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SB Technology Corp. Overview of Earnings Results Briefing for FY2023

This is a transcript of the SB Technology Corp. FY 2023 2Q Results Briefing held on October 30, 2023.

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

SB TECHNOLOGY, Enterprise and Public Sector contributed to sales growth; net income increased 4.7x due to transfer of shares of subsidiaries.

Summary

Summary

| FY2023 Q2

FY23H1 Financial Results

Higher revenues in Public Sector& Enterprise, [sales achieved record highs as H1](#)
Operating income was flat due to restrained investment in Telecommunication and strengthened recruitment.

Orders Received

Q2 orders received fell by ▲ ¥1.6 billion year on year, mainly due to the impact of the Telecommunications,[but the order backlog at the end of September was a record high of ¥30.3 billion.](#)

FY23 Forecast

[Full-year forecast: Steady progress toward net sales of ¥68 billion and operating income of ¥5.9 billion](#)
No changes were made from forecasts based on the effects of transfer of Fontworks, Inc.' stocks, etc.

3

Shinichi Ata: Hello everyone, I am Shinichi Ata, President & CEO of SB Technology. Thank you for participating in our financial briefing while you are very busy today. I would like to explain the outline of the results and the progress of the Medium-term Management Plan.

First is an overview of business results and a summary of financial results. Net sales reached a record high for the first half due to an increase in revenues in the Public Sector and Enterprise segment. Operating income was flat due to the impact of restrained investment in Telecommunication and the strengthening of recruitment.

Orders received declined ¥1.6 billion year on year in the second quarter, mainly due to the impact of the Telecommunication field, but the order backlog at the end of September was a record high of ¥30.3 billion.

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We are making steady progress toward our full-year forecasts of net sales of ¥68 billion and operating income of ¥5.9 billion. Note that there is no change in this figure from the forecast of performance that incorporates the effects of the transfer of shares and others of Fontworks, Inc. on July 19, 2023.

Consolidated P/L (Apr—Sep cumulative)

| Consolidated P/L (Apr—Sep Cumulative) | | | | FY2023 Q2 |
|---|-----------------------------|-----------------|--------|-----------|
| <ul style="list-style-type: none"> Despite growth in Public Sector and Enterprise, operating income was flat due to restrained investment in Telecommunication and higher SG&A expenses. Increase of ¥4.9 billion in net profit due to increase of costs and sale of stock of Fontworks, Inc. | | | | |
| [Millions of yen] (Profit margin) | FY23H1 | FY22H1 | Change | Change % |
| Net sales | RecordHigh 32,206 | 31,706 | +499 | +1.6% |
| Operating income | RecordHigh 2,282 (7.1%) | 2,270 (7.2%) | +12 | +0.6% |
| Ordinary income | 2,182 (6.8%) | 2,222 (7.0%) | ▲40 | ▲1.8% |
| Profit attributable to owners of parent | RecordHigh 6,272 (19.5%) | 1,346 (4.2%) | +4,926 | +365.9% |
| Net profit | | | | |
| EBITDA ※ | RecordHigh 3,156 | 3,093 | +63 | +2.1% |

