revision to the full-year forecast, and it is estimated that sales and operating income will increase 17.4% and 26.9%, respectively, year on year.

Sales are projected to increase 17.4% year on year to 22.9 billion yen. IoT-related sales are estimated to fall below the initial estimate due to conventional dedicated server services and defects, but it will be covered by the favorable performance of cloud services and Koukaryoku services (dedicated server services), and total sales are expected to be within the initial estimated range as a whole. As for IoT-related services, the company plans to promote a new model developed by eliminating defects from the fourth quarter, but it was not taken into account in the sales forecast.

Operating income is forecast to be 720 million yen, up 26.9% year on year. In the second half, the company will continue investing and incurring expenses for securing competitiveness by renewing VPS services, etc., renovating existing data centers, and so on. Accordingly, the earnings forecast was left conservative.

The year-end dividend is to be 2.5 yen/share. The estimated payout ratio is 45.6%.

Sales by services

	FY 3/19 Act.	Ratio to Total	FY 3/20 Est.	Ratio to Total	YoY
Housing services	2,643	13.6%	2,392	10.4%	-9.5%
Dedicated server services	3,998	20.5%	5,341	23.3%	+33.6%
Rental server services	3,277	16.8%	3,512	15.3%	+7.2%
VPS and Cloud services	5,305	27.2%	5,850	25.5%	+10.3%
Others	4,275	21.9%	5,805	25.3%	+35.8%
Total	19,501	100.0%	22,900	100.0%	+17.4%

* Unit: million yen

3-2 Initiatives for the fiscal year March 2020

The company is proceeding with its initiatives in the fields of cloud services, AI, Koukaryoku (high firepower), and data distribution. Additionally, its subsidiary Gehim Inc. released a disaster preparedness app.

Cloud services

The company is proceeding with “Marketplace” initiatives. In “Marketplace,” business software, etc. developed by external vendors that have signed partnership contracts are offered on “SAKURA Cloud.” The company also offers functions such as operation inspections, support, and automatic billing systems for licenses, and the usage fees for business software, etc. are shared by both companies. Up to this point, many customers have switched to its competitors’ cloud services as the industry has expanded, but the company will bear part of the business risks for its customers by offering service infrastructure, and will thereby build long-term partnerships.

For instance, they started to offer Trend Micro Inc.’s integrated server security for corporations in July as part of the partnership created with the hosting services provider Hyperbox Inc. (headquartered in Shinjuku-ku, Tokyo; Representative director: Taro Fukada). In addition, as part of the partnership created with Creator’s NEXT Inc. (headquartered in Shinagawa-ku, Tokyo; Representative director: Nozomu Kubota), which carries out website creation and content marketing support, they started to offer the automatic traffic analysis and web improvement report creation service “KOBIT” in September.

Moreover, “SAKURA Cloud” was used in the support system for dealing with child abuse, developed by the National Institute of Advanced Industrial Science and Technology (AIST). The support system for dealing with child abuse was developed by AIST as a project entrusted by New Energy and Industrial Technology Development Organization (a national research and development agency), and is a system which uses AI to support children’s welfare centers’ responses to abuse. “SAKURA Cloud” was used as its data communication environment. It is said to have been used for this project due to the fact that it met all of AIST’s specifications for cloud performance, security, and maintenance operations.

AI and Koukaryoku (high firepower) fields

The company is working towards the acquisition of large-scale public projects using solutions which connect its group’s services. While leveraging the presence of key employees who have plentiful knowledge about administrative organs, the company will be a provider of one-stop system design, system operation, and system maintenance services in addition to large-scale and high-speed computing resources. Its idea is to then expand into the manufacturing industry based on its achievements with large-scale public projects.

Currently, the company is offering its Koukaryoku (high firepower) service as a computer resource for the National Institute of Information and Communications Technology (a national research and development agency, NICT)’s deep learning translation project. NICT offers a free translation system (the multilingual voice translation app “VoiceTra”) which uses deep learning. It is a multilingual voice translation app for smartphones which was developed with the aim of overcoming language barriers, and it can translate travel conversations highly accurately. Its company’s Koukaryoku (high firepower) computing (which will be made available on a large scale starting in April) is used as its hardware infrastructure.

Its company’s cloud-type supercomputer ranks 54th in the world supercomputer ranking

The cloud-type supercomputer system which uses the company’s Koukaryoku (high firepower) computing infrastructure was ranked 54th in the world in the “TOP500” (supercomputer ranking), which ranks supercomputers’ processing abilities. This supercomputer is a system used for research, and was built by the company along with contract manufacturers and its subsidiary Prunus Solutions Inc. The “TOP500” was announced on June 17th, 2019 (Japan time) at the HPC-related international conference and exhibition “ISC 2019” held in Frankfurt, Germany.

