SoftBank Technology Corp.
Overview of Earnings Results Briefing for FY2018 1H

This is a transcript of the SoftBank Technology Corp. FY 2018 1H Results Briefing held on October 26, 2018.

Securities code: 4726

Speaker: Mr. Shinichi Ata, President & CEO, SoftBank Technology Corp.

Earnings Results Briefing for FY2018 1H

Mr. Shinichi Ata: I am Shinichi Ata of SoftBank Technology. Thank you very much for taking the time out of your busy schedules to meet with us today.

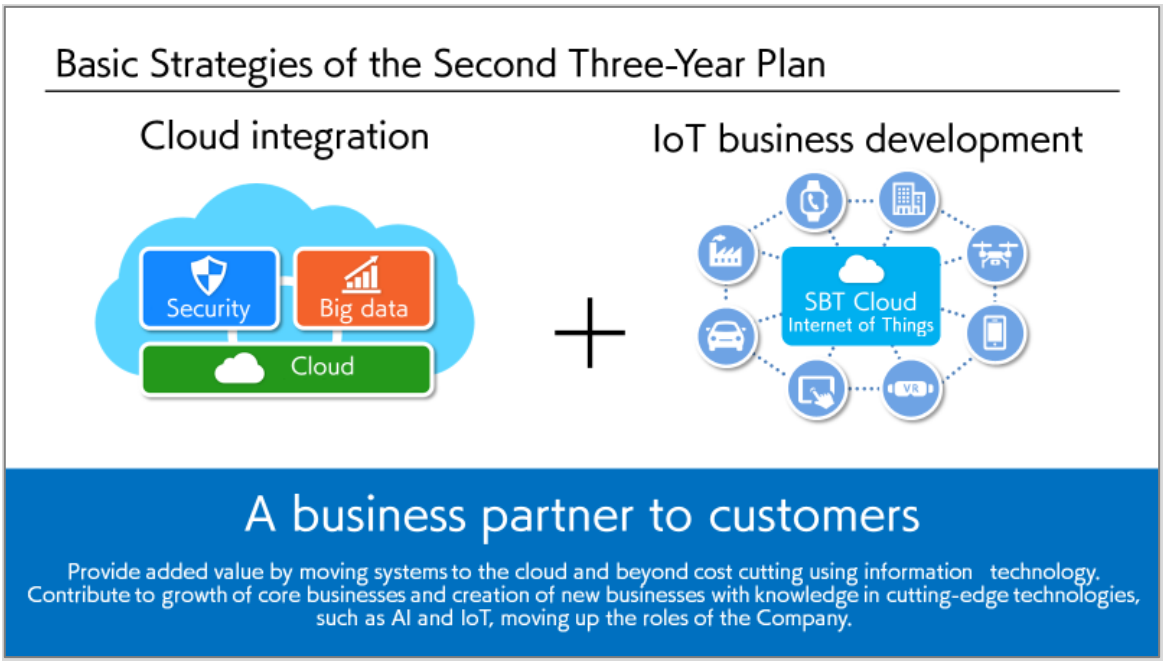
I would like to provide you with a briefing on our earnings results for the first half of the fiscal year 2018.

As we announced at 4:00 p.m. yesterday (October 25, 2018), both net sales and operating income (for the first half) achieved record highs.

We have positioned fiscal 2016, 2017, and 2018 as the second three-year plan. Five-sixths of the period of the plan have now passed. I would like to start by reporting on the status of the progress of the plan and provide you with a briefing of our earnings results.

Please refer to the Appendix for numerical data and other details.

Basic Strategies of the Second Three-Year Plan（FY2016～2018）



First, I will explain the second three-year plan. Under the first (three-year) plan, we strived for three years to achieve strong advantages in the three fields of security, big data, and the cloud in our attempt to create domains in which we are strong and will never be defeated by our competitors.

Under the current second (three-year) plan, we intend to do all of these things in the cloud, and will do little on-premises work. Of course, we have existing (on-premises) customers, so we will continue to serve these customers. Basically, however, we will continue to shift to the cloud.

We intend to compile our services in these three domains (and integrate them) in the cloud so that we can shift customers' computing systems to the cloud and they can use our technologies. This is one of our strategies.

Another point is that at the beginning of fiscal 2016, it was difficult to see what IoT is like. We understood the idea of connecting "tens of billions of things," but were not sure how we should help our customers in what areas in order to be useful for them. To put it simply, we told you that we would spend three years promoting development to find out how to monetize IoT and commercialize it.

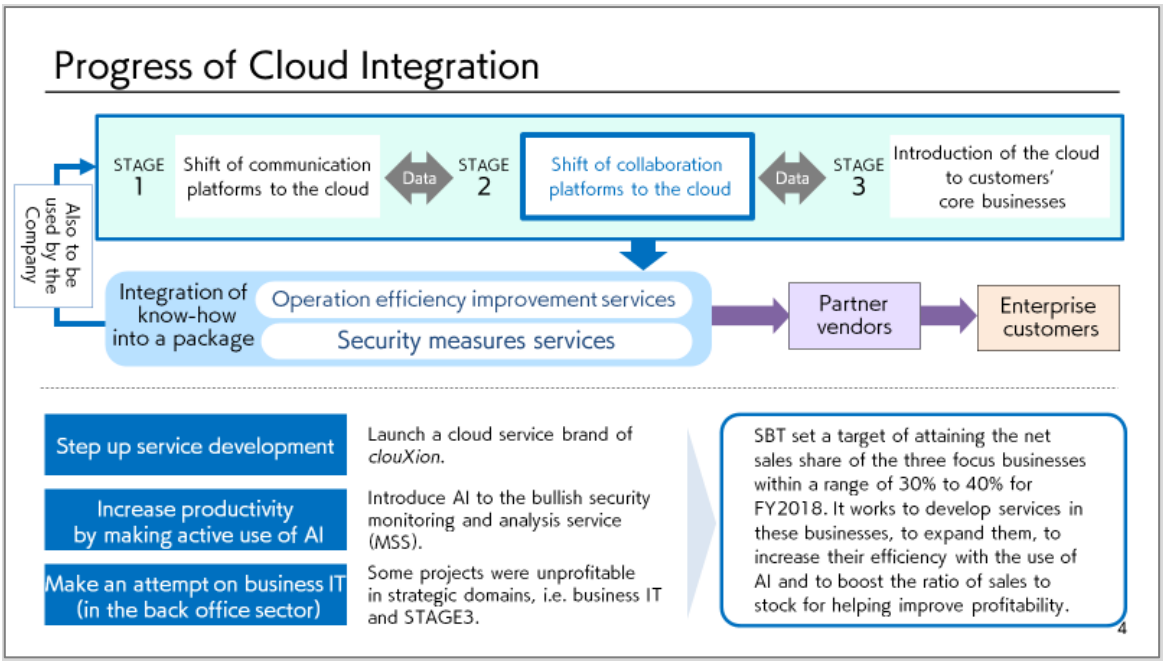
We also told you that we would strive to be a "business partner" of our customers rather than their "IT partner."

To tell you why, we began to hear the terms "corporate IT" and "business IT" this year (2018). The field of corporate IT is a forum for handling things such as communication infrastructure and mission-critical systems. This is costly, so cost reductions will be promoted continuously.

On the other hand, Business IT is based on the idea that we must utilize IT more to expand our businesses held by our business divisions. The cost of utilizing IT is mostly included in sales promotional expenses or sales expenses. We aim to try out this business IT.

These are our three qualitative targets under the three-year plan.

Progress of Cloud Integration



First, regarding "Cloud Integration," since we established our strategies six years ago (fiscal 2013), we have been striving to develop communication infrastructure and win trust by helping customers to develop it as our tasks in Stage 1.

Our task in Stage 2 is to provide Collaboration Infrastructure, on which employees have dialogues, or on which relationships between management and employees or between external partners and employees are built.

This is followed by Stage 3, in which we enter the core part. Here, we continue to bring to the fore our existing mission-critical tasks that have been undertaken with large mainframes. By "bring to the fore," we mean "shift (them) to the cloud."

In the current fiscal year, we are at a stage where some corporate customers want to finish Stages 1, 2, and 3 at once, while others want to consult with you about 3 because we finished 1 and 2 in turn in the last six years.

This is what we have done in the past six years. While we failed in various ways in the process, we have also acquired unique expertise thanks to these failures.

To sell this expertise in the form of a package, we launched it under the brand name of clouXion™ in August this year (2018). We intend to sell our solution package. (This is the first point: "strengthening service development.")

The second point is a story about security. During the first half of the last fiscal year (2017) , we implemented an information security cloud for 121 municipal governments in four prefectures. We found this process to be

extremely tough. In fact, in this field, there was a cost overrun of about 100 million yen in the first half of the last fiscal year.

In this process, we undertook development efforts to apply what had been our expertise in data analytics to this managed security service (MSS) and to discover irregular values by using AI. As a result, we created a monitoring platform with AI in spring this year. With this platform, we have connected MSS.

