Neural Group Inc.

FY2023 Q3 Financial Results Briefing Meeting

November 13, 2023

Event Summary

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[Participants]	
[Number of Speakers]	2 Roi Shigematsu — Chief Executive Officer Ryosuke Tane — Director, Chief Financial Officer

Presentation

Moderator: The time has come, so I will begin. Ladies and gentlemen, thank you very much for taking time out of your busy schedule today to participate in the FY2023 Q3 Financial Results Briefing Meeting of Neural Group Inc.

My name is Toyoda, and I will be your moderator today. Thank you very much for your cooperation.

Today's presentation will be based on the financial results presentation material that was disclosed on our IR site on November 10.

We will be sharing our presentation via Zoom, but if you are joining us via telephone, please view the presentation materials on our IR website.

Please note that no video recording or audio recording of this presentation is permitted.

I will now explain the flow of today's presentation. Chief Executive Officer Shigematsu will give a 30-minute presentation on our business overview and performance. This will be followed by a question-and-answer session that will last until 1:00 p.m. at the most.

Questions will be answered by CEO Shigematsu and CFO Tane.

Please note that we will be using the Zoom video conferencing system. We will use this system to designate a questioner for the question-and-answer session, so please indicate your affiliation and name in the account name.

Please note that your account name and profile picture may be shared with other attendees only if you speak during the Q&A session. If you need to change your settings, please do so in advance.

Thank you for your patience. Chief Executive Officer Shigematsu will now provide an overview of our business performance.

President, if you would please.

Shigematsu: Yes. Thank you all for taking time out of your busy schedule today to attend to our financial results.

Our company was founded in 2018; this year is 2023, which marks the sixth fiscal year since our founding.

Since our founding, we have been investing in the development of edge AI technology, which is unique in the world, and we have been witnessing the progress of such technology since the dawn of the technology and the progress of edge AI technology worldwide. I believe that the past six years have been a time of progress in research, commercialization, and sales expansion activities.

Under these circumstances, we have been promoting our business by breaking down the elements necessary to promote our business into their constituent elements.

Regarding the construction of the technology itself, the first step is, of course, to develop the AI technology, the video AI itself, and then to build an ultra-compact, high-definition AI model that can be installed in edge AI-equipped devices.

Then, we applied this model to the actual society as a social experiment, in a sense, by incorporating the model into this camera and applying it in the city.

In the process, we also worked on the development of laws and regulations for the actual operation of AI cameras in society, obtaining the understanding of residents and other members of society, and complying with the Camera Image Utilization Guidebook issued by the Ministry of Internal Affairs and Communications of the Ministry of Economy, Trade, and Industry.

Subsequently, we have achieved stable operation at the actual commercial level for social use, and AI cameras are now being used in every corner of the country. This has necessitated establishing an operation system, construction system, distributors, and partner companies throughout the country to expand sales.

Once this was in place, we would build a sales structure to expand sales, and within the company, we would build a deep understanding of the technology and the needs of customers, deepen our understanding, and expand sales. Based on this understanding, the company will then turn this edge AI into a profitable business in society. This is the cutting-edge reason why few companies worldwide are doing this. Simply put, we will become a company that generates profits from edge AI.

This is one of the challenges edge AI companies face worldwide, and that is what we have been doing.

In this context, we are now in our sixth fiscal year, and I believe that we have reached the point where we can see the establishment of a business model.

That is to say, all of these elements I just mentioned are now in place within the company, and we believe that we have raised them to the level where they can generate profits.

Today, I would like to give you a detailed business overview.

As I will explain later in this presentation, we have been engaged in investment activities while forming these businesses.

We naturally made the investments we had anticipated in our business plan. Still, we have had some unforeseen expenses and sales delays, making it difficult to forecast our business. However, I believe there were many areas where we were unable to meet these expectations because we had to change our plans many times. I would like to apologize for this.

In summary, I would like to say that I believe that the company has progressed to the point where it is within reach of returning to profitability for the next full fiscal year and beyond.

I would like to discuss these prospects in the financial results.

First, I would like to give an overview of our company and its strengths, which I would like to summarize in terms of the form of the edge AI business we have created over the past six years.

First, I would like to introduce our management team, which includes members with high potential in various areas, including technology business, which starts with the development of technology for edge AI and leads to the establishment of a business model, which is then monetized and commercialized, and financing business and established a system to nurture them as a team.

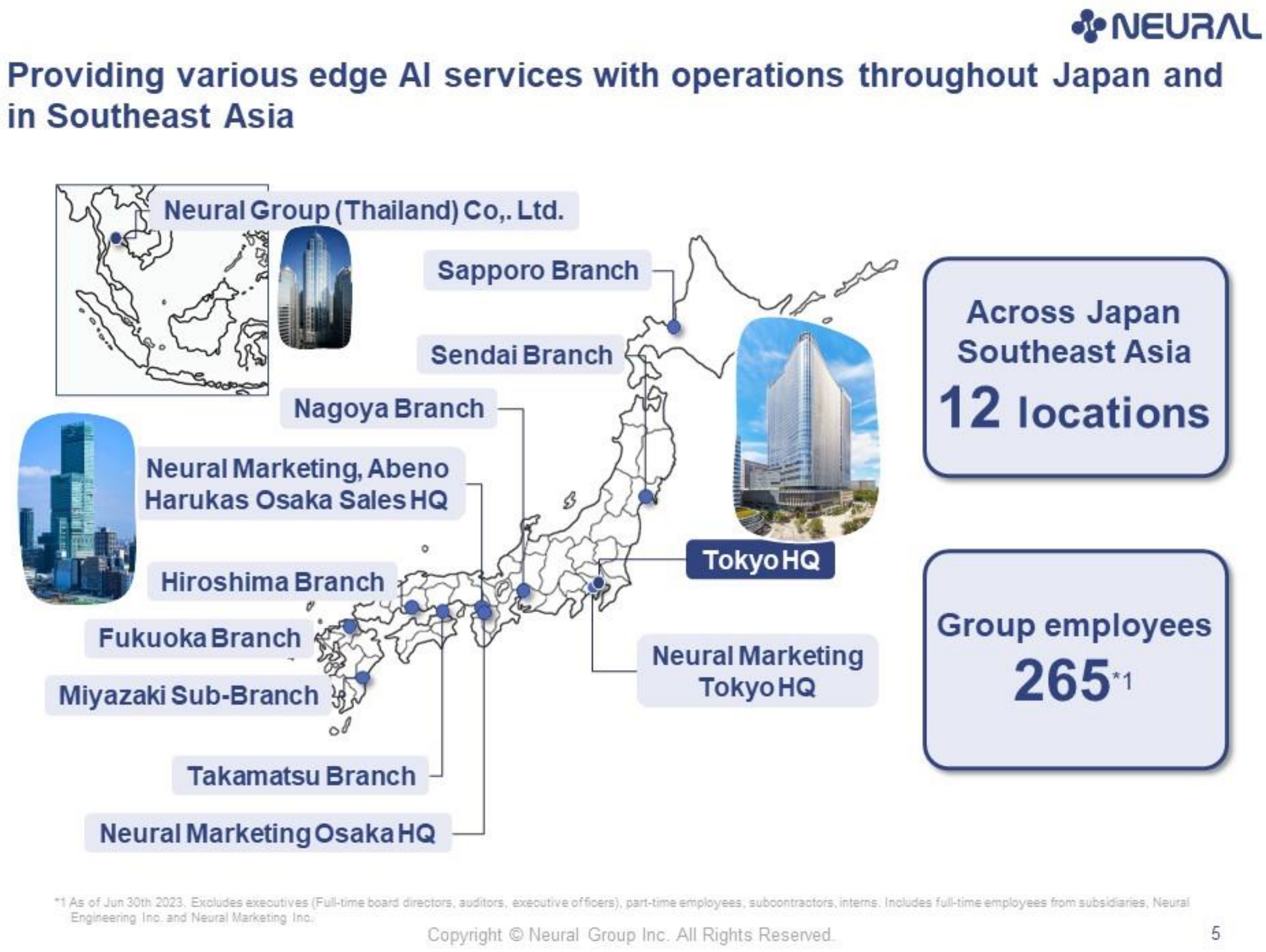
As a highlight of our business, we were listed on the Tokyo Stock Exchange in the third fiscal year of 2020, and in May 2023, we achieved a sales growth rate of 214% in two years, which is the highest growth rate among technology companies in Japan.