Data distribution field

In the field of data distribution, the number of account registrations for the satellite data platform “Tellus” has exceeded 10,000.

Version	Ver. 1.2 released (OS updated in September)
Number of account registrations	10,643 (as of the end of September)

About “Tellus”

“Tellus” is a business that offers government satellite data, etc. free of charge, in addition to offering computing resources necessary for analysis, processing, etc. for a fee. As for the period of government business (three years), they have established and are providing a limited free use for the company’s internet infrastructure (“SAKURA Cloud” and “Koukaryoku (high firepower) computing”).

The company executed a contract with the Ministry of Economy, Trade and Industry (METI) on May 9th, 2018 to make the company a responsible party for METI’s “FY2018 Project for Establishment of Open and Free Government Satellite Data and Business Environmental Arrangement for Data Utilization.” This project has created a new business marketplace that uses government satellite data, and aims at the realization of the five societal benefits identified in the report from the meeting for the “Establishment of Open and Free Government Satellite Data and Business Environmental Arrangement for Data Utilization.” By building and operating the “Open & Free Platform,” which features large-scale storage and high computational ability, the company provides an open and free use environment for government satellite data. It is planned that outsourcing fees will be received from the government in the first three years, and complete privatization will take place in the fourth year.

The five societal benefits are: ①Investing in the future through the fostering of human resources, ②Contributing to people’s safety and peace of mind, ③Contributing to regional revitalization by helping regions solve problems independently, ④Optimizing Japan’s industries by promoting a data-driven society, and ⑤Creating new businesses and industries.

Latest topics

In October, in addition to promoting the use of Japanese domestic satellite data for businesses, they started to offer a satellite data analysis course to increase “Tellus” users. As for the former, they will work with PwC Consulting LLC, which has a vast track record of creating satellite data businesses overseas, and will hold practical satellite data utilization seminars aimed at the sectors of logistics, transportation, administration, local government, communications, energy, insurance, and finance. As for the latter, collaborating with Remote Sensing Technology Center of Japan and SIGNATE Inc. (headquartered in Chiyoda-ku, Tokyo; Representative director and president: Shigeru Saito), which provides AI development and a recruitment and training service for talented data scientists, they have begun to hold a “Tellus Satellite Boot Camp,” which is a training course for engineers who use satellite data, and they have begun to offer an e-learning program called the “Tellus Trainer.” By training satellite data analysts, they will also create users of the satellite data platform “Tellus.”

The training course for engineers who use satellite data (Tellus Satellite Boot Camp)



(Taken from the reference material of the company)

Its subsidiary Gehim, Inc. releases a disaster preparedness app

In September, Gehim Inc. released a disaster preparedness app, and the number of downloads is now over 350,000. The disaster preparedness smartphone app sends prompt notices of earthquakes, tsunamis, volcanic eruptions, and emergency warnings as well as severe weather information for flooding, landslides, etc., after optimizing these notifications based on the user's location and registered locations. It was developed with the goal of fostering a precise situational awareness among residents and visitors in areas where damage is predicted, in addition to supporting their quick decision-making and actions. The severe weather information it offers is received directly from the Japan Meteorological Business Support Center (the main office of the Japan Meteorological Agency and the Osaka District Meteorological Observatory) via an exclusive line, thus guaranteeing the reliability of the information. The information is transmitted at the highest speed in Japan due to the technology which Gehim Inc. developed independently.

Gehim Inc. primarily offers services such as security consulting and website vulnerability diagnostics, and it became a subsidiary in April 2016 with the goal of strengthening its services and human resources in the security field. Progress has been made in the expansion of its lineup of security services due to its excellent security engineers, and it has also contributed to the strengthening of the security set-up within Sakura Internet Inc.

4. Conclusions

In the first half, sales increased steadily as the VPS and cloud services kept growing and the recent efforts for Koukaryoku computing for national research institutes (in the field of AI and Koukaryoku) and transactions for governmental satellite data (in the field of data distribution) paid off. Both Koukaryoku computing for national research institutes and transactions for governmental satellite data have a high profit rate, because they offer high-end computing required for analysis, etc. and can be expected to earn stable revenue from the second half onward. As for rental server services, whose sales were on a plateau, the company plans to give some leverage by releasing new services, implementing the campaign for commemorating the 15th anniversary, and so on. The company has been concentrating on after-sales care for existing customers rather than increasing new customers by improving services, etc. since the second half of the previous term, and thanks to this effort, cancellation rate decreased.