*EBITDA = Operating income + Amortization of goodwill + Depreciation

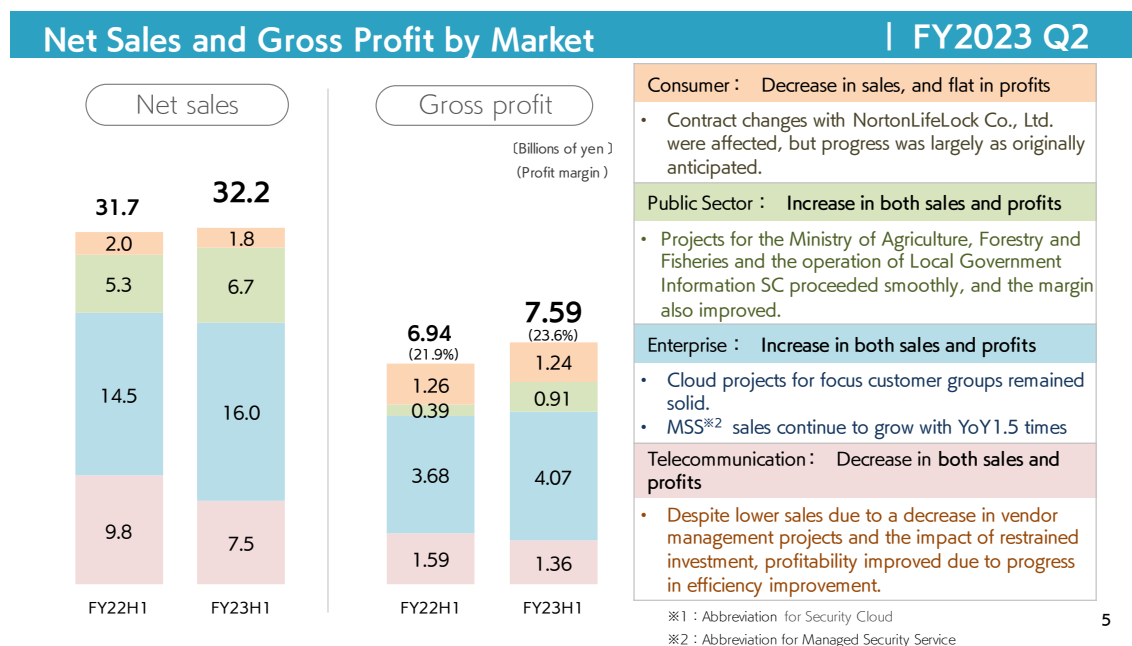
4

This is consolidated PL. Net sales and operating income were ¥32.2 billion and ¥2.28 billion, respectively. Net sales increased by approximately ¥500 million year on year, and operating income remained almost unchanged.

Ordinary income was negative by approximately ¥100 million from operating income due to expenses associated with the transfer of shares of Fontworks, Inc., etc., but profit attributable to owners of the parent Net profit was ¥6.272 billion and net income increased by ¥4.9 billion year on year.

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Net Sales and Gross Profit by Market



5

Net sales and gross profit by market. In the graph of the slide, the lower number is Telecommunication area. As you can see, the sales from ¥9.8 billion last year was 7.5 billion yen this term, down about 25%. However, gross profit fell only by about 200 million yen from 1.5 billion yen to 1.3 billion yen.

This is an area that is improving margins by reducing low-margin vendor management deals, shifting to higher-margin locations and using offshore overseas.

The Enterprise domain has grown about 10% from ¥14.5 billion to ¥16 billion. Gross profit has also grown by about 10%, from 3.6 billion to 4 billion.

The Public Sector increases nearly 30% growth, from ¥5.3 billion to ¥6.7 billion. Gross profit also roughly tripled, from ¥300 million to ¥900 million. In the past, provisions have been posted for large-scale development projects, but in the current fiscal year, the operation of these projects has progressed steadily and the profit margin has improved.

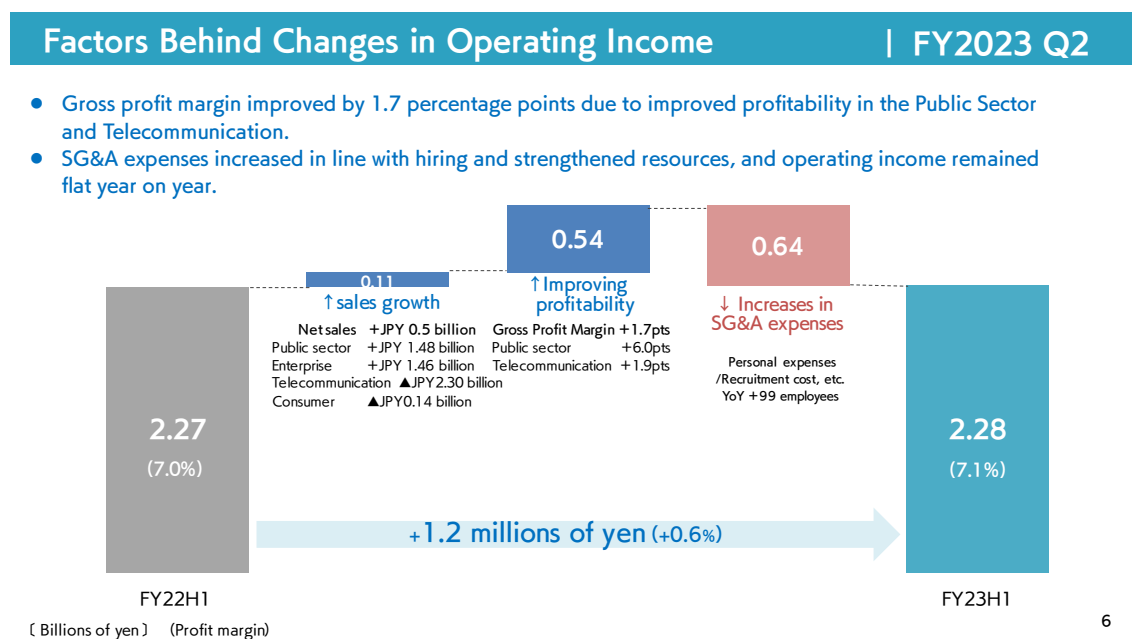
The top orange part of the graph shows sales of Consumer. This includes NortonLifeLock Co., Ltd.'s anti-virus software sales and Fontworks, Inc.' sales profit.