As I will explain later, we intend to have our partners sell it, in addition to selling it ourselves.

Third, we are taking on challenges in business IT (business divisions). We have very large-scale brands as our customers. Among them are customers whose IT divisions are extremely small (in terms of the number of staff members). In these divisions, requests come from business divisions one after another, while responses with mission-critical systems tend to be extremely laborious.

In helping our customers respond to such requests, slight differences in ideas between us and our customers or similar disagreements were generated, which resulted in unprofitable projects during the first half under review.

Launch of clouXion™ Brand for Cloud Services

First, we will look at clouXion™ (which is the brand of our cloud services).

We already have a lineup of 11 solutions, which are listed here. They were not launched this year (2018). We have been selling these solutions individually throughout the last five to six years.

At present, 500 enterprises are using the solutions, and the number of users is 900,000 (in total for the clouXion™ series).

Among them, ADFS on Cloud, which is listed second from the top on the left side, was developed in 2014. We developed it in the belief that the use of the active directory in the cloud would definitely be better for using the cloud.

ADFS on Cloud is our core service of the clouXion™ brand, and it is currently used by 550,000 people from nearly 70 companies.

To tell you why we have integrated this and other services into the clouXion™ brand, we have been working on this task with Microsoft for the last six to seven years by sharing strategy and exchanging opinions with the company.

Initially, concerning the cloud named Azure, Microsoft asked its partners like us how they should use Azure, the platform they had developed. We responded, “How should we do it?”

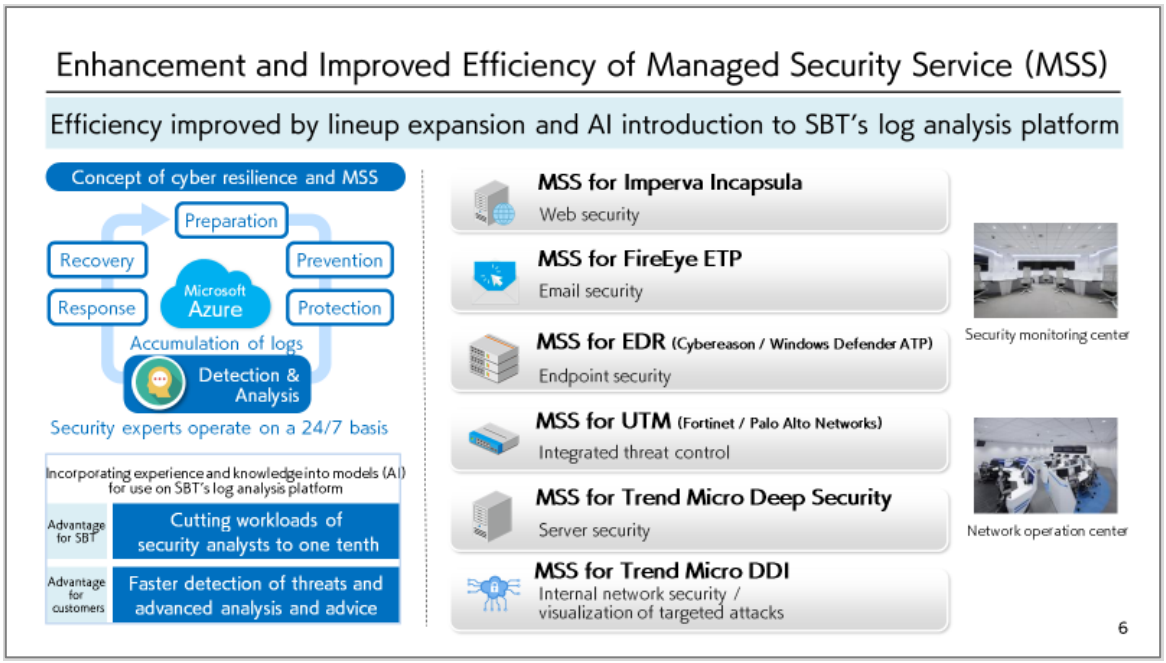
Then, while it (the use of the cloud) continued to accelerate, we began to discuss the following last fiscal year (fiscal 2017): “Could you create a solution that uses Azure? We at Microsoft will support its sales.” It seems that they call such support “Sell-with.”

In other words, Microsoft is a product vendor. This means that what has been done by a product vendor and a system integrator can no longer be done unless they are joined by an independent software vendor (ISV). This, in turn, means that customers will not use software unless it is a successful product that has been used by other customers. Above all, enterprise customers think like this.

This is why we have packaged 11 solutions (as clouXion™), which will be sold not only by us, but also by Microsoft. Or we will allow this package to be used by system integrators who compete with us, as well as ourselves.

We provide all software services under a recurring model, charging monthly fees. This means that the price varies according to customer size. We announced this service, which boasts highly flexible scalability, in August, and our engineers are now providing training to salespeople at Microsoft’s head office.

Enhancement and Improved Efficiency of Managed Security Service (MSS)



Another group of services is managed security services (MSS).

In the belief that we must operate in this field (security management), we have undertaken a range of trials. In 2013, we introduced an integrated monitoring software called SIEM. In 2014, we began to help our parent company with the provision of carrier services.

While we experienced these things, we received orders from 121 municipal governments in four prefectures during 2016 to 2017 and built the municipal information security cloud.

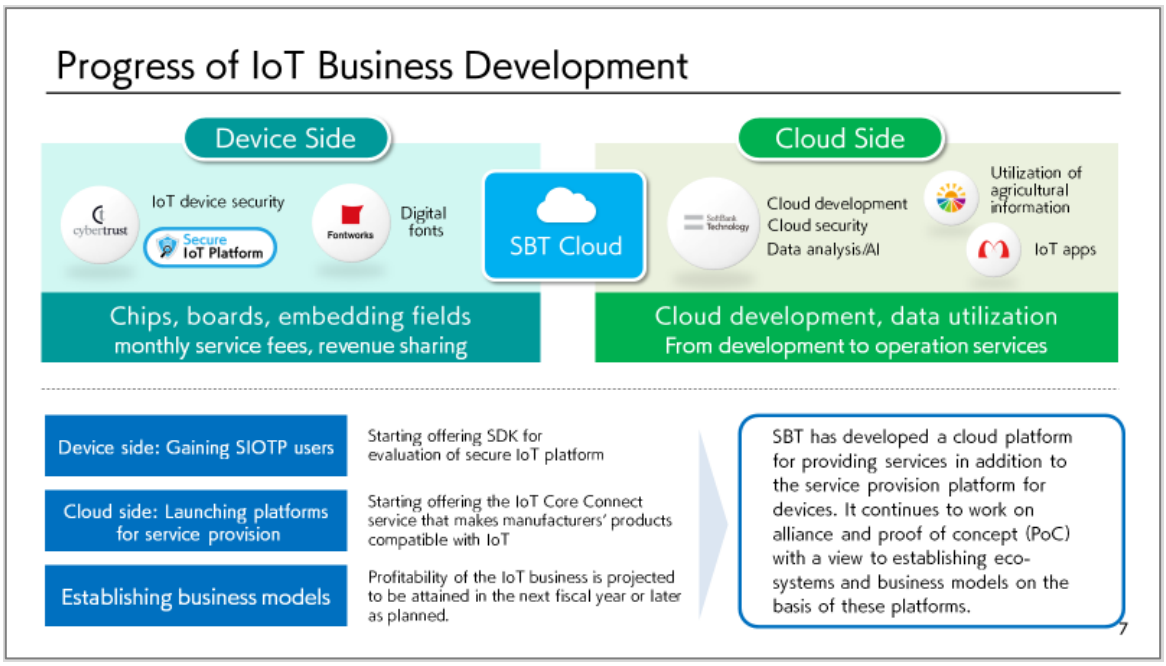
In this process, we received an enormous number of inquiries. We received inquiries for all the small defects (instead of major problems only). While we were wondering how to handle the situation, the opinion “We should use AI here” was expressed. This is why we introduced AI.

Here is the SBT Log Analysis Platform. We have introduced AI to this. We often use the number of monitoring points as the scale. In 2016, the number of monitoring points was only a matter of tens, being 60 to 70, and they were used only by corporate customers. Now (2018), the number has increased tenfold. We have 280 monitoring points in public offices, and about 400 in companies. As a result, we are now handling nearly 700 monitoring points.

The number of opportunities where our SOC is used has actually been increasing. For example, when a system integration company like us or a network integration company accepts a job as a comprehensive project, such a company says, “Let us do it with SBT’s service” concerning the security operation center (SOC). In the case of a

product vendor, we are asked, “Please do OEM.” We believe that this area will continue expanding, just as in the case of clouXion™ that I described earlier.

Progress of IoT Business Development



Next, in the IoT area, we established the new Cybertrust just a year ago (October 2017) by integrating the old Cybertrust, our subsidiary, with Miracle Linux.

We established the new company because there are two issues that we must never ignore. The first issue is “How do we manage devices safely?” IoT is used in such a wide variety of fields, so the important point is whether or not each individual thing itself is independent and recognizable, rather than issues regarding applications in each individual field. The task of Cybertrust is to distribute certificates for them one by one.

