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SB Technology Corp. Overview of Earnings Results Briefing for FY2021 1H

This is a transcript of the SB Technology Corp. FY 2021 1H Results Briefing held on October 27, 2021.

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

Full-year forecasts are also revised upward due to an increase in orders for public works, etc., and all indicators are expected to be achieved in the third medium-term management plan.

Results Summary

Shinichi Ata: Hello everyone. I am Ata, CEO of SB Technology. Thank you very much for attending our SB Technology's 2nd quarter financial briefing today despite your busy schedule. The materials prepared today show the business results for the first half and the situation up to the present, which is the final year of the three-year plan.

First of all, an overview of business performance. To summarize the first half results, we achieved record highs in all indicators, including sales and operating income, thanks to the steady implementation of projects by SoftBank and the Ministry of Agriculture, Forestry and Fisheries. In the second half of the fiscal year under review, we won a bid for the next fiscal year's Information Security Cloud in 10 prefectures, and we were able to accumulate an order backlog up to a record high of 26.4 billion yen. In addition, in light of the order backlog and the current business environment, we will upwardly revise our full-year earnings forecasts to net sales of 65 billion yen and operating income of 4.6 billion yen.

Premises regarding this explanatory material

We adopted the new revenue recognition standard in this fiscal year, and the graph below presents the application of prior periods to the new revenue recognition standard.

Sales of EC solutions are included in the blue portion of the graph as a net amount from this fiscal year. Therefore, the amount without the grey part will be the change in sales amount excluding this effect.

The slides show sales trends for the 10 years from fiscal 2012. In fiscal 2012, it was 32.7 billion yen, but if we applied the new revenue recognition standard, we would expect you to see 18.2 billion yen as the starting point.

Since then, we have been making serious progress every three years, starting in 2013, with the First Medium-Term Plan, the Second Medium-Term Plan, and the Third Medium-Term Plan.

I will talk about it later until I get to this term as well.

Consolidated PL (First Half Cumulative)

Although consolidated P/L, net sales were approximately 31.3 billion yen, an increase of approximately 8 billion yen compared to approximately 23.2 billion yen last year. Operating income was approximately 2.2 billion yen, an increase of approximately 600 million yen compared to 1.59 billion yen in the previous year. The current and quarterly net profits are as stated on the slide.

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Impact of change in accounting standards (net sales)

As a result of the change in accounting standards, net sales after subtracting 8.58 billion yen from 31.8 billion yen are adjusted for new revenue recognition in the first half of the previous fiscal year.

In addition, there were three companies that conducted M&A at the end of the first quarter of last year, contributing 790 million yen to those companies in the first quarter. Furthermore, there was an increase of 7.24 billion yen in revenues from existing businesses, which together resulted in an increase of approximately 8 billion yen, resulting in net sales of approximately 31.3 billion yen.

Solution classification

I would like to explain the contents of the sales amount by dividing the graph shown on the slide up and down. The top part of the graph is what we call business IT or corporate IT. Sales of cloud-based solutions grew from 10.8 billion yen to 14.9 billion yen.

The marginal profit shown on the right side of the graph on the slides grew from 4.4 billion yen to 5.1 billion yen. I would like to talk about this later on in terms of profit, but the reason that the business IT field has grown very much as sales is because we have recorded an order loss reserve for digital maps in large-scale projects. As a result, marginal profit growth has not doubled.

We will introduce digital map projects later, but we have been working with the Ministry of Agriculture, Forestry and Fisheries to create "Agricultural Land Navigation" with the current aerial map since five years ago. We will change this to a digital map captured from a satellite. Against this background, we accumulated reserves in the first half of the fiscal year because POC costs such as basic development and "in what areas will this map be used more?" as well as others came out greatly. In addition, corporate IT for the green part of the slide shows strong growth. Cloud development projects and the recommendation of zero trust security have helped to boost sales in this area.

The yellow part of the graph is a technical service. Mainly in on-premises business, we are advancing a project called "Be a strategic SIer," which we launched together with SoftBank in 2019. This has grown significantly to 14.1 billion yen compared to 10.3 billion yen last year. I think that marginal profit has also grown from 2.9 billion yen to 4 billion yen.

We expect EC to remain generally firm.