As we announced in July, we transferred Fontworks, Inc.'s stocks and others in September, but during the first half of the fiscal year, we are subject to consolidated accounting.

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Software sales of antiviruses are expected to have a negative impact on operating profit of approximately ¥400 million this year. This impact also appeared in the first half of the year, but due to the contribution of Fontworks, Inc. to its profits, gross profit was ¥1.2 billion, the same level as in the same period of the previous year.

Factors Behind Changes in Operating Income



6

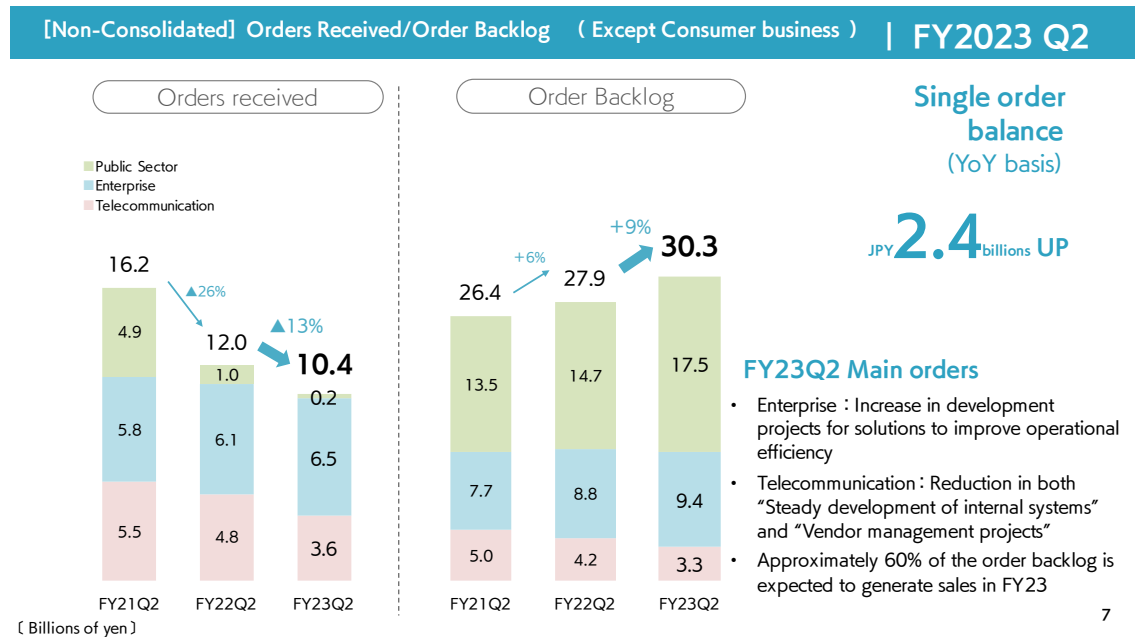
This is the factors behind changes in operating income. Net sales increased by approximately ¥500 million in total. As shown on the slide, Public Sector and Enterprise sales grew by a little less than ¥3 billion, Telecommunication sales were negative ¥2.3 billion, and Consumer was negative ¥140 million. As a result, operating income increased due to the effect of higher sales of ¥110 million.