We then created the concept of Secure IoT Platform.

With the approval of an enormous number of customers, a committee on Secure IoT Platform was established. In addition, the Ministry of Internal Affairs and Communications has also issued a guideline that mandates the adoption of these secure-by-design practices.

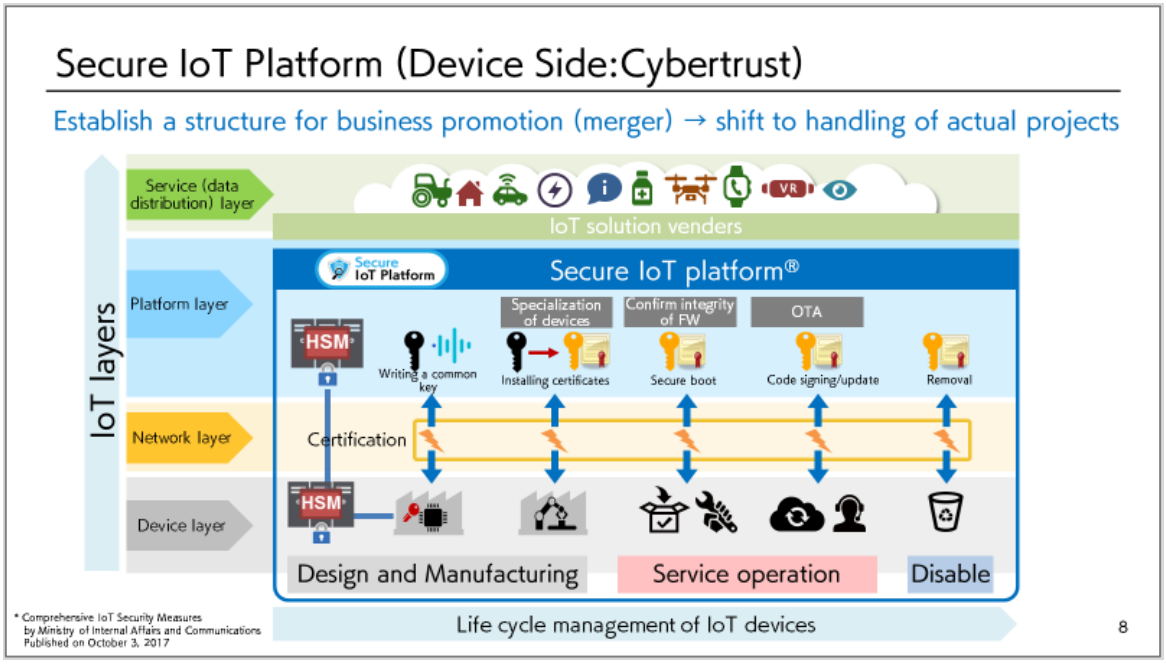
The second issue is “What it is that SoftBank Technology will do?” SoftBank Technology is a system integration company. We provide solutions with a focus on servers. Accordingly, in the belief that we have things to do regarding the cloud, we have undertaken several trials in the form of proof of concept (PoC).

Regarding the fact that this is costly, I have provided explanations here (in the earnings results briefings) several times. It costs tens of millions of yen to build and set one prototype and obtain a result from PoC in a cycle of three to four months. We sometimes proceed with these tasks by splitting the cost between us and the customer. In other cases, we assume the entire cost.

As we undertook several trials, we found a solution that made us think “It all comes down to this.” We announced it this week (October 23, 2018). The solution is IoT Core Connect. We have begun to provide a package with which customers are recommended to start IoT.

We have received a lot of inquiries about this since we issued the news release. We have also received resounding approval from our partner companies.

Secure IoT Platform (Device Side:Cybertrust)



I will now describe some of the contents of the Secure IoT Platform. These layers on the left are what the Ministry of Internal Affairs and Communications deemed “necessary for secure-by-design practices.” The idea is to achieve them as a platform.

First, let’s put a key in the chip. Then, the system incorporating the chip … For example, we ask a manufacturer of industrial equipment, machine tools, or similar products to install the certificate here and prove that this product is so-and-so from the lot manufactured during a certain period in a certain year.

Then, when the product is turned on for the first time in a factory, a plant, or a construction site, for example, the

information that it is to be used in this factory is added to the certificate. Such equipment is not replaced after two or five years like a smartphone or PC. Equipment that can be used for ten years, 15 years, or 20 years is required in IoT.

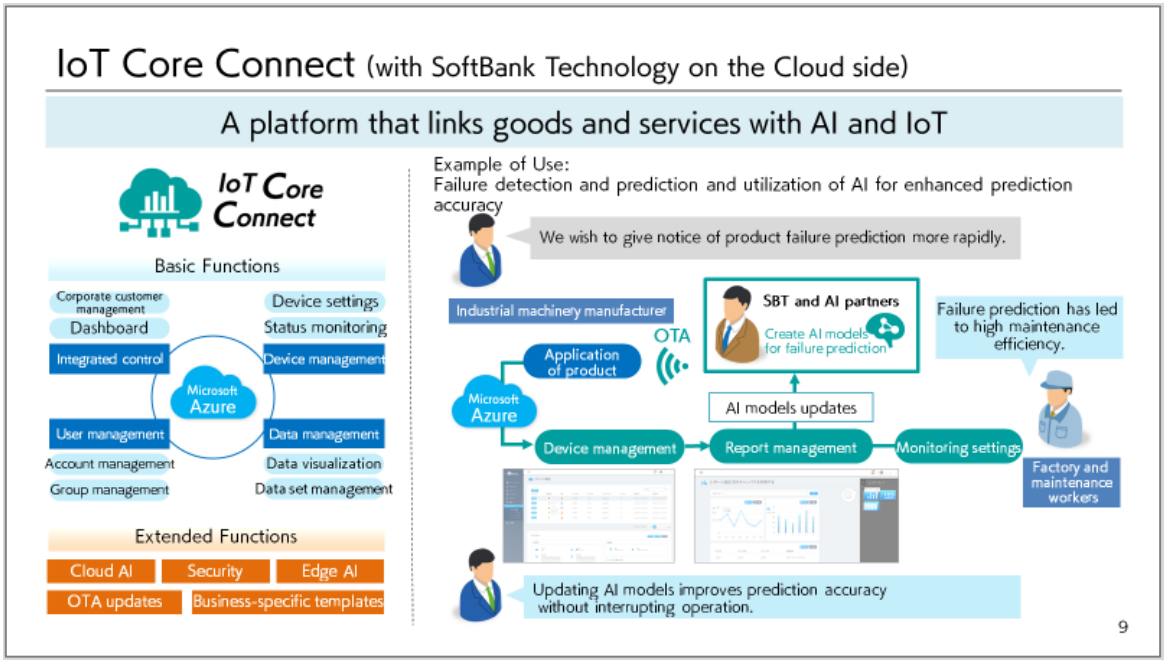
While it is used, various software must be updated as a matter of course, and a patch needs to be applied whenever vulnerability is found.

If an incorrect, malicious code is entered in such a case, a problem will occur. Accordingly, certificates identify each other as the right ones, and a code is proven to be the right one before it is downloaded for an update.

And finally (as a further measure), it must be disabled so that it cannot be used for any unintended purpose as a result of resale or theft, or so that it will not be connected to unspecified equipment.

In other words, the certificate is disabled so that it will no longer be connected to the network. This is the final task in the entire lifecycle. As one of the only two public Certification Authorities in Japan, Cybertrust provides authentication as its main task.

IoT Core Connect (with SoftBank Technology on the Cloud side)



The other thing is IoT Core Connect, which I talked about earlier. We thought that one of the IoT areas that are suitable for SoftBank Technology should be manufacturing after all. We undertook PoC in plants and factories as well. We also undertook it for building management.

For example, the electric power system of a building is divided into three power lines. These are the lighting line, the satellite, and the power line. Electric power is provided via these three lines by three different companies.

They are monitored together by the building management center. It was pointed out, however, that a location for the centralized monitoring of tens or hundreds of buildings is necessary. Failure to carry out the pre-maintenance of a plant will cause major problems. There was a case in which periodical maintenance is no longer sufficient at all.

While the concept of the Secure IoT Platform is great, it does not mean that all pieces of equipment are renewed at once. As I told you earlier, the average service life of equipment is 15 or 20 years. This means that it takes 20 years for the equipment to be replaced.

Instead, we tried to quickly connect the sensors we have now in order to achieve visualization right away. This is why we launched this IoT Core Connect.

This is the summary of the current status of progress concerning the cloud and IoT.