This is the second-highest growth rate of all listed technology-related companies, and we have been working to expand our business using this edge AI technology.

In this context, we have been issuing patents for the technologies that give us the necessary competitive edge.

In recent years, most recently in October, Digipark, a parking solution using edge AI that we have developed, received the Good Design Award.

As we develop our business, we are conscious of the need to gain recognition in society, to have our products used by people, and to have people become familiar with our products.

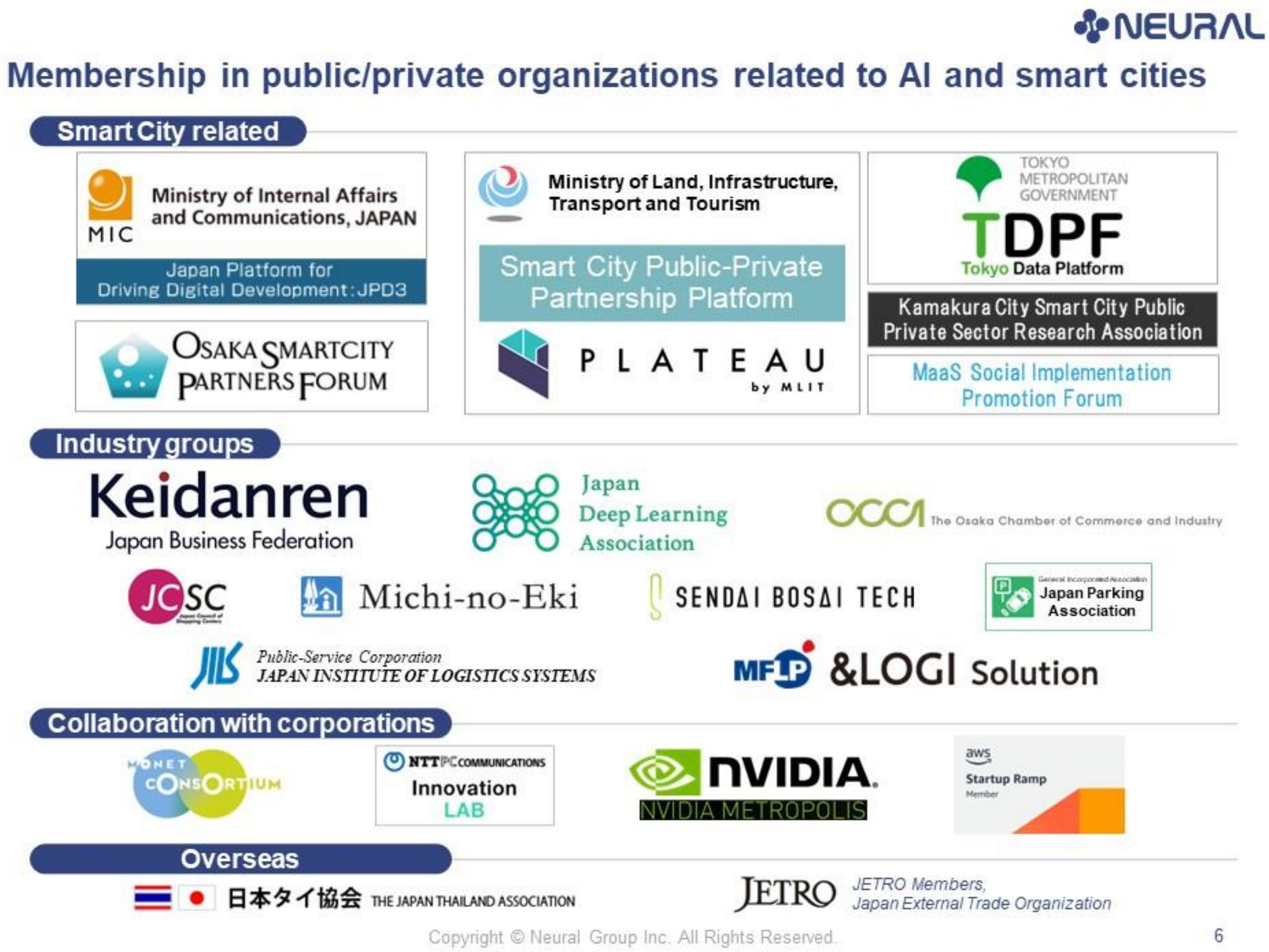


As an overview of this business structure, we were established in Tokyo at the time of establishment and have now expanded our support to 12 locations both in Japan and overseas.

We have been asked why we have a base and whether it is necessary for an IT company to have a base, but the answer is that it is necessary.

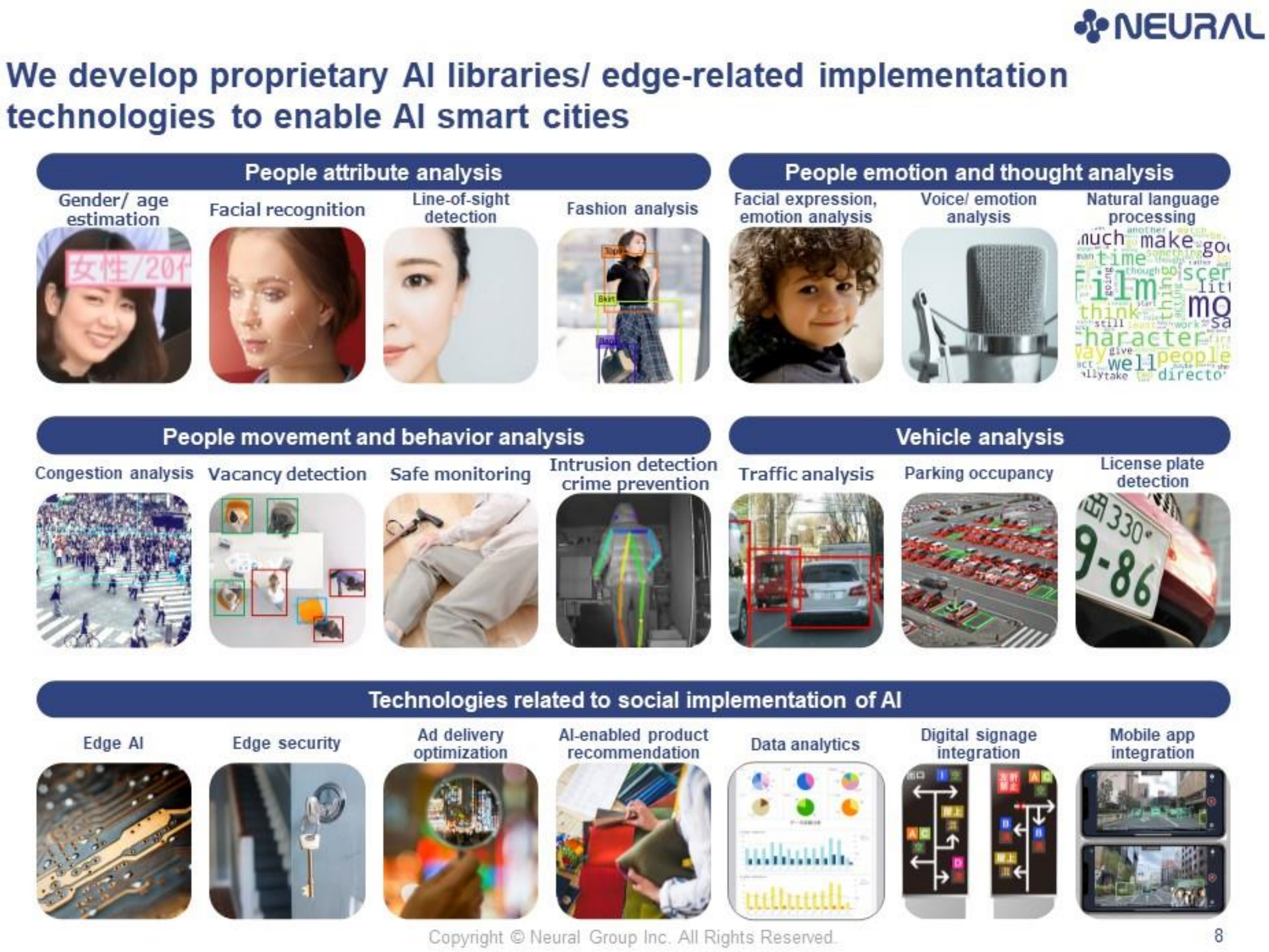
The reason is that our edge AI is used at customers' facilities all over the country, which means that we have a system that can immediately come to the customer's location when a problem occurs. We also participate in many smart city activities in each local community, and it is essential to use AI closely related to local issues in each community.