In terms of improved profitability, the gross profit margin rose 1.7 percentage points in the Telecommunication and Public Sector, which is a positive ¥540 million margin.

Selling, general and administrative (SG&A) expenses increased by ¥640 million from the previous year, partly due to an increase in the number of employees by approximately 100. As a result of the above, operating income was flat at ¥2.28 billion.

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



The slide shows changes in orders received. Orders received in the second quarter were ¥16.2 billion in fiscal 2021, ¥12 billion in fiscal 2022 and ¥10.4 billion in fiscal 2023. In addition, the Telecommunication area at the bottom of the bar graph is ¥5.5 billion for fiscal 2021, ¥4.8 billion for fiscal 2022, and ¥3.6 billion for fiscal 2023.

In the Enterprise segment, growth has been modest, at ¥5.8 billion in fiscal 2021, ¥6.1 billion in fiscal 2022, and ¥6.5 billion in fiscal 2023. Public Sector orders for Information Security Cloud services for 10 prefectures increased in fiscal 2021, but there are usually not many orders in the first half of the fiscal year.

The order backlog increased steadily from fiscal 2021 to ¥26.4 billion, ¥27.9 billion, and ¥30.3 billion. Telecommunication has fallen, Enterprises have increased, and Public Sector orders have remained large because of the two-year operation at the end of the last year. In the second half of this fiscal year, we plan to see sales rise to just under 20 billion of the 30.3 billion yen backlog in fiscal 2023.

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FY23 Full-year Earnings Forecasts

FY23 Full-year Earnings Forecasts

| FY2023 Q2

- Not changed from forecasts of results taking into account the impact of the transfer of stock, etc. of Fontworks, Inc.
- Aiming to improve profitability by expanding in-house services and improving quality and productivity

| [Millions of yen] (Profit margin) | | FY23 earnings forecast ('23/7/19 revision) | FY23H1 | Progress rate | FY22 | YoY |
|--|-------------------|--|------------------|---------------|-----------------|--------|
| Net sales | | 68,000 | 32,206 | 47.4% | 67,227 | 47.9% |
| | Telecommunication | 16,300 | 7,515 | 46.1% | 19,575 | 38.4% |
| | Enterprise | 35,400 | 16,020 | 45.3% | 30,356 | 52.8% |
| | Public Sector | 14,000 | 6,779 | 48.4% | 13,224 | 51.3% |
| | Consumer | 2,300 | 1,890 | 82.2% | 4,070 | 46.4% |
| Operating income | | 5,900 (8.7%) | 2,282 (7.1%) | 38.7% | 5,557 (8.3%) | 41.1% |
| Ordinary income | | 5,750 (8.5%) | 2,182 (6.8%) | 38.0% | 5,499 (8.2%) | 39.7% |
| Profit attributable to owners of parent Net profit | | 8,200 (12.1%) | 6,272 (19.5%) | 76.5% | 3,497 (5.2%) | 179.4% |

* Fontworks Inc. is not subject to consolidation after Q3

This is the full year earnings forecasts. As revised in July 2023, we forecast net sales of ¥68 billion. The forecasts for operating income, ordinary income, and net income remain unchanged at ¥5.9 billion, ¥5.75 billion, and ¥8.2 billion, respectively. We intend to work toward the second half of the year in order to achieve this goal.

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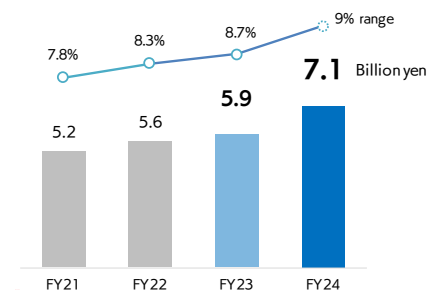
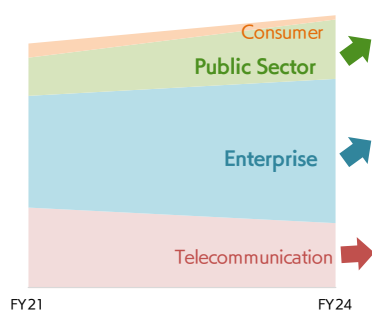
4th Medium-Term Management Plan

4th Medium-Term Management Plan

| FY2023 Q2

FY24 Management Indicators

1. Operating income JPY 7.1 billion*
2. Operating Income 9% range
3. Cloud Security & Services Net sales over JPY 50 billion



Aiming for operating income of 7.1 billion yen/operating income margin in the 9% range through growth in Enterprise and Public Sector

※Adjusted to 8.0→7.1 billion yen due to transfer of subsidiary shares (Jul. 27, 2023)

10

Progress of the Medium-Term Management Plan. At present, half of the Medium-Term Management plan has passed. The 4th Medium-Term Business Plan sets three numerical targets.