Net Sales by Customer

Sales by customer are broadly divided into two categories. As shown on the left side of the slides, not only SoftBank but also the SoftBank Group itself has grown from 10.9 billion yen to 14.6 billion yen. In addition, sales in the Corporate/Public Sector have increased from 11.3 billion yen to 15.6 billion yen.

As shown in the center of the slides, SoftBank Group saw a significant increase in sales of technical services projects at SoftBank, which amounted to approximately 3 billion yen. The field of cloud solutions also saw an increase in sales of 800 million yen, from 2.6 billion yen to 3.4 billion yen. In the Corporate/Public Sector as well, when BIT and CIT, both cloud solutions, increased revenues by more than 3 billion yen, from 8.1 billion yen to 11.7 billion yen. Technical solutions are also growing, but this is due to the effects of the consolidation of the new subsidiary that I mentioned earlier.

Factors behind changes in operating income

Factors behind the change in operating income. Operating income, which was 1.59 billion yen in the first quarter of last year, increased marginal income by 1.84 billion yen. There was an increase in marginal profit by 60% for technical solutions and 40% for BIT and CIT cloud solutions.

Personnel expenses and expenses of acquired consolidated subsidiaries were recorded in the first

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quarter, resulting in an increase in fixed costs of 980 million yen. In addition, the digital map that I just talked about accounts for a large part, but the loss reserve of 250 million yen has also increased in aggregate for the other small ones. As a result, operating income was 2.2 billion yen.

[Non-consolidated] Orders Received/Order Backlog (Excluding EC Solutions)

Forecast of business performance. Although system integration is a major source of sales, the graph below shows the amount of orders received and the order backlog within this segment. Looking back to two years ago, orders at the end of September 2019 totaled 10.4 billion yen, but last year we were able to significantly increase this year to 11.8 billion yen and this year to 16.3 billion yen.

Among them, I think you will see that the part of the stock, which is the blue part of the bar graph on the slide, is growing more and more. Please consider that we are able to receive orders for businesses that will surely lead to next quarter or next term, including multi-year contracts.

The graph in the middle of the slides shows the order backlog at the end of each second quarter. With this in mind, we will move toward the second half of the fiscal year, but two years ago we had a total of 15.7 billion yen, and last year we had a total of 18.2 billion yen. This year, we will be able to move toward the second half with a very large order backlog of 26.4 billion yen. According to our current estimates, we expect that about 60% of this 26.4 billion yen will be recorded in the current fiscal year. As I will explain later, I understand that factors such as the receipt of an order for the next information security cloud project and the steady expansion of projects for Softbank have led to 26.4 billion yen.

Revision of Earnings Forecasts

I talked about the performance forecast at the beginning, but the sales amount is 65 billion yen. We announced the initial forecast of 59 billion yen in the form of 6 billion yen or a positive 10% or more. Accordingly, operating income is forecast to be 4.6 billion yen, compared with the previous forecast of 4.3 billion yen, ordinary income to be the same, and net income to be 2.8 billion yen.

Previous Medium-Term Plan and Long-Term Targets

Regarding the progress of the medium-term plan up to the present. Just now, two and a half years have finished out of the three-year period of the medium-term plan, but I would like to tell everyone about the progress to date when the full-term prospect, including the second term, is set. On the management side, we will be shifting our focus from this month toward the formulation of a mid-term plan that will start next term.

I have explained my past mid-term plan and long-term goals many times, but I have been assigned as the president of this company in 2012, and this is exactly the tenth year. The three-year plan is repeated three times, in the form of the final year. Under the First Medium-Term Plan, we have set our focus areas and at the same time worked on the necessity of steadily implementing business reforms and increasing the number of personnel.

Under the Second Medium-Term Plan, we focused on developing cloud services, security and big data on a single cloud, and developed the IoT business by concentrating on the cloud.

In the Third Medium-Term Plan, the key themes are "Let's evolve into a service provider" and "Let's create more business IT" as we are now able to provide consulting services.

Progress of the policy of "growing tremendously"

Looking back over the past 10 years under the current new revenue recognition standard, we are now able to forecast sales of 65 billion yen, which was 18.2 billion yen. As for the operating profit, it is coming in such a way that we can predict the amount of JPY14.6 billion to JPY4.6 billion.

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Medium-Term Management Plan (1st Medium-Term Management Plan/FY13-15)

Let me explain the degree of growth for each of them. We have begun a medium-term plan in the year following 2012, the first year of the plan. As for the top line, I think it feels like it is growing, but what I focused on was to expand the three businesses of cloud security and big data at this timing. We have been acquiring companies through M&A, making them subsidiaries, and consolidating them, so that we can generate sales in the aggregate and that this has led to today's growth.