In each region, for example, there are various social issues such as disaster prevention in the center, countermeasures against earthquakes in Kyushu, and economic revitalization in the Tokyo metropolitan area. We have been working on creating AI services and customizing these technologies in-house to meet such various needs.



In these circumstances, over the past six years, we have participated in various activities related to smart cities, urban development, and the building of society.

Naturally, we have actively participated in the activities of the national Ministry of Land, Infrastructure, Transport and Tourism and the Ministry of Internal Affairs and Communications, as well as those of local governments at various levels, such as the Osaka and Tokyo metropolitan governments.

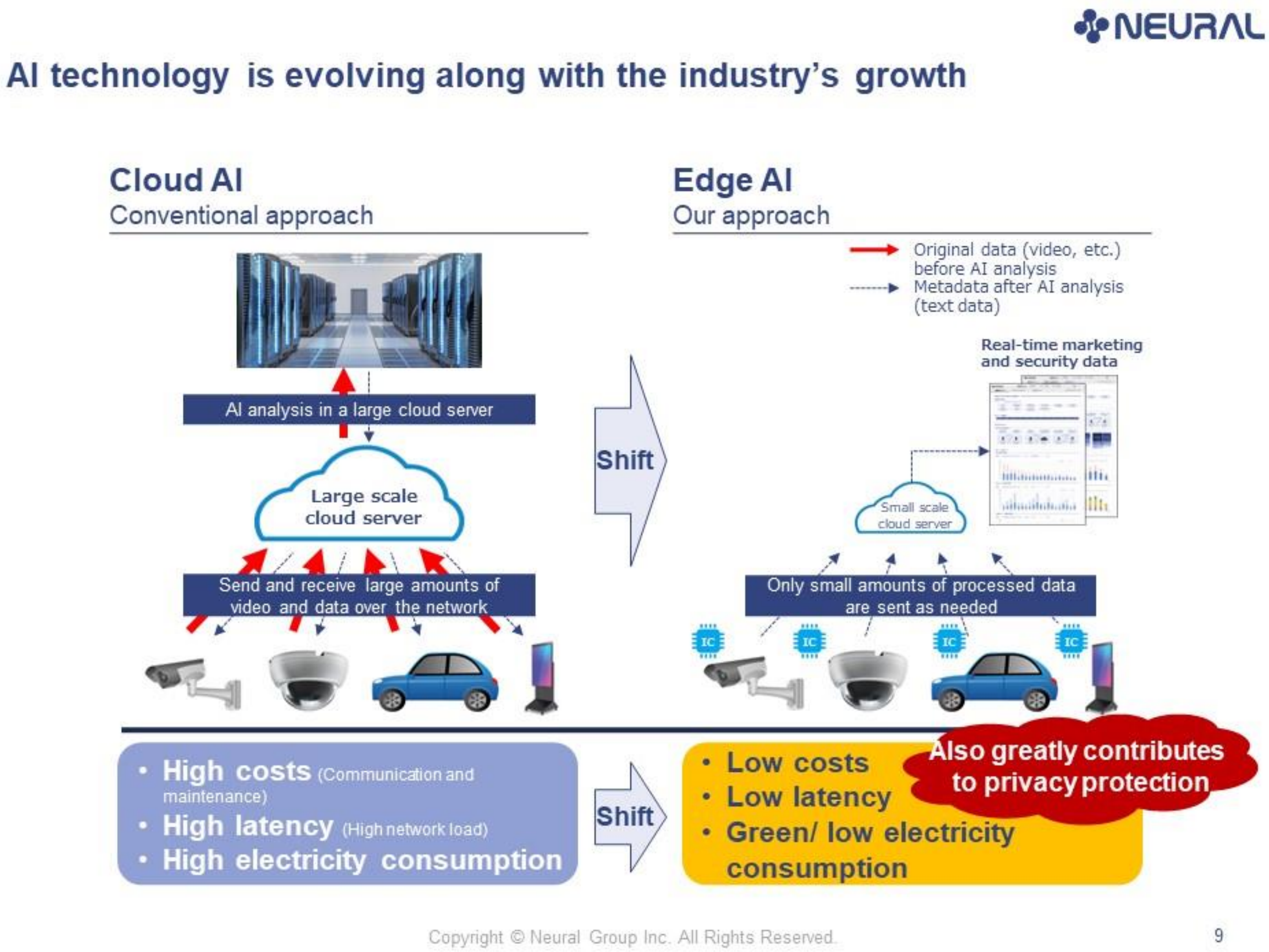


Next is AI technology. Of course, as a company that handles imaging AI, we are actively developing this area, but I must reiterate that AI requires a great variety of technologies to operate.

In fact, the most basic of these are technologies for judging the attributes of AI systems and for judging things, such as facial recognition, facial expressions, eye contact, voice, language, congestion, vacancies, cars, and many other things.

Also, as mentioned earlier, it is necessary to combine these various perspectives to respond to these various social technologies.

At the same time, the so-called technologies for social implementation, which are under this section, require such edge AI to be operated 24 hours a day, 365 days a year, and to be operated securely so that there should be no information leakage, hacking, or other such incidents. We have been working nationwide to ensure the stable operation of such a system.



This is the basic essence of all our edge AI services. Our business is motivated by the evolution of society from cloud AI to edge AI. Cloud AI not only uses these large-scale servers to create AI models and learn from them but the actual AI analysis itself is done here using the AI's inference, which is the reason for our business.

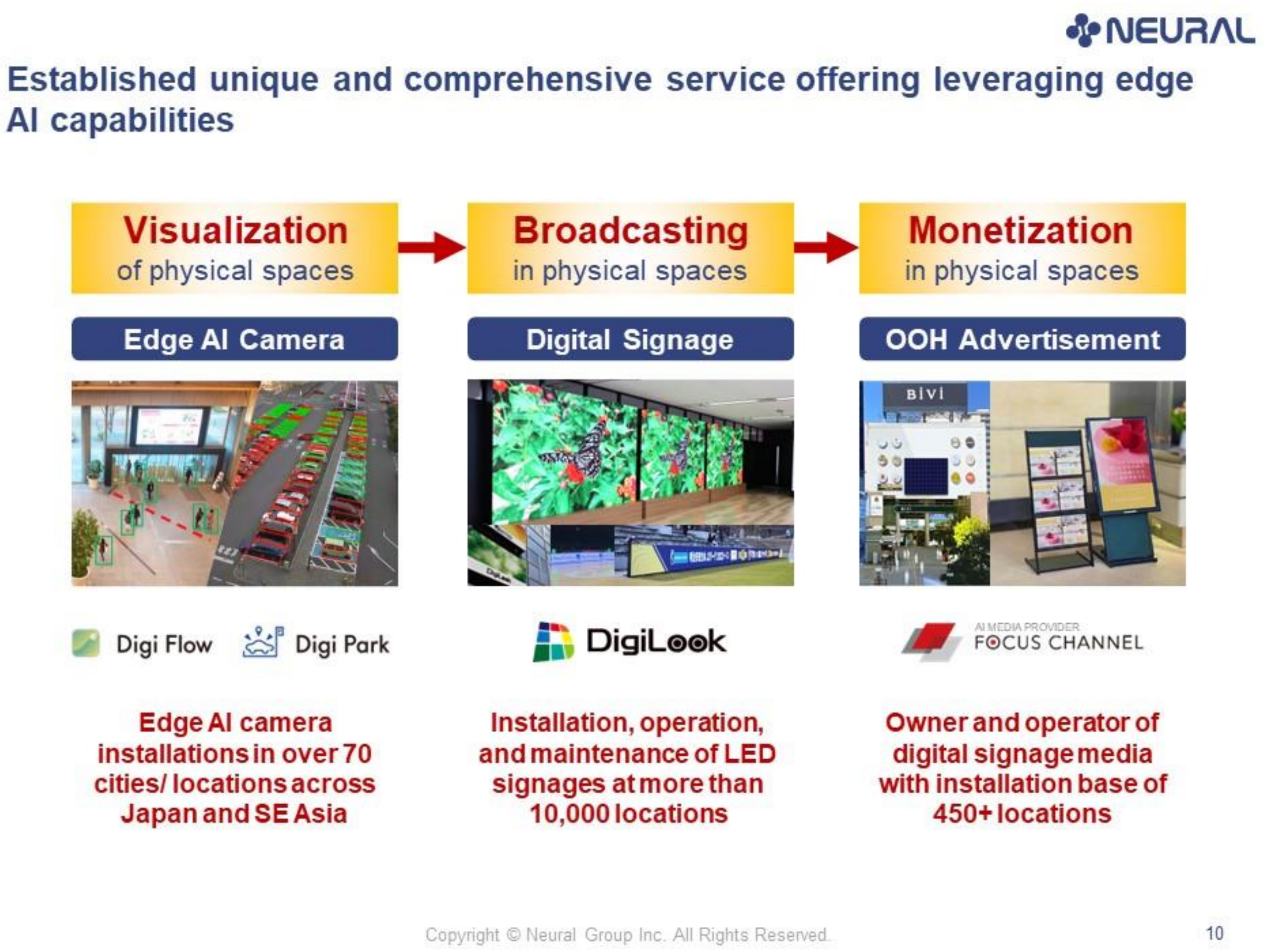
This type of cloud AI used to be the mainstream in the imaging domain in the past.