FY 2018 ending March 2019 H1 Results (vs. previous year)

Consolidated FY 2018 ending March 2019 H1 Results (vs. previous year)

(Millions of yen)	FY18H1	FY17H1	Amount of change	Ratio of change
Net sales	24,561	24,203	+ 358	+ 1.5%
Marginal Profit	7,013 (28.6%)	6,480 (26.8%)	+ 533 (+1.8pt)	+ 8.2%
Fixed costs	5,999	5,759	+ 239	+ 4.2%
Operating income	1,014 (4.1%)	720 (3.0%)	+ 293 (+1.1pt)	+ 40.8%
Ordinary income	778 (3.2%)	693 (2.9%)	+ 85 (+0.3pt)	+ 12.4%
Profit attributable to owners of parent	487 (2.0%)	412 (1.7%)	+ 75 (+0.3pt)	+ 18.2%

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I will now go on to announce the earnings results that we released yesterday (October 25, 2018).

We posted net sales of 24.5 billion yen, marginal profit of 7.0 billion yen, fixed costs of approximately 6.0 billion yen, operating income of 1.14 billion yen, and ordinary income of 0.7 billion yen. The first-half operating income exceeded one billion yen for the first time in the history of SoftBank Technology, so we use the term “record-high.”

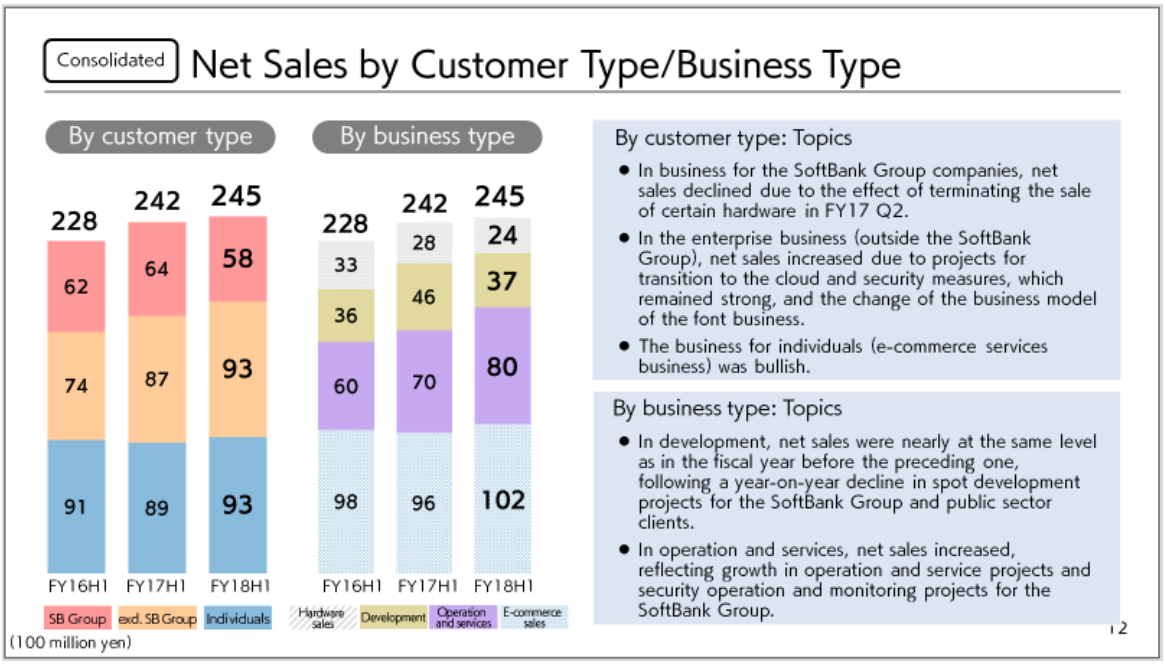
The main point to focus on is ordinary income. In the earnings results briefing for the previous fiscal year that was held in April this year, I said, “The profits of equity method affiliates are consolidated.” Accordingly, (in the full-year results for the fiscal year ended March 2018,) operating income was 2.17 billion yen and ordinary income was approximately 2.4 billion yen.

We posted ordinary income from the application of the equity method at 240 million yen (because an equity method affiliate posted a large amount of profit in the fourth quarter of FY2017). (In the first half under review, that equity method affiliate posted a huge loss, which we consolidated.) As a result, ordinary income declined 240 million yen. And we sold (all the shares in) the company at the end of September this year. This has resulted in a return of 86 million yen as ordinary income (in the form of gain on sales of investment securities). Tax is charged on the amount including this 86 million yen, which is why it is included in the calculation of the profit attributable to owners of parent.

(These are the consolidated results. Looking at the non-consolidated results,) Put simply, our company invested 41 million yen in the said company four years ago. As a result, we gained 180 million yen.

We sold our shares in the company during the first half under review because we can no longer expect synergy with it. What was ultimately left is 41 million yen (that we invested) four years ago and 180 million yen that we gained this year.

Net Sales by Customer Type/Business Type



I will now move on to explain the results of our main business. This slide shows the breakdown (of our net sales) by type of business and by customer.

(First,) Please look at the lower left corner. The blue parts indicate sales from so-called private users, with whom we transacted mainly via e-commerce. The sales are 9.1 billion yen (H1 of FY2016), 8.9 billion yen (H1 of FY2017), and 9.3 billion yen (H1 of FY2018). We can say that the result was *slightly better* this year (H1 of FY2018).

The orange parts in the middle indicate sales from enterprises outside the group. Sales from these custom ers have remained strong.

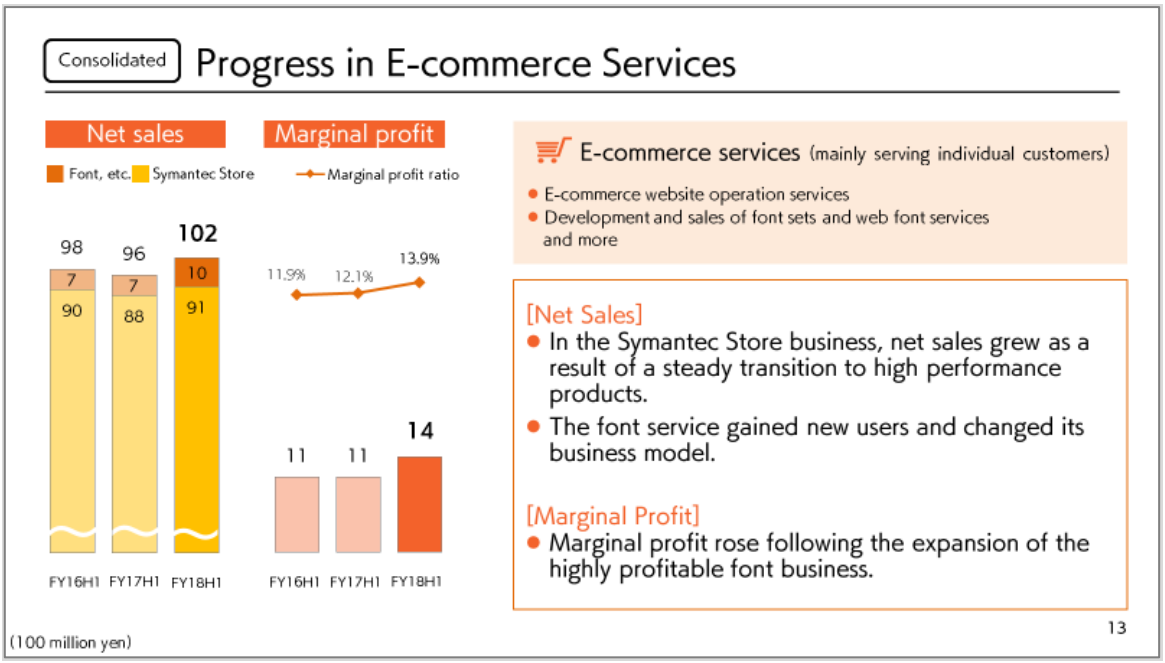
Sales from group companies are indicated by the red parts at the top. For these customers, we stopped selling hardware and servers in the first quarter of last year (H1 of FY2017). Because of this, a difference of approximately 1.0 billion yen from the previous year's sales exists as the precondition. While the value in the graph declined 600 million yen from the previous fiscal year, I would like you to interpret this as an increase of 400 million yen as sales from other transactions.

Next, the graph at right shows sales by type of business. E-commerce sales (at the bottom) include sales of Fontworks Inc., which contributed to sales and profits for the first quarter. While sales were previously concentrated in March, they are now concentrated in April because we replaced packages to send with download models. Due to the license fee for this, the amount is 10.2 billion yen.

Next, let's look at sales from operation and services. What we have developed so far have been converted to operation, and we continue carrying out maintenance in the operation. This is how the style has changed. The next ones are sales from development.

With regard to hardware sales, we do not handle hardware itself. However, things such as the license for Microsoft Azure are included here.

