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SB Technology Corp.

Overview of Earnings Results Briefing for FY2022

This is a transcript of the SB Technology Corp. FY 2022 Results Briefing held on October 26, 2022.
Speaker: Mr. Shinichi Ata, President & CEO, SB Technology Corp.

SB Technology achieved record highs in all indicators, including net sales and operating income in H1. Structural reform and profitability improvement as planned.

Results Summary

Shinichi Ata: Hello everyone. Thank you very much for participating in our first half of the fiscal year's briefing today despite your busy schedule. Then, I would like to start right away.

Today, I will explain the general status of our performance and the progress of our medium-term management plan. First of all, an overview of business performance.

As for the summary of financial results, all indicators, including net sales and operating income, reached record highs for the first half of the fiscal year. Under the 4th Medium-Term Plan, we have set the goal of "improving profitability," and are gradually shifting resources to higher-value-added projects.

Compared with the same period of the previous fiscal year, orders received in the second quarter declined by 4.2 billion yen compared with the same period of the previous fiscal year due to a reactionary decline in Local Government Information Security Cloud. We will also explain this using the graph later. The order backlog at the end of the second quarter reached a record high.

Regarding the outlook for the full fiscal year, the initial forecasts for the full fiscal year are for net sales of ¥70 billion and operating income of ¥5.4 billion. We expect to make progress as planned.

Consolidated P/L (Apr—Sep)

It's consolidated P/L. Net sales were ¥31.706 billion, an increase of 1.2% from the previous fiscal year. Operating income was ¥2.27 billion, an increase of 2.9% from the previous year. The following Ordinarily Income is shown on the slide.

Net Sales and Gross Profit by Market

It's Sales and gross profit by market. Gross profit has been disclosed since the current fiscal year. The orange part of the graph is for consumer, where NortonLifeLock and Fontworks fall. Net sales were ¥2 billion, the same as in the previous year, and gross profit was ¥1.26 billion, a decrease from ¥1.31 billion in the previous year.

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As a result of a contract change with NortonLifeLock, many parts will be covered directly by NortonLifeLock over the next few years. We believe that the impact on earnings for the current fiscal year will be from ¥300 million to ¥400 million, but the impact of this will be delayed, and I think that it will become larger from the third quarter.

As for the Public Sector in the green portion of the graph, net sales are growing due to projects for the Ministry of Agriculture, Forestry and Fisheries and the operation of the Local Government Information Security Cloud. However, the cost of responding to the failure of the Local Government Information Security Cloud occurred on August 8, and unfortunately, the gross profit has not increased as much as the net sales.

The light blue portion of the graph shows an increase in both sales and profits in the Enterprise domain. Net sales have grown by around ¥200 million, but this is due to the large growth of Cybertrust, which announced its financial results today, and non-consolidated net sales have not grown so much.

I will explain later how we will replace the contents. In particular, we are withdrawing from low-margin license sales and improving profit margins. I think you can see that gross profit was 3.69 billion yen, up from 3.25 billion yen last year, and profit is growing even though net sales are not growing.

The Telecommunications business of the pink color portion of the graph will be related to our parent company, SOFTBANK CORP. These net sales decreased by around ¥1.1 billion. However, we are gradually shifting from vendor management projects within this framework to high-value-added areas.

Despite the decrease in net sales, I think gross profit shows that the profit margin is improving as efficiency improves.

Factors Behind Changes in Operating Income

This is an increase or decrease factor in operating income. Although the effect of the increase in sales is slight, it is 80 million yen. In addition, the gross profit margin improved by 1.6 percentage points and the loss provision decreased. As a result, profitability improved by 490 million yen. Selling, general and administrative (SG&A) expenses increased by ¥510 million in personnel expenses and operating activities, resulting in an operating income of ¥2.27 billion.

[Non-Consolidated] Orders Received/Order Backlog (Except Consumer business)

Regarding the amount of orders we have conveyed earlier. In Public Sector projects, orders received were ¥4.9 billion in the second quarter of last year, but this was due to orders for Information Security

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Cloud in the six Tohoku prefectures and Niigata prefectures. In the second quarter of 2022, there was a reactionary decline to the previous year's figure of 1 billion yen. However, this year's Local Government Information Security Cloud projects received orders from Saitama Prefecture and Yamaguchi Prefecture, and this was recorded in the first quarter of the fiscal year under review, and has not yet entered the second quarter's order book.

The order backlog as of the end of the second quarter grew to 14.7 billion yen for Public Sector projects and 8.8 billion yen for Enterprise projects. Telecommunications projects declined to ¥4.2 billion, but the order backlog reached a record high for the second quarter.

Full-year Earnings Forecast

Forecast of business performance. The current degree of progress is 45% for net sales and 42% for operating income. While it is hard to see how the impact of Norton LifeLock's contract changes in the second half will appear, we intend to achieve operating income of ¥5.4 billion.