The current mainstream language models, such as ChatGPT, use cloud AI for analysis and inference. Still, the video domain is considered to have undergone a slight social evolution, and analysis in the imaging domain can no longer be done in the cloud. Due to its large data size, the amount of data transmitted it too big for practical use.

In order for each customer or facility owner to be able to use AI cameras without stress, they would have to use the edge, where the computer is built into the device, rather than this model.

To have an AI model running on such a small computer and performing inference, the AI model itself must be very light.

Then, the quality of this AI must be good in order to perform inference on light software. It was extremely difficult to run this AI system with the same or higher accuracy on a small model with a small source code and memory usage.



Against this backdrop, we have summarized the business model we have created over the past six years on a single sheet, and I believe it has resulted in this form.

We believe this case study can serve as a model for all companies in the world that should use edge AI in their business.

There used to be a lot of companies that used to simply put a camera on the edge and analyze it, but most of them have stopped doing that business. The reason why is because it is not profitable.

Also, customers don't use it in the first place. In the past 10 years, the social evaluation in this field has been that there is almost no social meaning in placing an edge AI camera, performing a simple analysis, and storing the analysis data.

What we have done is to visualize the space with this HI camera.

This is, of course, the first step in making such visualizations in the city, in parking lots, etc.

Next, the visualized information is directly connected to digital signage or smartphone apps, as shown in the middle of the slide, to disseminate information.

Without this, we will not be able to change people's behavior in the city.

Edge AI was originally intended to be used to change people's behavior and provide services that would transform people's behavior in a better direction, a direction that aims to add value.

While we have been building these digital signage capabilities through M&A and other means, this alone is insufficient.

The third point is how to further evolve this capability. It was important not only to transmit such information but also to push it up on a platform that generates revenue from it.

In other words, we need to organically link the information analyzed by the edge AI cameras and the transmitted information in the space and monetize the information in the form of so-called outdoor advertising in order to utilize the edge AI cameras in the outdoor space. This is our understanding.

When we consider the scene of Google's business model, for example, being able to search for information using a search engine was, of course, the visualization of information.

The many websites in the world would all be included in that database. But this alone is not interesting.

Then, that's where the information dissemination comes from. In addition to the fact that a better algorithm would assume it and show what was of more interest to people, the third thing was that advertising was connected to it.

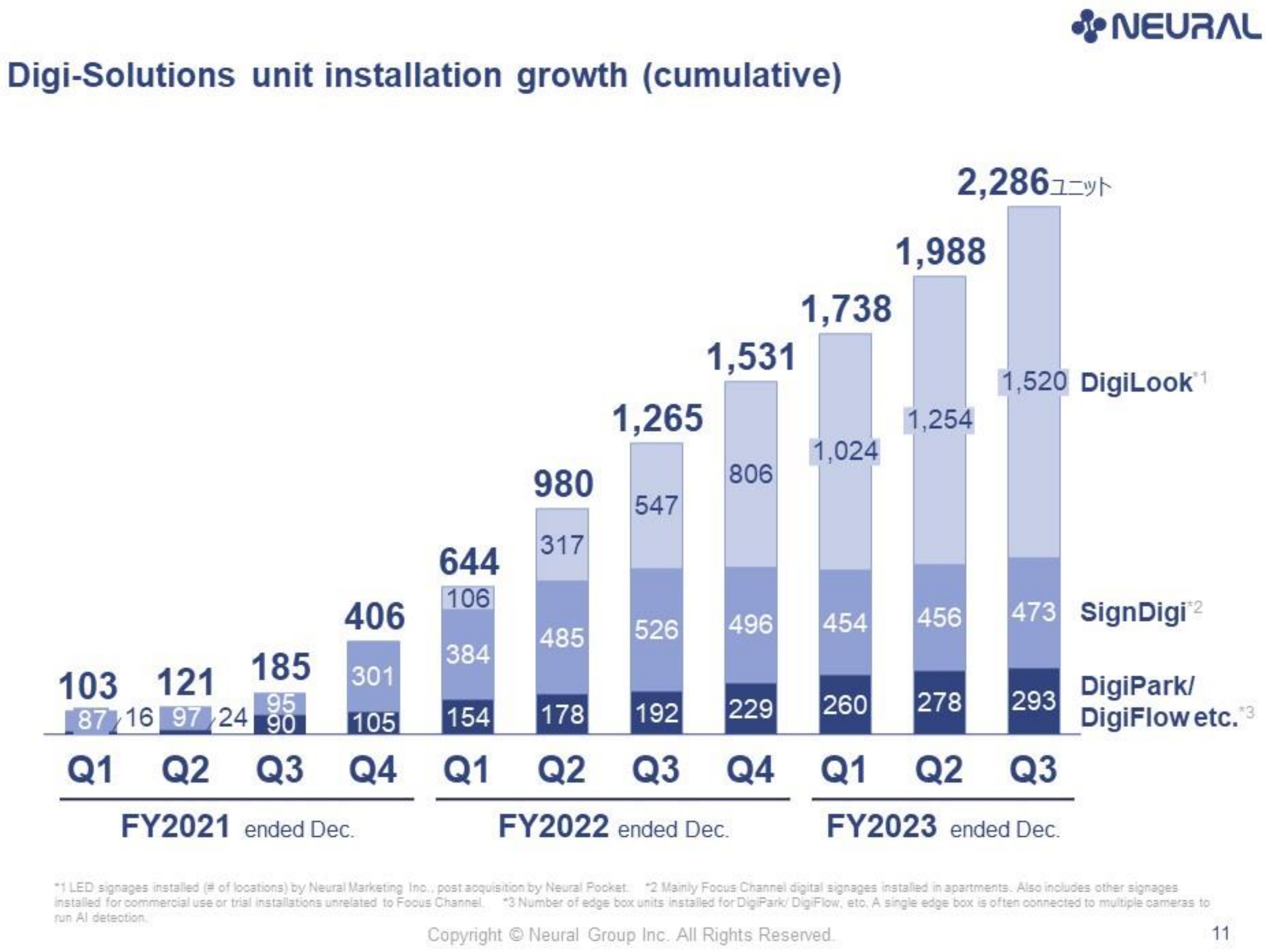
In other words, Google will push information that people want to know based on related words. The user then recognizes this information as new information, and the user becomes aware of a new experience.

I believe that the evolution of online business, the utilization of information offline or outdoors, and monetization are actually very closely related.