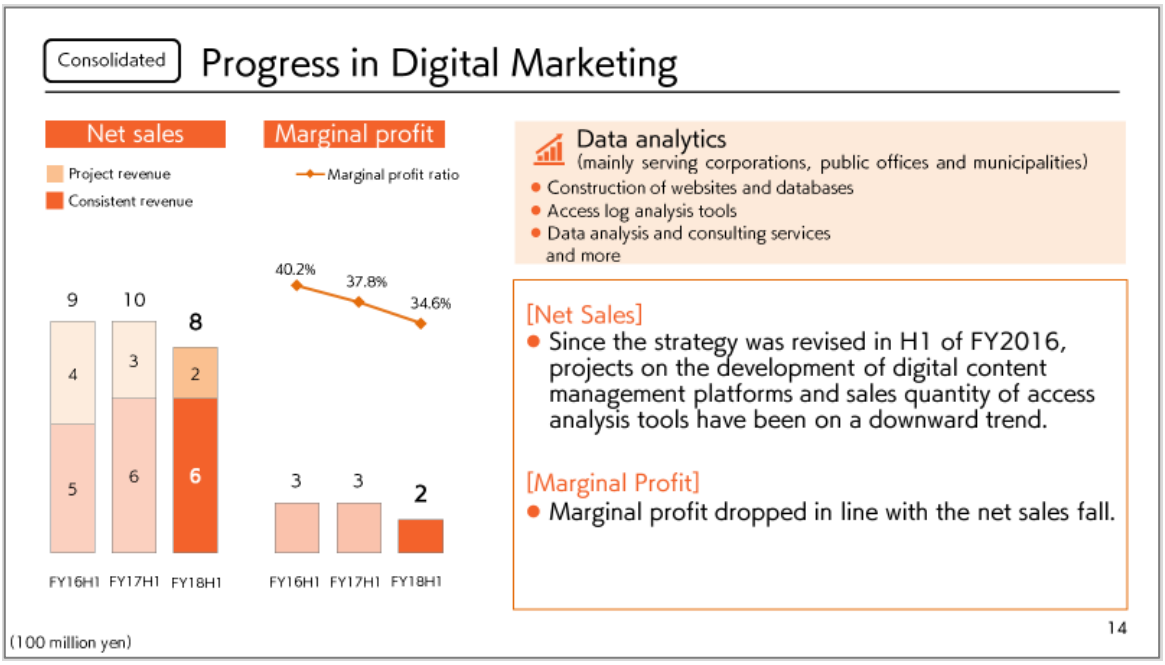
Progress in E-commerce Services



Sales from e-commerce services produced this result thanks to a slight increase attributed to Fontworks and others.

Fontworks also contributed to profits. Because the Symantec business has been very steady, we also achieved positive growth in this area.

Progress in Digital Marketing



Next, we will look at data analytics.

Three years ago (FY2016), we decided to “(undertake) data analytics in the cloud.” At that time, we assumed that Adobe and Sitecore, which are product vendors concerning data analytics, would shift to the cloud.

Sitecore shifted to Microsoft Azure as a partner of Microsoft. The only thing we have been working on for three years is Sitecore on Microsoft Azure. This was not the case with Adobe. There were also significant changes in the trend in the last three years.

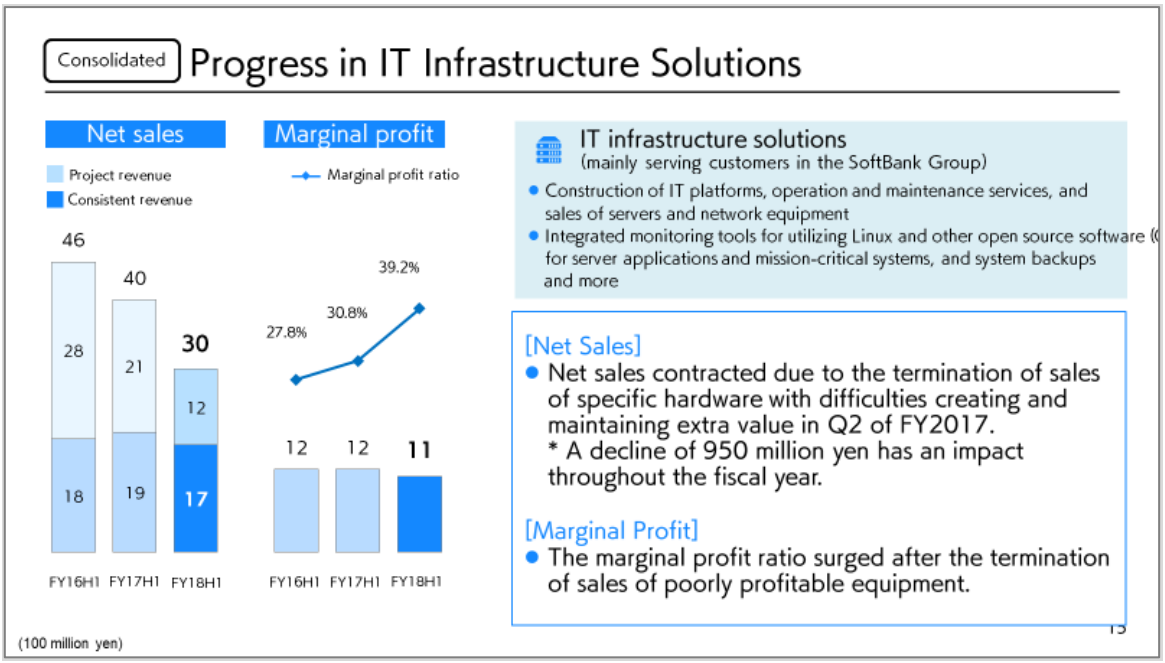
Adobe changed its main partner from SoftBank Technology as a system integrator to Dentsu and Hakuhodo, which are advertising agencies. While TV, newspapers, magazines, etc. have gradually been replaced with websites as major advertising media, salespeople from advertising agencies have been engaged in activities for acquiring entry-level Associate Web Analytics Consultants certification, conducting web analyses with extremely simple tools, and selling online advertising spaces or keeping advertisements as their legacies by adding the analysis service to advertisements.

Let me tell you one more thing. Adobe Analytics is an extremely expensive, high-performance product. It costs at least 100 million yen per year. To pay this cost, you need at least 10 billion yen in sales. In Japan, there are fewer than 100 e-commerce sites with sales exceeding 10 billion yen per year. We had more than 30 customers three years ago, but we cannot expect this (the number of customers) to increase.

As a result, net sales and marginal profit are declining. They remained unaffected last year, but were affected this year.

The (second) three-year plan will be over, and we will implement the next three-year plan in April. We understand that in this process, we will need to think about how we will work and how we will interact with customers.

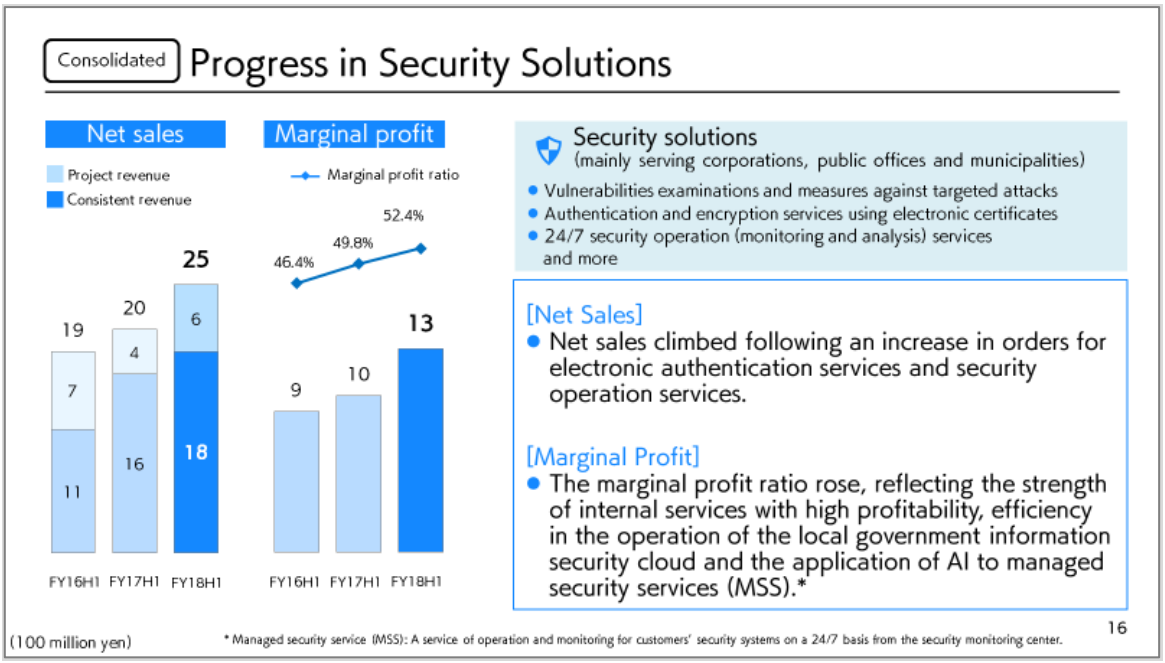
Progress in IT Infrastructure Solutions



Concerning IT infrastructure solutions, you may regard the sales decline simply as a result of the termination of server sales.

However, marginal profit, or so-called variable profit, virtually did not decline. I would ask you to consider that we achieved this level of profit.