We intend to achieve operating income of ¥7.1 billion, an operating income margin of over 9%, and net sales of over ¥50 billion for Cloud Security & Service.

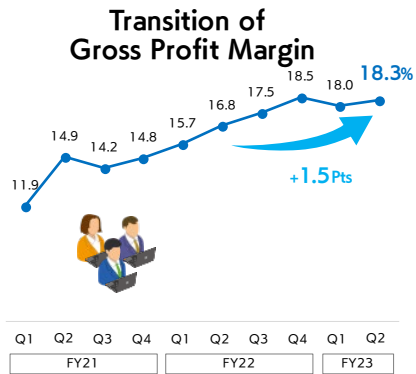
Looking at operating profit in fiscal 2021, I think the target is 5.9 billion yen for this fiscal year and 7.1 billion yen for the next fiscal year, a 20% increase.

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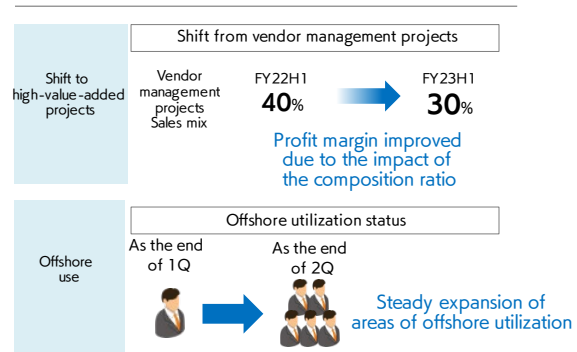
Business for Telecommunication

Business for Telecommunication

| FY2023 Q2



Initiatives to Improve Profitability



Steady improvement in gross profit margin due to expansion of high value -added projects and offshore utilization areas to improve profit margin