So far, AI in the imaging domain has not progressed very well, nor has it progressed very well on a global scale.

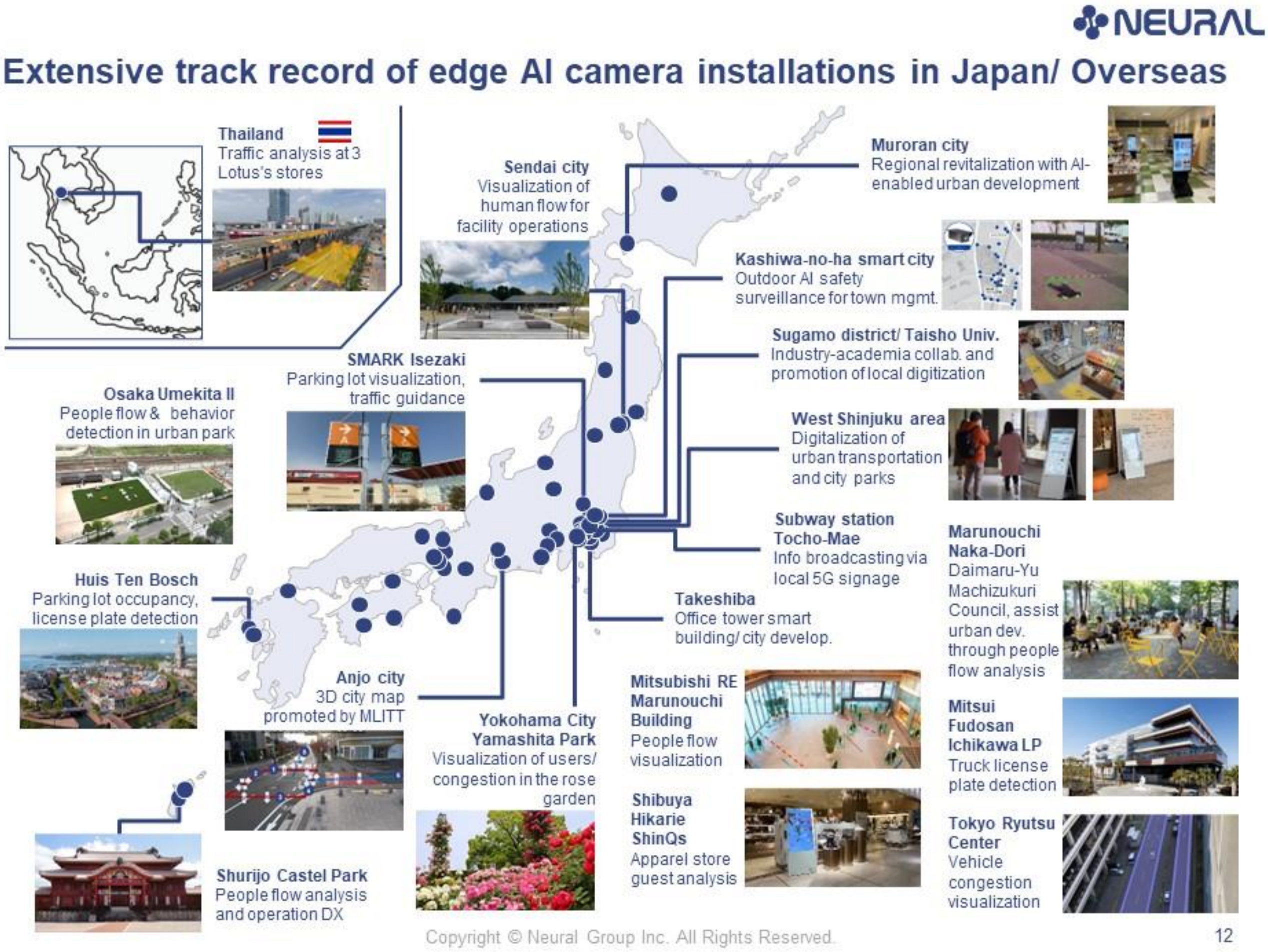
In some Asian countries, where crime prevention is extremely important, AI cameras have been used for crime prevention purposes, such as taking 360-degree photos of the entire population and catching crimes as soon as they occur. However, this was not a service that would be useful to citizens or that citizens would want to use.

Our company's business is not like that. Still, we are trying to realize a world where people naturally use their smartphones to search for information and enjoy themselves outdoors, which we believe is a new way of thinking about the city or smart city.



We have been building a series of such services over the past six years.

These services are now being used in various regions across the country.



Here are the areas where the Edge AI cameras are installed in the first visualization section, which were only a few places when the company listed its shares on the stock exchange.

As mentioned earlier, there are various ways to use AI cameras. In the case of Muroran City, which has been using it for a long time, it was, of course, used in the context of regional revitalization and stimulate consumption in a city with a declining population. In the case of Shurijo Castle in Okinawa, which is currently under reconstruction after an unfortunate disaster, we are trying to analyze the situation with an AI camera so that tourists who visit the castle can see the reconstruction status at the same time and think about what kind of reconstruction exhibition would attract more visitors to the castle, in order to achieve the purpose of the reconstruction.

At the same time, as you can see in the lower right-hand corner, logistics bases are a completely different issue, and in recent years, especially with the recent generalization in society of buying things via e-commerce, as was the case with COVID-19 in the beginning, there has been a social change in which goods are not sent from stores, but directly from logistics warehouses.

In such a situation, the number of drivers in logistics is not unlimited, and with the 2024 issue, the protection of drivers will be further strengthened. The load on drivers will increase when trucks are stuck in front of and behind logistics warehouses or when the time to enter a facility is difficult to read. In such cases, AI camera analysis will help guide drivers smoothly through the process, thereby addressing social issues related to the 2024 issue.

There are many other examples, but we have been providing services to address these various social issues with one technology, the edge AI camera.

On the other hand, regarding information dissemination, we have acquired technology, sales, and marketing capabilities from Net Ten, a company we acquired through M&A the year before last. To date, the company has a track record of outdoor LED signage at more than 10,000 locations, and we have been working within our group to use this sales force to disseminate information and incorporate edge AI technology into our technological capabilities and link it with HI cameras. I believe that this information dissemination has been concentrated within the Group.

Advertising operation business on large LED display launched Oct. 2023

We launched an ad management business as a dedicated agency (media rep), utilizing our know ledge and sales network in ad sales, ad broadcasting, and operation through our Focus Channel operations

Neural responsible of media reps (Examples of partner agencies)