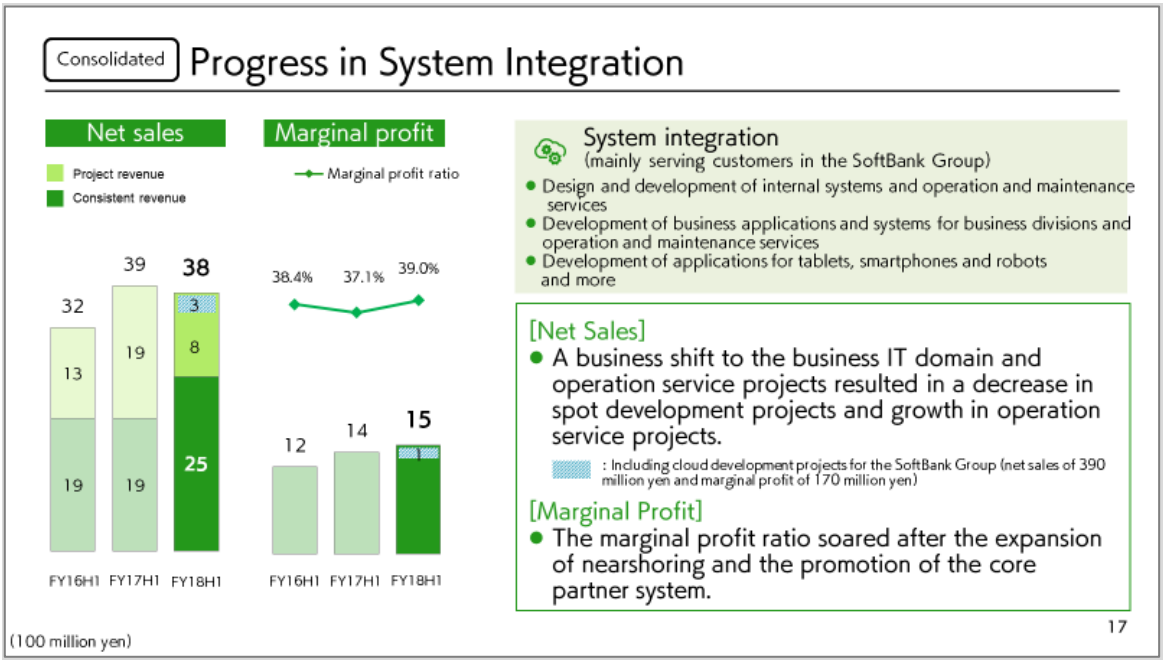
Progress in Security Solutions



Security solutions have been growing steadily.

Although marginal profit was growing last year … Because we were in an extremely difficult situation in terms of internal manhours, we were far from achieving positive growth. Please interpret this as indicating that the situation is becoming healthy this year.

Progress in System Integration



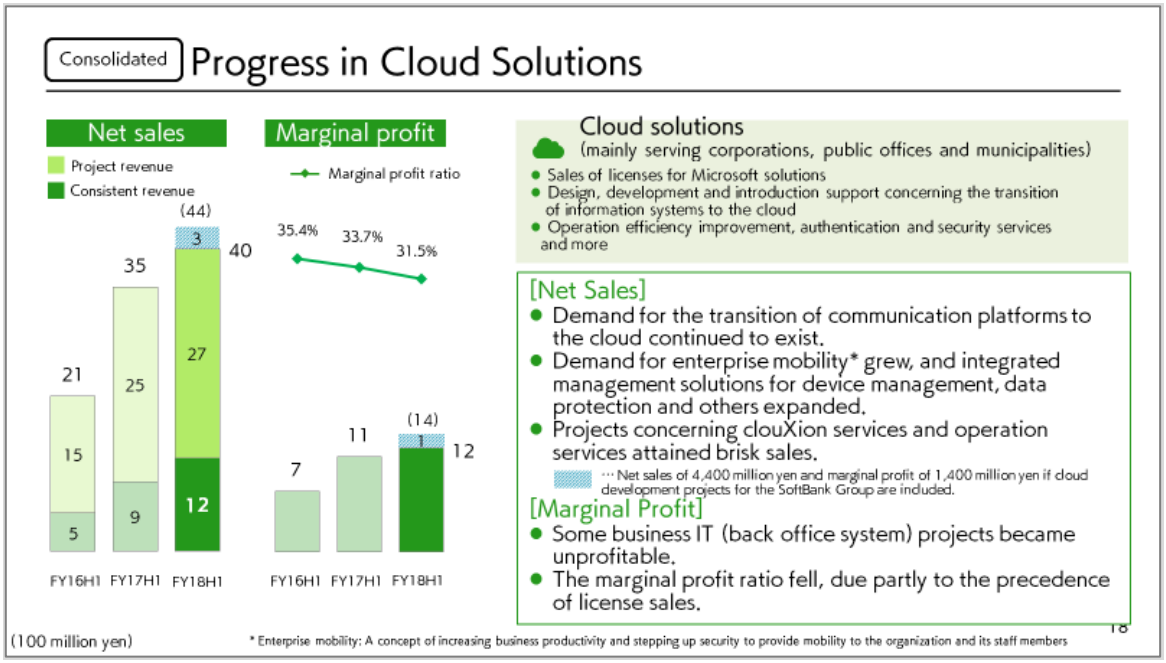
System Integration mainly includes services for the SoftBank Group.

Because the carrier itself has both data centers and the network, it will not shift to the cloud. It also provides cloud services. As a result, sales and profit from the carrier have not been posted as those from the cloud (but as those from system integration).

For your reference, sales from system integration for the first half under review include 300 million yen from projects using Azure Cloud, and marginal profit for the same period includes around 100 million yen from such projects.

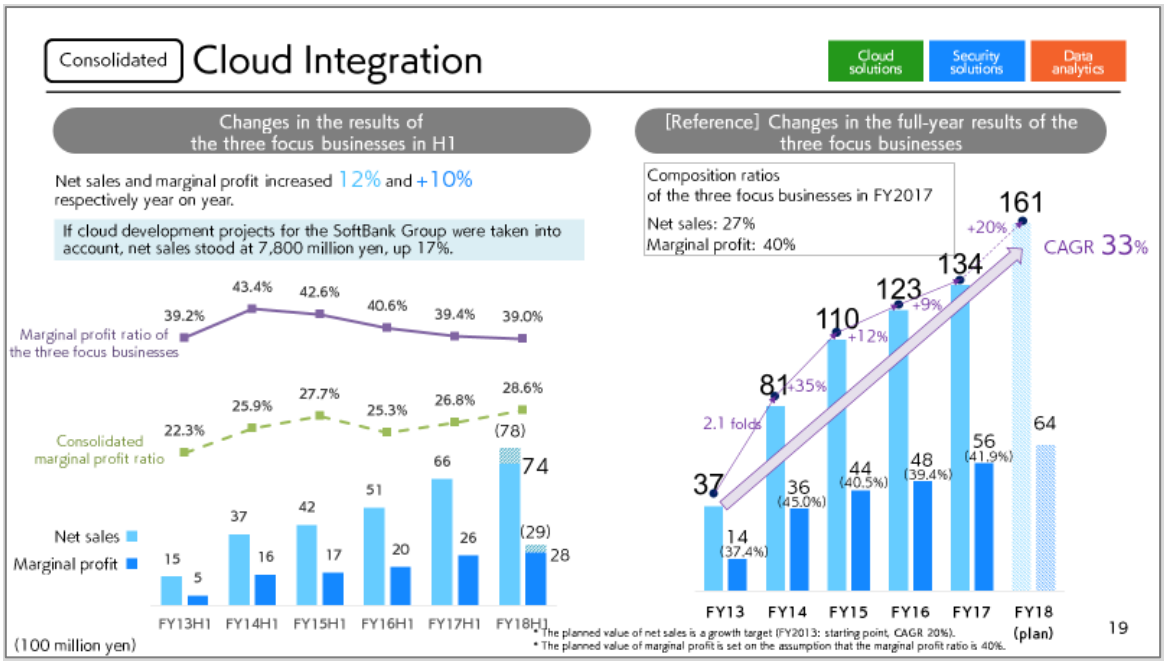
These are very big projects for us. I would like you to understand that our team of several hundred members is working on them in the belief that they will be great showcases for Stage 3 (the stage for the "cloud migration of customers' core businesses" in "cloud integration").

Progress in Cloud Solutions



In terms of cloud solutions, I would like you to understand that, combined with the current ones (of cloud development projects for the SB Group), the business is becoming strong.