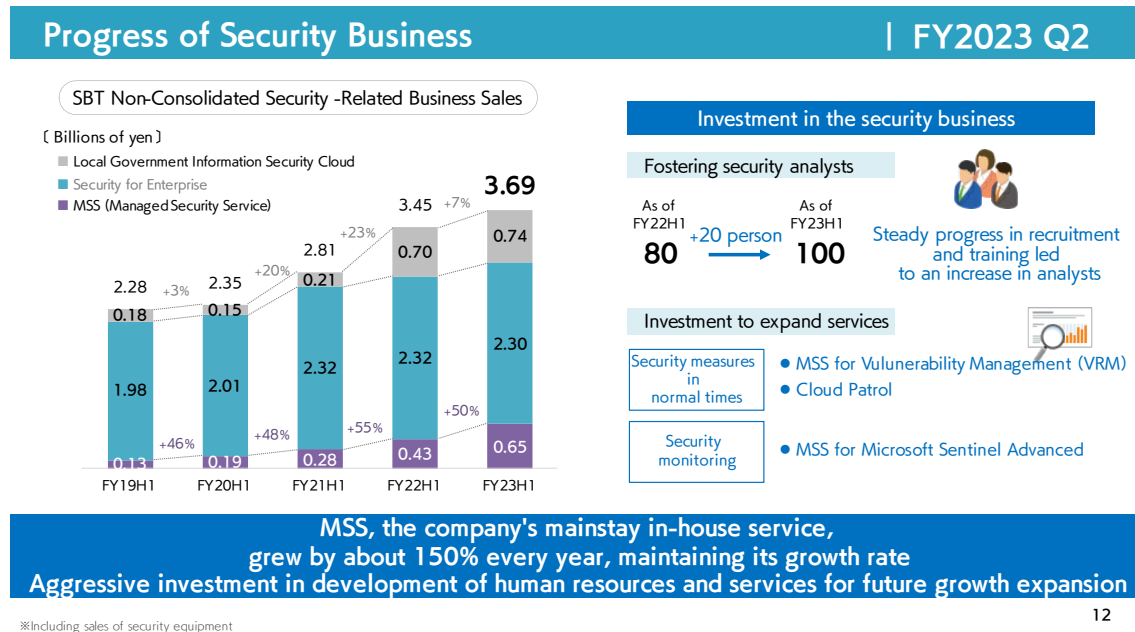
11

Although sales in the Telecommunication business have declined significantly, we have been working to improve the gross profit margin this fiscal year. As shown on the right side of the slide, there were 40% of low-margin projects in the first half of fiscal 2022. In the first half of fiscal 2023, however, we were able to improve our profit margin by reducing the proportion of these projects to 30%.

In addition, the gross margin was 18.3% in the second quarter, down slightly from 18% in the first quarter due to the use of offshore and the challenge to strategic areas. We intend to continue to increase our margins on a quarterly basis.

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Progress of Security Business



12

About Security Business. Net sales for fiscal 2019 were ¥2.28 billion, compared to ¥3.69 billion for fiscal 2023.

The blue in the middle of the graph indicates sales of security for Enterprise. Although we are building this part from network security or systems, growth in this part has stopped for three years.

On the other hand, MSS (Managed Security Service), shown in the purple part at the bottom, has grown by about 50% every year. Our basic strategy is to extend this part.

In addition, the grey part at the top is the Local Government Information Security Cloud. It was renewed in fiscal 2022 and is currently being provided to 12 prefectures, with some portions emerging.

Regarding the development of security businesses and MSS, it is not yet possible to complete them with AI, and in fact, without a security analyst, it is impossible to respond to early detection of incidents, quick response, and causal analyses.

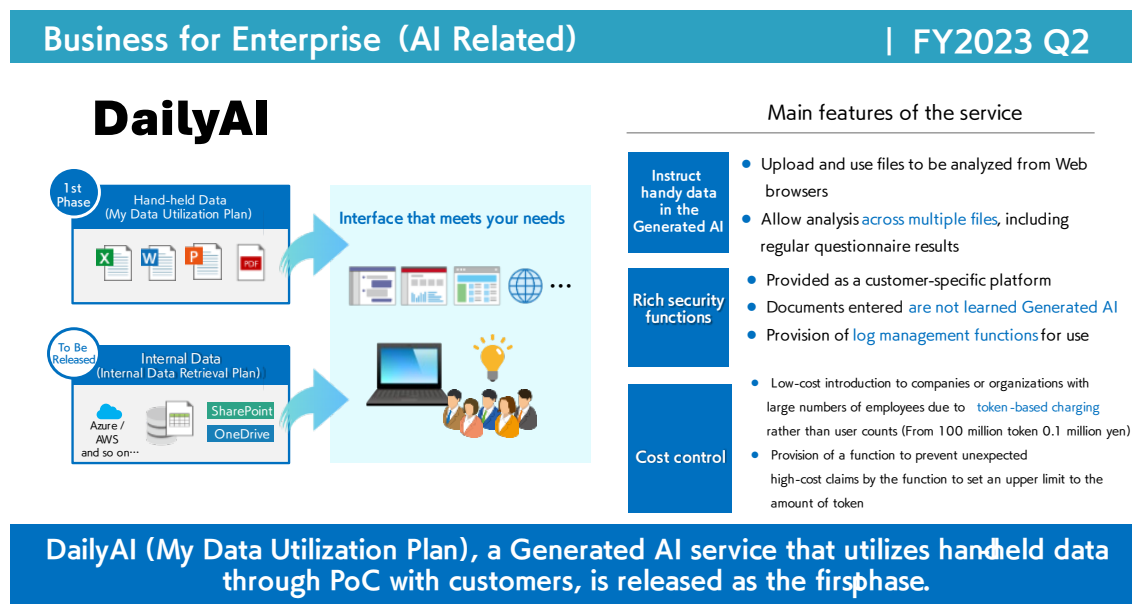
For this reason, 80 security analysts were employed last year, but we are currently focusing our efforts on recruitment and training, with a goal of increasing the number to 100 and 150 by the end of the next fiscal year.

In order to expand security services, we have begun providing MSS for Vulnerability Management

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(VRM), Cloud Patrol, and MSS for Microsoft Sentinel Advanced for security monitoring in normal times. These services are now being used to support customers' security measures.