dentsu · HAKUHODO 東北博報堂 · ADK · jeki · 河北新報社 · tbc 東北放送 · ICHCO 株式会社第一広告社

Examples of Advertising Sponsors

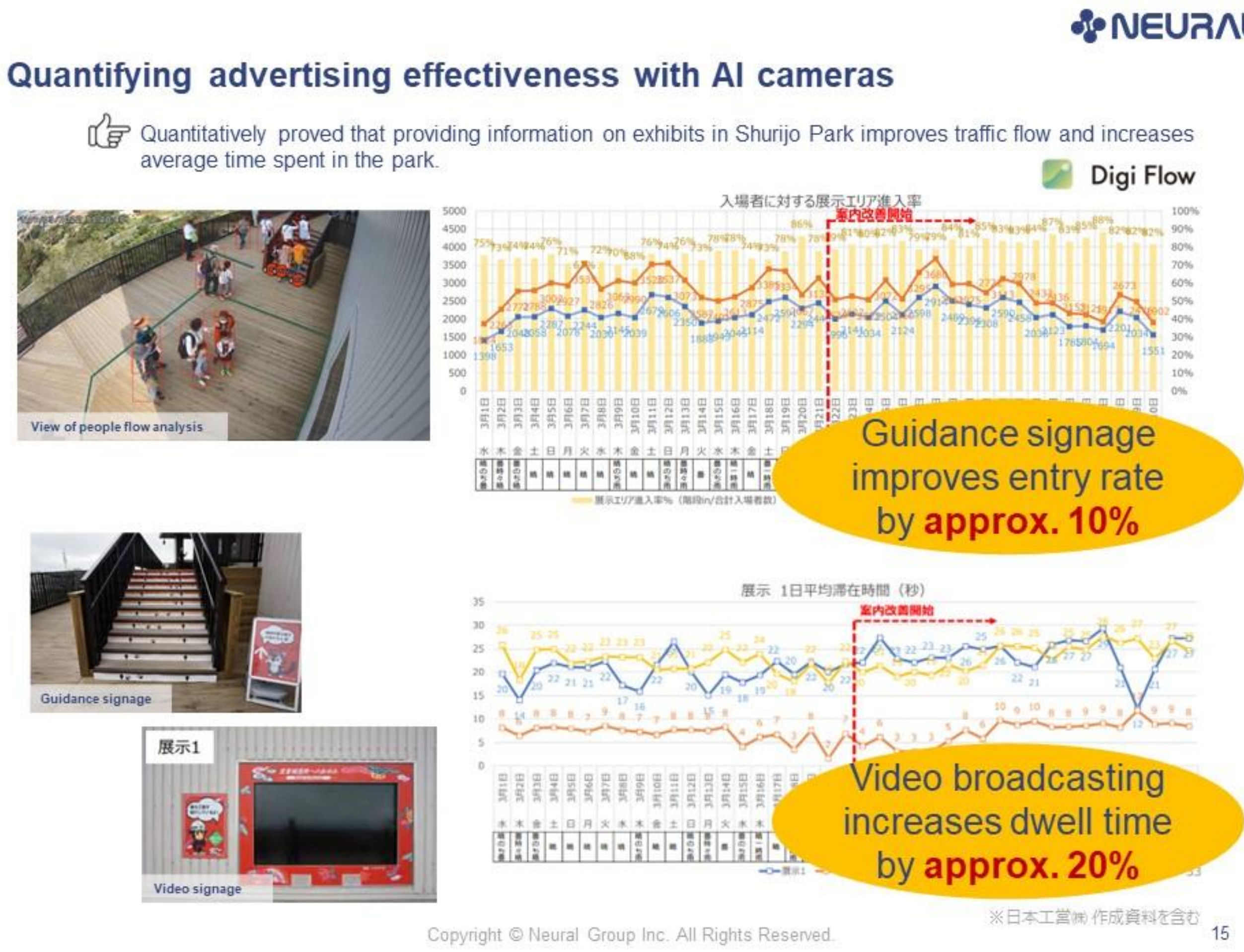
DIO CLINIC · Human Wave ヒューマンウェイブ · MARUHAN

Llarge LED vision system at BiVi Sendai Station East Exit, an urban commercial facility adjacent to JR Sendai Station

As a full-time advertising sales agency, we are currently airing advertisements in partnership with 20+ Sendai-local advertising companies

 14

This is an example of how we provided such a large LED vision in front of a station in the Sendai area, and we not only provided the vision but also introduced an advertising agency to help distribute advertisements by incorporating the AI advertising devices and technologies we have developed. We have also been working as media reps to create and disseminate such business models themselves at this center.



Here is another example of using AI cameras to evaluate such information transmission.

This is an example of Shurijo Castle in Okinawa Prefecture. As I mentioned earlier, we are trying to guide tourists to enter the reconstruction exhibition at the place of reconstruction support, but how should we actually place the guidance signs, and how well should we make the guidance videos?

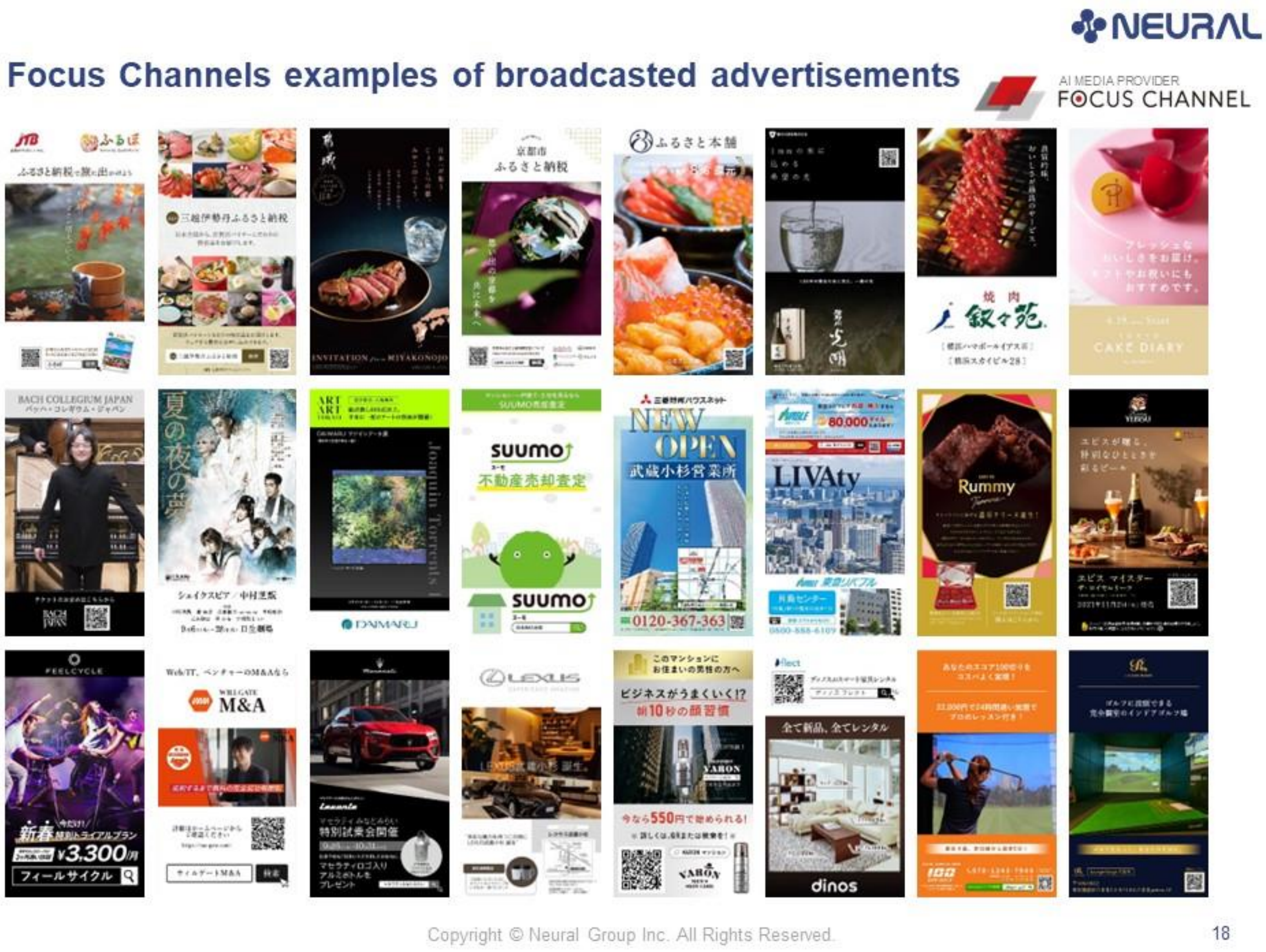
While we continue to strengthen our efforts to increase the flow of visitors by approximately 10% to 20%, in other words, the change in behavior of people who see the information that is disseminated through this visualized information is actually quite dynamic.

It is not just 1% or 2% of the population that will change their behavior, but 10% to 20% of the people who see the information, and I believe this kind of action has great social value.

It is essential to evaluate whether such behavior change is brought about by sending out information and using cameras.

The third element is monetization, or generating revenue. This is regarding FOCUS CHANNEL, which we acquired the previous year, before acquiring FOCUS CHANNEL; in fact, we had been providing this type of advertising signage. FOCUS CHANNEL has a track record of being installed in about 250 condominiums nationwide, and after joining our group, we have doubled that number. We have also been replacing these devices with new devices with AI embedded in them.

As a result, we are currently operating 450 condominiums in the Tokyo metropolitan area and real estate properties built and operated by various top developers, where we have placed advertising devices that can transmit information with AI functions to approximately 200,000 residents.



This is a picture of the advertisement device used to post advertisements in the condominium. Various companies and local governments also favor this.