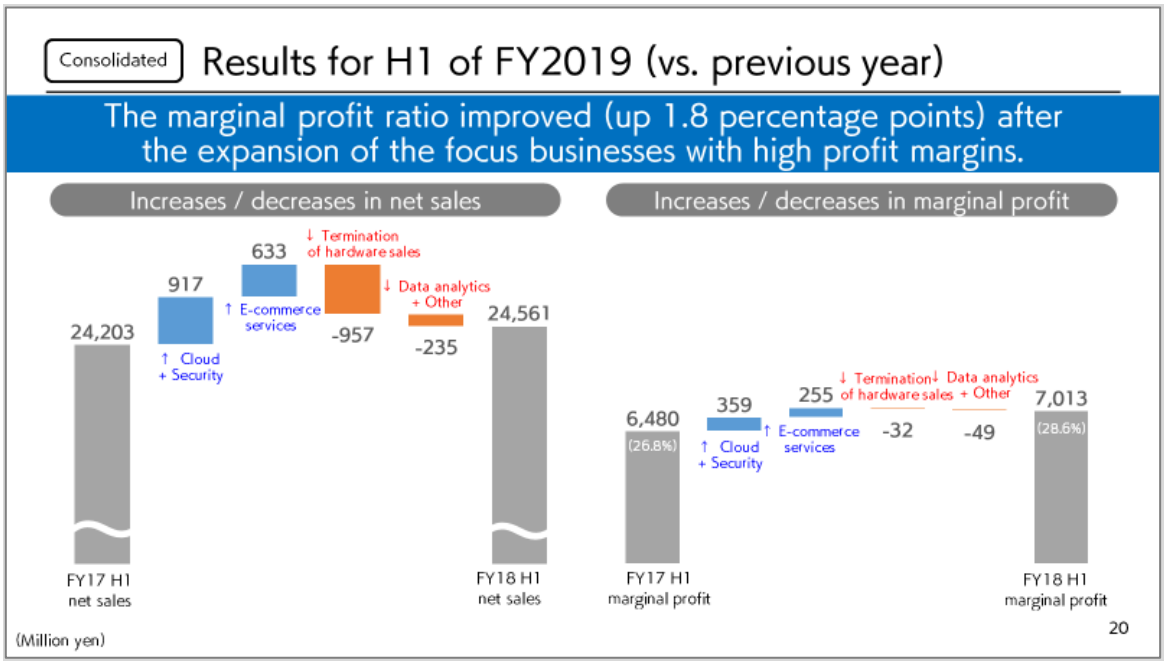
Cloud Integration



In any case, we would like to proceed with cloud integration thick and fast.

Although we face a range of difficulties, we are promoting the training of engineers in the belief that it is our strength. We would like to continue promoting this cloud shift; that is, shifting various things to the cloud.

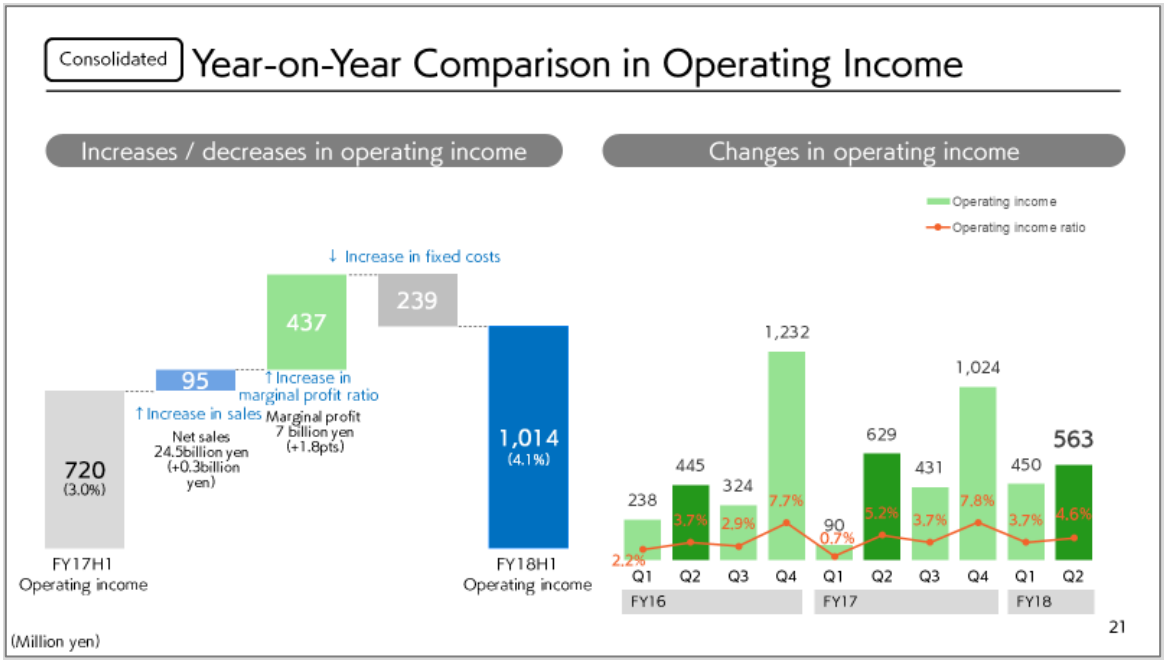
Results for H1 of FY2019 (vs. previous year)



These are bridge charts of net sales and marginal profit. As you can see, “Cloud + Security” and “E-commerce services” grew positively, while sales decreased by 957 million yen due to the termination of “Hardware sales.”

As for marginal profit, “Cloud + Security” grew positively, while a slight decline can be seen in “Termination of hardware sales” and “Others.”

Year-on-Year Comparison in Operating Income



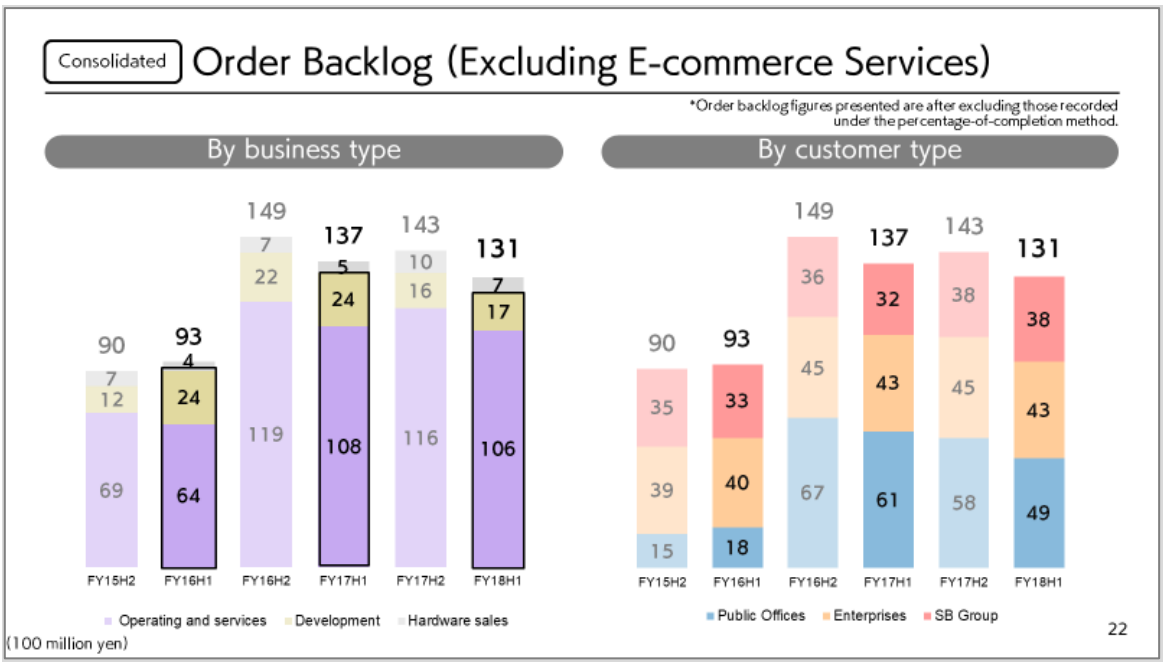
With regard to the change of operating income, the marginal profit ratio improved. The marginal profit improved because we stopped carrying out business that was not really profitable. And fixed costs increased because, as a matter of course, we cannot avoid personnel costs.

Changes in operating income are as shown on the right side. Income in the second quarter and the fourth quarter continue to constitute a large portion. There is the idea of earned value among the ideas of Project Management Professional (PMP), an international standard qualification on project management. When we have completed 60% of a project, we post 60% of the project’s value as sales and profit, respectively.

In 2016, this method had yet to mature. Currently, concerning system integration projects of 25 million yen or more and projects that continue over multiple terms, we apply the earned value approach for the calculation.

Accordingly, sales and profit for what has been completed in the current term, which will be subject to acceptance inspection in the following term, are posted in the current term. Where we know we will make a loss, we post an allowance for the loss at the end of the current term. This, I believe, has improved the predictability.