As a result, we were able to increase our sales by a proportional percentage for three years. At the same time, the contents of the company are not "three sacred treasures" as system integration, but in particular, we have tried to bring three powerful weapons to the mainstay of our sales.

The two parts shown in dark green and light green on the bar graph on the slide are just stretched out. Of course, there was an existing business, but it was three years of "Let's get the gun stretch anyway" for the three species of this cloud security big data. The purple part will be the sale of the equipment that evaluates the IT hardware that has not been introduced in Japan yet and sells it with good points.

Regarding the sales of equipment with technical support, one of the themes of this era was that it was difficult to stabilize this situation and it was difficult to make a profit.

In addition, due to the active recruitment of employees, 400 employees doubled in fiscal 2012, to 800 in fiscal 2015, over the past three years.

Medium-Term Management Plan (Second Medium-Term Management Plan/FY16-18)

This is the second medium-term plan. If you look at the graph on the left side of the slide, you'll notice that the top line hasn't changed that much. What I had to do in the meantime was try to break away from the equipment sales business, which is regarded as extremely unstable and of very low added value. So, I have been moving forward so as not to drop the top line.

The theme was to "focus on the cloud," which is also stated in the green part of the graph on the left side of the slide and in the blue part of the graph on the right, so that part of the "Three Sacred Treasures" is expanding steadily on the cloud. As a result, sales of equipment have decreased, and as a result, the top line has not changed much. Both the deliberate part and the result-theoretic part are included, but at this time I thought of gaining physical strength anyway.

"Upstream Shifts and Enhanced Operation" means that engineers love to do new things, but that they have to develop management skills that can surely generate profits. I remember asking senior employees and engineers to obtain PMP (Project Management Professional) qualifications, and having them take more than 100 people in a year or so.

Then it says "SOC", which is Security Operation Center." What do you see as the added value of security in the future?" This makes it impossible to say, ""I will never put it in"" into the security where new attacks occur every day, and various types of clouds are coming up."

To this end, we have launched the SOC because it will be necessary to constantly monitor and analyze new incidents and predictions of new changes and take countermeasures. It is connected to the present MSS (Managed Security Service).

The Second Medium-Term Plan is designed to challenge adults and government agencies by using the cloud's large weapons, security, and big data, as well as the BI and AI in the cloud.

And what areas should we tackle for IoT, IoT is the Internet of devices. How can I help us as a group when I create a cycle in which I bring a variety of data from there, analyze it on the cloud side, develop all the applications necessary for control, etc. on the cloud side, and download them to devices?

SBT alone is growing increasingly with engineers who are extremely skilled at cloud management. Within that, it will become possible to create a job after receiving the data, that is, an analysis or a

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program, but the former Cyber Trust works as a certification agency. In addition, Miracle Linux has a large number of engineers, including embedded systems, who are dedicated to the core programming of LinuxOS (Linux OES).

And for 2017 during this period, we are integrating Cyber Trust and Miracle Linux to create a new CTJ (Cyber Trust Japan Co., Ltd.). This company was able to go public on April 15, 2021.

The intention of publication is obvious, and we would like you to know the company's internal situation in order for this company to certify the standard equipment in the future. I'm not shouldering any kind of capital, but at a very low price for the equipment anyway, I'm going to put in the certification system more and more. This itself leads to security.

Now, as is the case with the zero trust security for the enterprise that we are advancing, it is required that we can always authenticate. From this 2017 timing, authentication must be open.

There is a background that the company went public because everyone wanted to create a standard so that local dialogues were full and there was no such thing as "Where can I authenticate, but if I go elsewhere, I can't authenticate." This is the second medium-term plan.

Medium-Term Management Plan (3rd Medium-Term Management Plan/FY19-21)

This is the third medium-term plan. The graph shows the transition for 10 years, but the right-hand side of the slide, "Strengthening Customer Competitiveness" refers to business IT. We have shifted to a divisional system, in which we understand our customers well and act based on what kind of solutions are needed for our customers' businesses. Public businesses and telecommunications businesses have also been strengthened. As a result, I think it is leading to a big increase in sales. Another theme is addressing the IT talent shortage. I can't continue the way I work on system development like a waterfall type, where I'm going to finish from start to finish in my own company. We expanded our service business in order to increase development efficiency without coding or testing each piece by adding various parts through various applications or micro-services.