Business for Enterprise (AI Related)



13

About our AI related servicing. In October, we announced that we will begin offering a generation AI service named “DailyAI.” We plan to expand the use of the first and second phases.

In the first phase, various files such as Word, Excel, PowerPoint, PDF are imported into AI, and the results and directionality of textual summarization and inference are conveyed to users.

There is a Microsoft "Azure OpenAI Service" service, but you can prevent AI from learning the data, that is, from having or seeing the data. “DailyAI” is developed using this “Azure OpenAI Service” and can be used securely.

In addition, Microsoft has announced a “Microsoft Copilot” with the meaning of "first officer" and I think AI will help you in most cases when making materials using Office devices such as Word • Excel • PowerPoint. This is a global development, offered at US\$30 per person per month, or approximately ¥4,500 when converted into Japanese yen.

Since this spring, we have been conducting PoC with more than one company's customers regarding the use of AI generated, but we feel that there are not so many companies that are introduced company-wide at once. Rather, it is often used by research institutions, sales planning departments, or groups

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that conduct financial affairs. Also, some of them use it and some don't.

We chose a volume-to-volume system in exchange with Microsoft to talk about "how many people will charge in such an environment-many thousands and tens of thousands of employees in the future, and how many will truly buy licenses for those people."

I think it is difficult to understand the unit of token, but this "DailyAI" is a decomposition of text into the unit of token, which we have created with a monthly set of 100 million token and a monthly amount of ¥0.1 million. When a small start in one department is extended to the entire company, only the amount used is charged. We would like to begin with this service.

In addition, as a second step to promote this system, we consider that large chunks of data in Microsoft Azure and AWS can be handled, and we have developed a file-based system, followed by a server, and so on.

We would like to demonstrate our presence in situations such as using "Microsoft Copilot" or using our products in terms of providing "Microsoft Azure" in a form that does not allow them to learn.

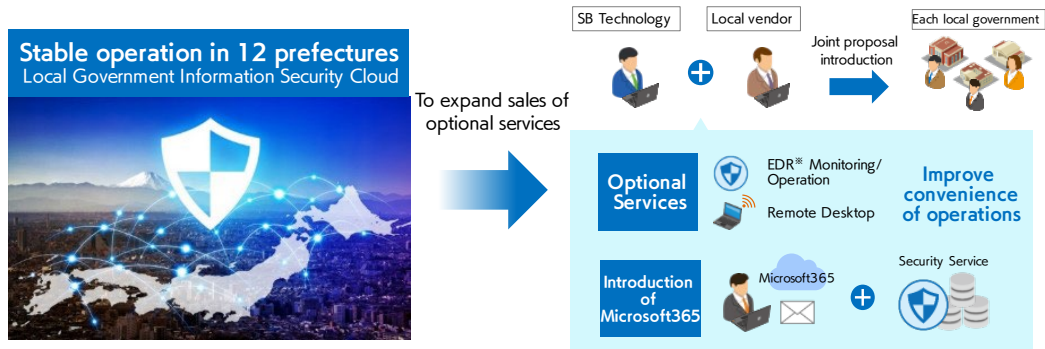
However, we believe that there are very few AI businesses in the current fiscal year that can be seen as sales. In the next fiscal year, the core users will use the product, and the effects will be exploited. We believe that we will continue to talk more and more since around 2025.

Therefore, we intend to provide AI servicing in response to this trend.

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Business for Public Sector

Business for Public Sector | FY2023 Q2



Joint efforts to propose and introduce optional services using relationships with local vendors established at the time of the introduction of the Information Security Cloud

※Security of endpoints such as computer terminal (Abbreviation of Endpoint Detection and Response)

14

Regarding business for Public Sector, we have been worrying about and annoying the Local Government Information Security Cloud for two years. However, we have been operating stably since August last year.

Next, the need for this additional product is growing ever higher. Remote work cannot be performed easily in places such as prefectural offices, municipal offices, or town halls. If possible, this is a limited situation. In this situation, the need for remote desktops to jump over the layers of the three networks in the office is now very high.

To achieve this, security is required for the endpoint's terminal, so it is currently provided as an optional service.