In the fourth quarter (Jan. to Mar.), the company will resume the sales promotion of IoT modules. The sales volume of IoT modules has been stagnant, because they have been used only tentatively, but if they enter the practical use stage after PoC (proof of concept: tests and demonstration for verifying concepts, theories, ideas, etc.), the sales volume will grow dramatically. The start of 5G services by communications carriers is expected to make the business environment favorable.

In addition, as 5G and IoT-related activities, the company established a joint venture named BBSakura Networks, Inc. with BBIX, Inc., which is a subsidiary of SoftBank Corp. and operates the Internet exchange (IX) business for the purpose of offering mobile network solutions in August 2019. By fusing the network and selling capability of BBIX, Inc. and the virtual hardware emulation (mounting virtual hardware devices in software) of SAKURA Internet Inc. in the communications field, the company will offer low-cost yet high-quality communications solutions to communications carriers inside and outside Japan. BBIX, Inc. and SAKURA Internet Inc. estimate that the importance of software will increase as cloud computing has been spread recently and 5G will be put into practical use. We would like to expect their future progress.

<Reference: Regarding Corporate Governance>

◎Organization type, and the composition of directors and auditors

Organization type	Company with an audit and supervisory board
Directors	6 directors, including 3 outside ones
Auditors	4 directors, including 3 outside ones

◎Corporate Governance Report (Updated on December 27, 2018)

Basic Policy

Our company has strived with the basic policy about corporate governance: promote the maintenance of business management organizations and enhance efficient and systematic management and internal controls of each department while expanding the company size. There is a greater social responsibility in internet industry than in other industries as communication facilities are released to a large number of invisible customers and its market is the internet users around the world. We consider that the establishment of corporate governance at our company means the management base which enables to fulfill such social responsibilities.

<Reasons for Non-compliance with the Principles of the Corporate Governance Code (Excerpts)>

Principle 3-1 【Improvement of information disclosure】

(4) The board of directors' policies and procedures for appointing and dismissing executives and nominating candidates for directors and auditors

As candidate directors, we will nominate those who are strongly interested in our business, take action for following our corporate ethos, possess plenty of practical experience and technical knowledge, profound knowledge of company management, etc., and could appropriately oversee the business administration of our company based on their advanced insight. As candidate auditors, we will nominate those who are strongly interested in our business, can highly fulfill the roles and responsibilities as an auditor, audit business from a neutral, objective viewpoint, contribute to the soundness of business administration, possess plenty of experience and advanced knowledge for carrying out audit, technical knowledge, and profound knowledge of company management. As for the policy and procedure for dismissing them, we will discuss appropriate processes so as to oversee and evaluate the results of managerial plans, etc. and deliberate them sufficiently at a meeting of the board of directors.

Supplementary Principle 4-1-3 【Roles and duties of the board of directors (plan for successors)】

Our company is designing a plan for successors as CEO, etc. The board of directors will continue discussions regarding the process for nominating successors, a plan for training them, etc. based on our ethos and management strategies.

Supplementary Principle 4-2-1 【Remunerations for the management】

As for remunerations of directors, the representative director gives a proposal and the board of directors makes a decision for each director, while comprehensively considering the division of duties, the contribution to business performance, etc. From now on, we will keep discussing an objective, transparency system for remunerations and the adoption of remunerations based on mid/long-term performance and stock options.

Supplementary Principles 4-3-2 and 4-3-3 【Appointment and dismissal of CEO】

As for the appointment and dismissal of CEO, we will discuss them as well as the plan for successors mentioned in Supplementary Principle 4-1-3 【Roles and duties of the board of directors (plan for successors)】.

Principle 5-2: [Formulation and disclosure of management strategies and plans]

When formulating our business strategies and business plans, we have set our goal based on the premise of achieving the Group's goal; that is, a continuous sales growth rate of 10% or more, a gross profit margin of 30% or more, and an ordinary income-to-sales ratio of 10% or more. With regard to disclosing management plans that accurately describe the cost of capital, we will carefully consider how to best communicate information by maintaining an open dialogue with shareholders through financial results briefings and individual meetings.

<Disclosure Based on the Principles of the Corporate Governance Code (Excerpts)>

Principle 5-1 [Policy regarding constructive dialogue with shareholders]

The Company has established an organization for managing IR, and holds financial results briefings for shareholders and investors at least twice a year. We also create opportunities for dialogue by obliging individual interviews with persons such as the Director and Chief Financial Officer upon request. We have also created a system for sharing the opinions received during these interviews with management on an as-needed basis. As discussions unfold, we consider the topic of the discussion and strictly control insider information.

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