Also around the same time, although it is MSS (Managed Security Service), it is actually inefficient that various companies make dedicated SOCs. Of course, in some parts of defence and finance, PSOC(Private SOC is needed, but since attackers are aiming in various ways, rather than trying hard in a small situation, it is more efficient to proceed in a place where a great number of incident data are gathered.

In addition, as we expand our development partners, we will naturally increase the number of employees as we become a strategic SIer of SoftBank, but in addition, we will incorporate vendors that were previously used directly by SoftBank into our management.

Currently, we have just under 900 employees, of whom more than 600 are engineers, accounting for 70% of the total. Our business is supported by more than 2,500 development partners per month in addition to our engineers, or by the power of our operational partners.

Sometimes I receive various partners from SoftBank and work for SoftBank as they are, and there are also cases where I ask for jobs other than SoftBank, such as so-called enterprise jobs and public jobs.

In June of last year (2020), we made the electric line a consolidated subsidiary through mergers and acquisitions. The slide says "Responding to Industry Challenges." For the next information SC (security cloud), we would like to provide services to local governments.

SIer basically receives requirements from customers, defines them, outlines designs, basic designs, acceptance tests, and even operations after full operation. I would like to try to "How about this kind of service" ahead of time.

For five years from 2016, the current information SC was headed by 10 government-designated cities in 47 prefectures, and to the municipalities under them, such as cities, towns, and other local governments, "Unify the contact points for coming out of the Internet within the prefecture. Be sure to secure the various information that comes out or comes in." At that time, we made proposals to 47

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prefectures and 24 prefectures. As a result, we were able to acquire four prefectures. We have been working hard to maintain these four prefectures for five years.

When I propose it next time, I would like to make it lighter and lighter because it's a cloud, not in this way. And since security is also used by everyone, I would like to work on the light more lightly and faster to make it a service.

Up to now, we have been listening to requests from each prefecture and making them one prefecture at a time, but in response to the requirements of the guidelines issued by the Ministry of Internal Affairs and Communications, we have prepared them in three layers: "This 12 items are necessary for the mast," "This 8 items are recommended," and "8 items are options for local governments in each synergy unit to add areas that have not yet been completed." "We were able to propose a service by requesting payment from the monthly usage fee, such as ""Please choose from these." "In this way, there is no build fee."

I will talk about it later, but I have been working with a great number of construction general contractors at the "Con-Bridge" for the construction industry. Since there are various facilities at the construction site, not only the construction owner, but also general contractors such as electric and air conditioners always enter and exit the construction site. People who work in that facility must receive certification in a different way each time they change sites in several places a day.

In order to make this common, we developed Con-Bridge. We are also supporting the DX Strategy project of the Ministry of Agriculture, Forestry and Fisheries.

So far I have explained about the right side of the slide. Regarding the last 65 billion yen in the sales graph on the left, the "public works" project in the purple color portion has so far been on the scale of approximately 3 billion yen, but I think that we can probably book sales on the scale of 10 billion yen in this fiscal year. Growth in this segment is making a significant contribution to the 65 billion yen forecast this time.

[Project progress] Information Security Cloud

Regarding the security cloud project, I told you that at the end of the first quarter, we won the bids for the Tohoku 6 prefectures and the Niigata 7 prefectures, but in addition to that, we won the bids for the Tochigi, Saga, and Nagasaki prefectures. Nagasaki Prefecture is not counted in the order because it was at the beginning of October, but we are currently bidding on 10 prefectures.

From now on, I understand that there will still be opportunities in more than a dozen provinces toward the next fiscal year. I don't think any other company can probably provide such a service type in this way. I would like to continue to grow and expand this cloud service information security cloud model next year.

Third Medium-Term Management Plan/FY21 Management Indicators

I told you that I had a prospect of achieving the operating profit of 4.6 billion yen, so I think that I can almost achieve the goal of 4.3 billion yen that I set three years ago. In addition, I think that the proportion of sales in the cloud solution BIT&CIT will probably be able to achieve 50%. We have already achieved 13% of ROE in the previous fiscal year, and we will continue working to maintain this level this year.

That is the explanation for the second quarter. Thank you for your attention.