There are also prefectural governments that have already started, but we also hear a lot of requests for "Microsoft 365" combined with AI to be introduced.

I think it would be difficult for all 417 organizations to introduce the new e-Gov system, but I think that we will expand the networking, increase the flexibility of handsets, and realize remote desktops in terms of working styles. To this end, we plan to provide products that meet DX of local governments as appropriate.

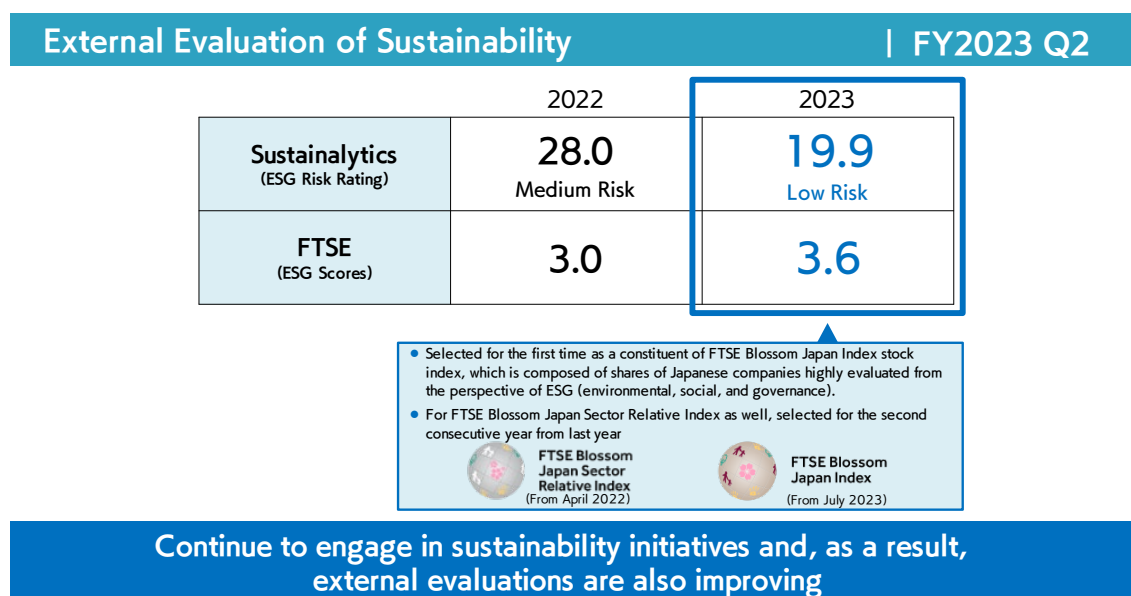
If these budgets are finalized this autumn or in the next year's conference, we think it will be necessary

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to introduce them. In addition, in order to approach such places, we plan to make proposals together with vendors in each region in the future.

Currently, MSS is managed by our security monitoring center. However, we are asking for customer support on the face-to-face for the suspension in front of it. At the same time, we will provide information on technologies and remote control. We hope to promote DX of local governments while making the businesses larger in this way.

External Evaluation of Sustainability



15

As a member of the Prime Market, we are also engaged in activities related to sustainability. Last year was an indicator of Sustainalytics, which was 28.0 points on Medium Risk, but this year Low Risk was 19.9 points, and FTSE scoring rose from 3.0 to 3.6.

Consequently, we were the first to select the component brand of "FTSE Blossom Japan Index" together with the previously selected "FTSE Blossom Japan Sector Relative Index". We will continue to strengthen our efforts for sustainability and ESG through our business and corporate activities with the aim of enhancing corporate value.

This is the first year's results announcement.

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4th Medium-Term Management Plan / FY24 Management Indicators

4th Medium-Term Management Plan / FY24 Management Indicators

1. Operating income JPY 7.1 billion※

2. Operating Income 9% range

**3. Cloud Security & Services
Net sales over JPY 50 billion**

※Adjusted to 8.0→7.1 billion yen due to transfer of subsidiary shares (Jul. 27, 2023)

Again, the goals of the Fourth Medium-Term Management Plan are to achieve operating income of ¥7.1 billion, an operating income margin in the range of 9% and net sales of Cloud, Security & Services of over ¥50 billion in fiscal 2024. We will work steadily with this figure as our target. Thank you for your attention.

Disclaimer:

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.