4th Medium-Term Management Plan

Regarding the Medium-Term Management Plan, we explain our initiatives for fiscal 2022 through fiscal 2024 and their progress. I sorted it out a little easier to understand. We can't be off our guard yet, but we are slowly coming out of the coronavirus pandemic. On top of this, we believe that the flow of DX will not stop, but will continue to progress.

Customers are making clouds and working on DX, but I would like to explain the word "making DX self-propelled." "Driving by yourself" means that we have so far been having our customers create applications that explain them to System Integrators and work well. However, this means that the customer will be able to develop more and more on their own.

While we have received many applications on paper, those who know the work flow best in the Local governments are staff and those who have customer contact points in the Enterprise.

Paper may pass through, but the system may fail to pass through if even one point is incorrect. It is best to have people who are familiar with the workflow create a system, but I think that solving this is one of our roles because it is difficult.

I think that the use of data will become more active around 2024. The trend toward expanding this system to group companies, business partners, and companies in the supply chain of our customers will strengthen the competitiveness of our customers as a result.

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Under our 4th Medium-Term Plan, we will first educate human resources who can provide consulting support to promote DX. It is a person who can tell us about the advantage and how to proceed. In addition, we will provide support for IT literacy training.

If data is not used eventually, the information-oriented society can hardly be realized. To make DX self-propelled, we need an application platform that allows staff, employees, and front-end people to build them with no-code low-codes.

By clicking on the icon on the screen and dropping it, you just write an arrow in between to provide a platform for one application to complete. Since the collected digital data is collected according to the correct route, we would like you to fully utilize the tools on the cloud for analysis and other purposes.

It is difficult for other companies in the same industry to analyze their products and if they want more business opportunities, but they can match them with those of other industries targeting customers just as they do.

"Is the customer of Company A also purchasing the product of Company B?" Personal information such as names, addresses, and contacts is not permitted to be sent to other companies, but it uses data on rough age groups and what they are purchasing.

For example, if 70% of the users matched, we can promote and cross sell A's products to B's users. It is not permitted to approach the individual client at the pinpoint, but even if advertisements are developed for the entire client, the situation arises that it fits the target by as much as seventy percent.

Conversely, if only 10 percent is correct, then matching is meaningless. I think you'll discover the opportunity that there are many people in the world who only deal with 10% of their own products.

With regard to privacy tech, which will continue to advance in the future, we will continue to use the data while observing the stringent laws of European GDPR and the laws of the State of California. Security will support them.

It is difficult to utilize data unless security is securely followed and privacy rules are adhered to. Security measures are very difficult and costly for those starting from here, but the model of Local Government Information Security Cloud that we provide to 12 prefectures and 405 local governments can be used by all local governments.

There are cities with a population of 1 million and towns with thousands of people, and the budget is

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naturally different. However, the same service is available with the same quality. Of course, the cost of finally paying for the number of people used varies, but we have been sublimating to such services until now.

As a successful example of self-propelled, our affiliate company taught a total of 3,600 staff members of the Ministry of Agriculture, Forestry and Fisheries how to make a common application by themselves, and almost all over 3,000 electronic applications were made by the hands of staff on our platform.

In addition, there are some Local Government Information Security Cloud, such as those that were included five years ago and terminated last year, but now the requirements are very increasing. Computers are said to be 100 times more powerful in 10 years, and 10 times more powerful in 5 years.

Therefore, a new security problem arises. This is not carelessness, but must be protected from those who are aiming at such places.

So we have to put the latest one and apply the latest information. We can't do it if we are in a small company. However, everyone can enjoy by this service.

Customers sometimes tell us that they want to provide security for all parts of the corporate group. There are various ways of thinking about costs, such as dividing them by the number of employees, sales, and transactions. However, there are also cases in which the entire Group is protected and "if the manufacturing line is not checked including the supply chain that provides the materials, the production line will be stopped."

We would like to do sublimation to such services. In addition, various services that we do not offer come here, but we will proceed to the rule that anything that is not on the foundation of security should not be used in the company on its own.

Of course, customer data should not be used on its own. The correct understanding of them is a major pillar of our 4th Medium-Term Management Plan.

Efforts to Improve Profitability by Customer

We have set annual targets for net sales and operating income. We must create the base for achieving our fiscal 2024 operating income targets of ¥8 billion and an operating income margin of 9%. At the beginning of this fiscal year, employees kicked off and decided on their respective priority themes.

In Telecommunications, we will focus on high-value-added operations and increase profit margins. In

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In addition, our goal is to improve quality even further to avoid reworking.

At Enterprise, we will focus on companies that promote DX and continue to deepen our efforts. We will also support security measures that bring together groups and supply chain companies.

At the Public Sector, the development of municipal-related businesses. Although security was achieved, paper application forms are still being used. We would like to make this more and more self-propelled with the know-how of the Ministry of Agriculture, Forestry and Fisheries's electronic application.