In fact, as you can see in the upper left-hand corner, I believe that hometown tax payment is a wonderful activity that promotes exchange between local governments and citizens in the Tokyo metropolitan area.

However, it was a big challenge for local governments to find a way to promote their wonderful local products to residents living in big cities, for example. It is difficult to find a way to appeal to them, and in the first place, there is no channel to do so.

Although spending huge amounts of money on advertising would not be a resource for regional revitalization, the FOCUS CHANNEL is a channel that can be used to promote the so-called large-scale condominiums in these areas, including 450 condominiums where many affluent people live. The appeal of FOCUS CHANNEL is that it is a direct channel between rural areas and large cities, and we have been monetizing our business with this significance in mind.

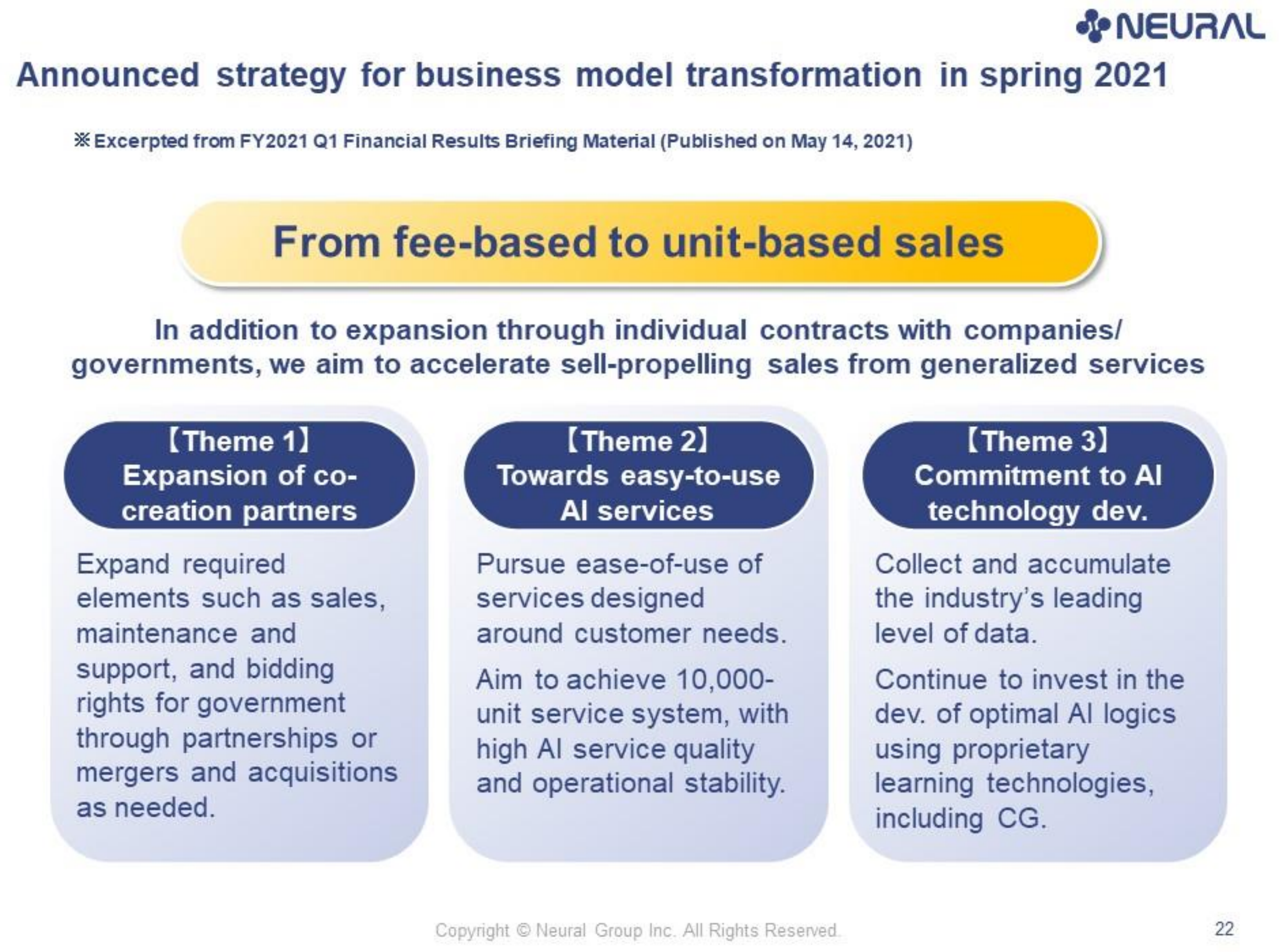
At the same time, it is not only about connecting rural areas and the city center but also about making the lives of people living in the city center more enjoyable.

As you can see on the left side of this page, the needs of people who want to know about music, exercise, theater, cars, real estate, new houses, new cities, what to do on weekends, entertainment, exercise, golf, and so on, as a place to search for new lifestyles, we are using FOCUS CHANNEL to analyze which content was viewed most frequently by residents using AI cameras and provide feedback to advertisers.

By doing so, we are able to directly understand what kind of appealing approach will actually lead to a change in behavior among residents and how they will receive it. This business has evolved as well.

In recent years, we have also been strengthening our activities in Thailand. Although our main focus is on Japan, we hope to expand our activities to overseas communities in the future.

Now, I have just introduced the services and business sophistication that we have developed over the past six years. Still, I would like to explain some of the innovations we have made in our business model and our financial perspective.