Order Backlog (Excluding E-commerce Services)



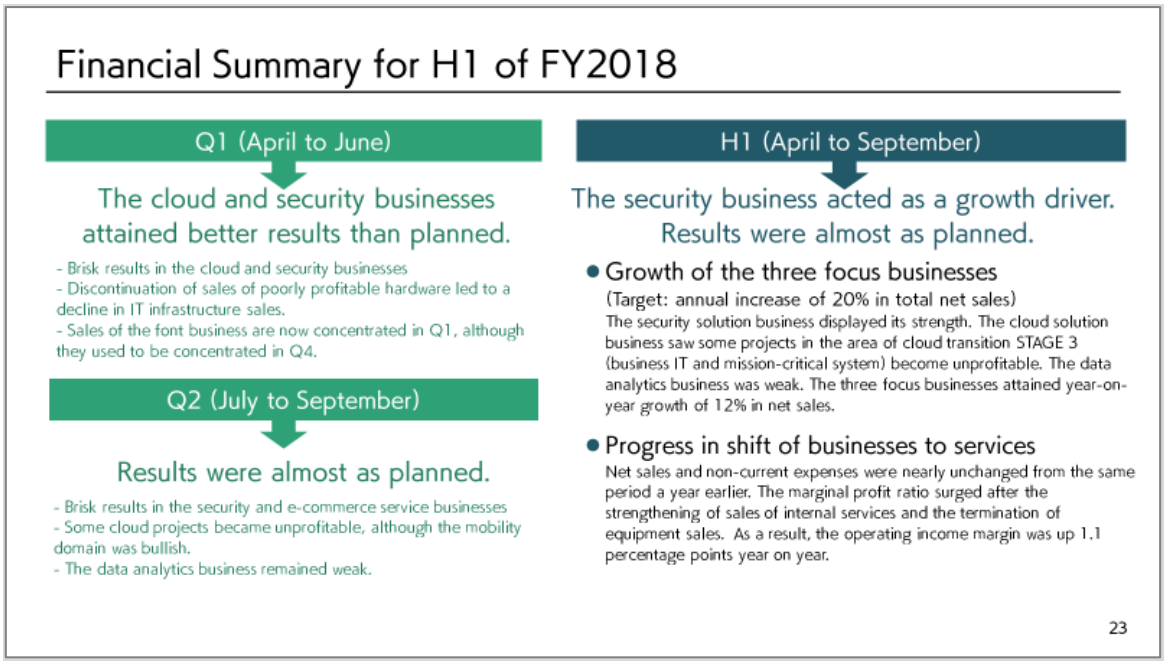
The order backlog stood at 13.1 billion yen.

Looking at the order backlog by customer, the value for public offices decreased about 1.2 billion yen compared to last year (FY17H2). We have received orders for five years, whose value is slightly more than 1.0 billion yen per year, so I would like you to interpret this as indicating that we are proceeding without delay.

In the second half of last year, the supplementary budget was not set smoothly, due in part to the election, and the regular budget remained unchanged. As a matter of course, we made a range of suggestions during the second half.

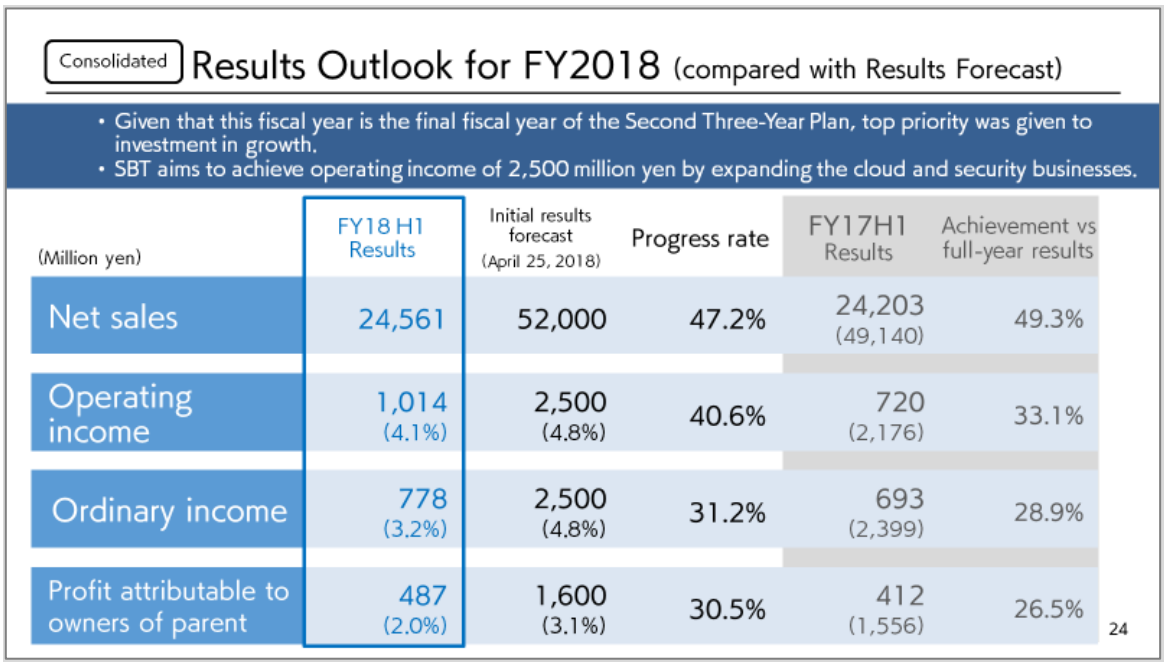
I am not sure whether the supplementary budget will be reflected in the regular budget. But I believe that we still have numerous opportunities to receive orders from public offices.

Financial Summary for H1 of FY2018



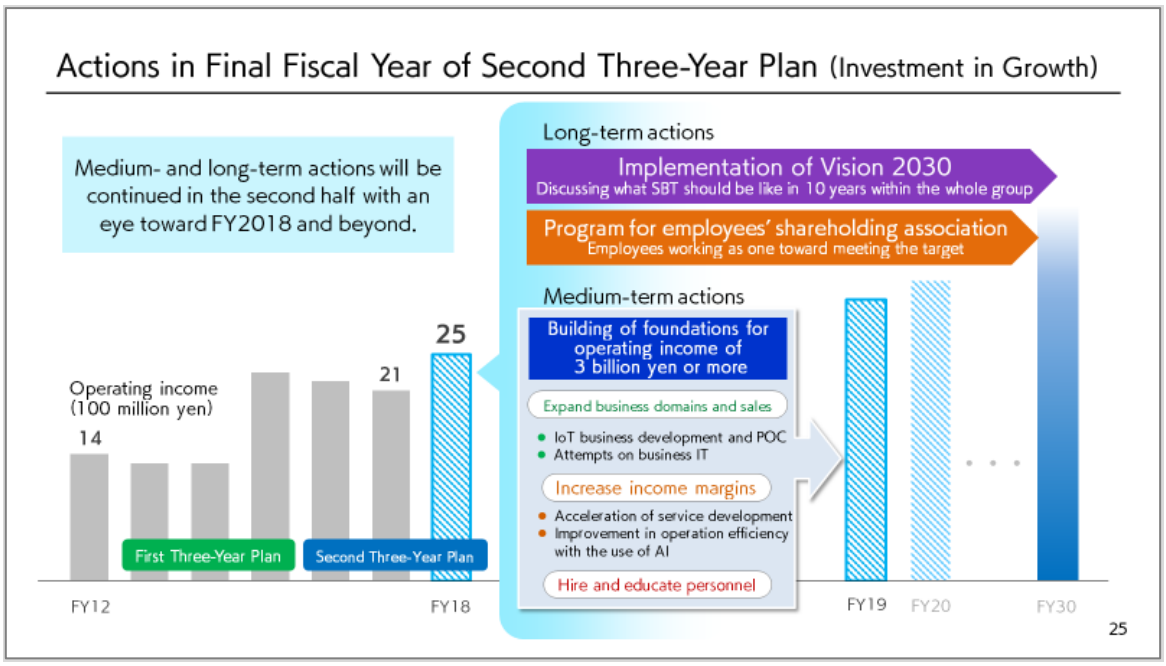
The financial summary shows what I have already told you. (I will therefore omit the explanation of it.) These are our views.

Results Outlook for FY2018 (compared with Results Forecast)



The forecast values for the current fiscal year remain unchanged from the ones we announced in April (2018).

Actions in Final Fiscal Year of Second Three-Year Plan (Investment in Growth)



The second three-year plan will end in the current fiscal year. Next year, SoftBank Technology will celebrate its 20th anniversary since it changed its name to the current one.

We have taken the coming 20th anniversary as an opportunity to launch the project called Vision2030, under which our present employees will pursue “what society will be like ten years from now” and “what contributions our IT can make.”

We are planning to have a total of 750 people from around 150 teams, with five to six members each, summarize what IT will be like in the coming ten years, in which direction SBT will go, and what kind of company it should be, together with university faculty members and other professionals, for one month in November.

In October, we introduced the employee ownership scheme. Until September, we belonged to the shareholding association of the SoftBank Group. However, partly because SoftBank K.K. became our parent company in April this year, in October we established the shareholding association, whose members purchase SBT shares, after spending six months making preparations.

Fortunately, 50 percent of all employees participate in the association. I hope that they will deepen their understanding of the company and make it a place where we think together.

That is everything I wanted to explain. Thank you very much for your attention.