Business for Telecommunication

In the telecommunications business, we have increased the number of vendor management projects for SoftBank over the past three years. We received a request for vendor management for development and operation projects held by each department, and we have been working on standardization for these three years.

We have been gradually returning items that we believe have completed standardization since last year. Then, we are gradually shifting from vendor management to the development of new fields with high added value.

On the right side of the slide, we described "Building a growth cycle," but by studying and proceeding with new approaches, the gross margin was temporarily reduced to 11.9% and the overall margin became stricter.

However, as shown in the line chart, the second quarter improved to 16.8 percent. We believe that we must make further progress from this fiscal year to the next fiscal year.

Focus on Cloud

About 10 years which is relatively early time, we started cloud integration and various services on the cloud. Initially, the communication infrastructure replaced the cloud, becoming increasingly new, and groupware was added to it to store data.

In the future, supply chain management and CRM will come in. Alternatively, we expect that key systems will be subdivided and cloud services will become increasingly available.

In this decade, we have built and operated a cloud environment for more than 1,000 enterprise customers. Needless to say, it stops in the communication infrastructure, and customers do not want to move to the cloud yet. In that case, we purchased and sold licenses each year, but the transaction

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value is extremely low gross profit even in hundreds of millions of yen units.

As described in "In the past" on the slide, Company C and Company D, which did not move to the cloud for a while, prompted them to purchase licenses from other companies. Currently, as in the "From now on" portion of slides, we are deeply cultivating our customers who are willing to utilize the cloud.

In the first half of the fiscal year alone, the business for licensing was reduced by several hundred million yen. As a result, we have been able to improve profits.

Development of Security Business

In the Security business, we greatly expanded our security monitoring operation center, SOC (Security Operation Center). The total floor space and the number of seats have been doubled, and the number of personnel has also increased.

We monitor and analyze various threats. Our policy is also to have engineers in place and service so that we can proceed on a one-stop basis until restoration.

Until now, we have conducted security monitoring and operation on a reasonable scale as a business for one client company. Customers are not very large companies, such as group companies and supply chain companies.

We do not know where there is a security risk in practice. Various problems have also occurred, such as a gap between the company and the company and the need to enter a password, etc., again.

We want to provide security services in response to such needs as "want to enter only by certification" and "cannot be assured unless the same security mechanism is in place."

Progress of the Security Business

This is the status of the security business. Net sales in the first half of fiscal 2019 were ¥1.85 billion. The gray part of the bar graph is the Local Government Information Security Cloud, and I think it is sales for four prefectures.

The cyan area is security for companies and delivers a customized solution to each clients of Enterprises.

The purple area is operational and MSS (Managed Security Service). It has accumulated year by year, and it was only 110 million yen in six months three years ago, but now it has increased to 423 million

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yen.

Local Government Information Security Clouds have increased from this fiscal year to nine prefectures. As the number will increase from April next year to twelve prefectures, I think the growth will spread further.

Enterprise security builds up with the latest and most advanced technologies that meet corporate requirements. Because a large number of skilled personnel are required, it is absolutely difficult to increase sales. Therefore, we intend to expand MSS even further in the future. I believe that the figures to be announced in three years' time will have different digits.

Service for Local Governments

Local government services are not terminated by the security cloud alone. We are currently proposing optional services such as monitoring EDR such as terminals. The most inquiry is now a remote desktop for remote work. We are working to ensure that our products can be used by many local governments.

Another area aimed at is the "Service development for local governments to improve business efficiency" on the right side of the slide. Now, we can apply from PCs and smartphones, and it seems as if the digitization has advanced, but it does not lead to the so-called Basic Resident Registration Network System with "My number".

It is quite common for public offices to print out an application form and type it again on a PC in a closed network. To eliminate this, you will need to prepare for security. However, I think that DX will not proceed unless this is the case.

More than 1,000 types of services for such local governments are available in one municipality. Now it is spinning because it is paper, but in order to systematize it, we have to make 1,000 pieces of workflow. It is a self-propelled platform that we have already communicated and secure as a service for the security cloud.

We will then use our tools, other tools in the world, and other tools that we believe do not pose any security problems, and propose to digitize services for local residents.

Only the staff can digitize. If there is something similar in other municipalities, I would like to proceed with making sure that they use it as much as possible.

The government intends to establish such a mechanism of digital governance in 2025. We intend to promote our medium-term management plan through 2024 and support our employees so that they can run their own as quickly as possible.

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4th Medium-Term Management Plan / FY24 Management Indicators

Going forward, we plan to implement a medium-term management plan that will enable us to further support new DX for customers and genres.

The management indicators of the medium-term management plan are operating income of ¥8 billion, an operating income margin in the 9% range, and net sales of more than ¥50 billion from cloud security and services. We have completed one-sixth of our efforts to achieve this. We look forward to your support in order to further accelerate our progress.

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This is an English translation of the captioned release. This translation is prepared and provided for the purpose of the reader's convenience. All readers are recommended to refer to the original version in Japanese of the release for complete information.