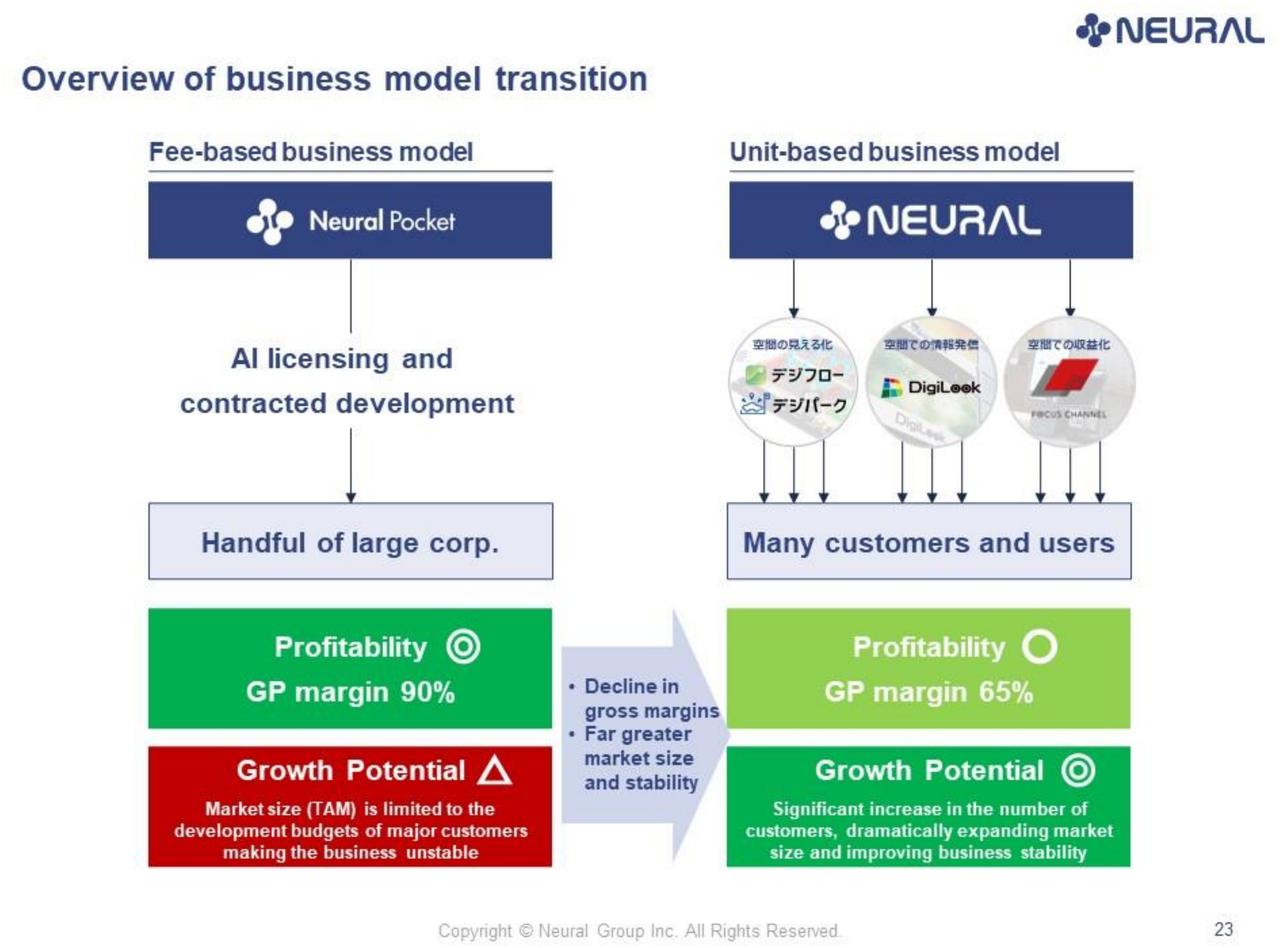


In 2021, which is our fourth fiscal year, if we include the year of our founding, we announced a change in our business model immediately after our listing on the stock exchange in that year. This was in the first quarter of 2021.

At that time, we announced that we would change our business model from a fee-based to a unit-based business model.

By fee-based, we mean that consulting firms, for example, receive commissions from large companies, which we call fees. We provide such human services and receive a fee for the man-hours involved. Such is referred to as a fee.

The unit-based business model is based on the sale or operation of a number of units of edge AI, and the direct service is provided to the customer for a direct fee. This was the year we announced the shift in our business model.



To give some details, as shown on the left-hand side, what the AI industry needs immediately is the concept of receiving AI license fees by actually renting out AI models.

Or, to begin with, we can develop AI to meet the individual needs of large companies while receiving a development fee and then provide it as intellectual property to our customers, a model we call EPS.

In this business model, a small number of large companies are our customers.

The customer tries out the model, determines what the social needs are, and then sells the product to the end customer.

Rather than directly responding to social needs, the AI company's business model is to contribute to the interests of large companies and their research areas.

This model also has its advantage, which is that it is very profitable.

For example, when we receive a contracted development project, there is almost no cost involved.

This would only cost internal administrative costs, but then the gross margin would be extremely high.

For example, if an AI model can be used in a similar model that has been developed in the past, the operating profit may or may not be good, but such profitability is attractive.

In this way, this fee-based business model is important, especially for companies in their infancy. Still, one problem is that the size of the market and TAM is limited to the development budgets of a few major clients.

Another downside of the fee business model is that the venture company's earnings are greatly affected when personnel or strategy changes occur at these major companies.

As we have announced, we have not been that active in contracted development itself for a long time, but we were actually doing a lot of AI licensing when we went public.

We have fundamentally departed from this, and venture companies themselves are building their own services. The right side is to build some kind of sales system by marketing it themselves or developing distributors by themselves. This is the good side.

By selling the product yourself, you can directly listen to the voice of the end customer. In other words, what the real needs of the customers are. For example, the needs of an edge AI camera provided to Muroran City, the needs of an AI camera provided to Okinawa City, or the needs of an AI camera provided to a real estate company in the city center are completely different. However, the AI model itself is actually quite similar in terms of the engine, but the sales process is completely different.

In fact, the actual use of AI and the value it provides are the responsibility of the startups themselves, which is the business model on the right side of this page.

The profitability of this business model is actually a little lower. The gross profit margin for our company is currently in the 65% range, which means that we have to sacrifice about 30% or less of our profits, which is a short-term disadvantage.

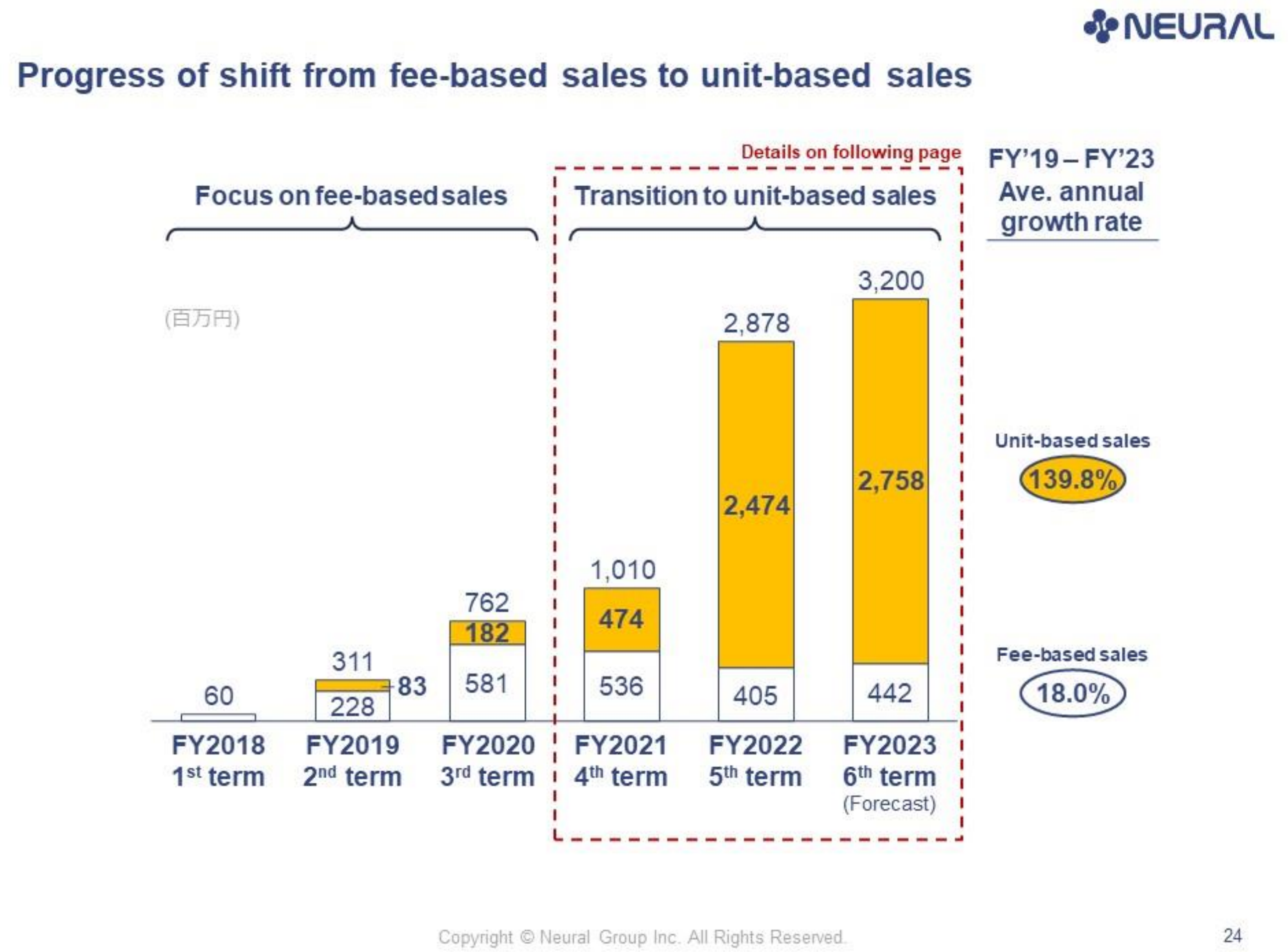
On the other hand, in terms of growth potential, the scale of TAM is completely different from the scale of the market in terms of our customers' actual consumption and economic activities.

For example, if a company that had an operating profit of JPY1 billion were to change its business model, 25% of JPY1 billion, or JPY250 million in operating profit, would be lost if the gross profit margin were to disappear. In other words, if the company were to change its business model, it would lose approximately 25% of its operating profitability.

However, the reason why we are doing this is because we do not consider a gross profit margin of 65% to be low. The attraction, of course, is that we do this because we think this is high.

We will continue to be very profitable, although we will sacrifice some profitability.

On the other hand, I think that such a large social scale is what the model on the right was all about.

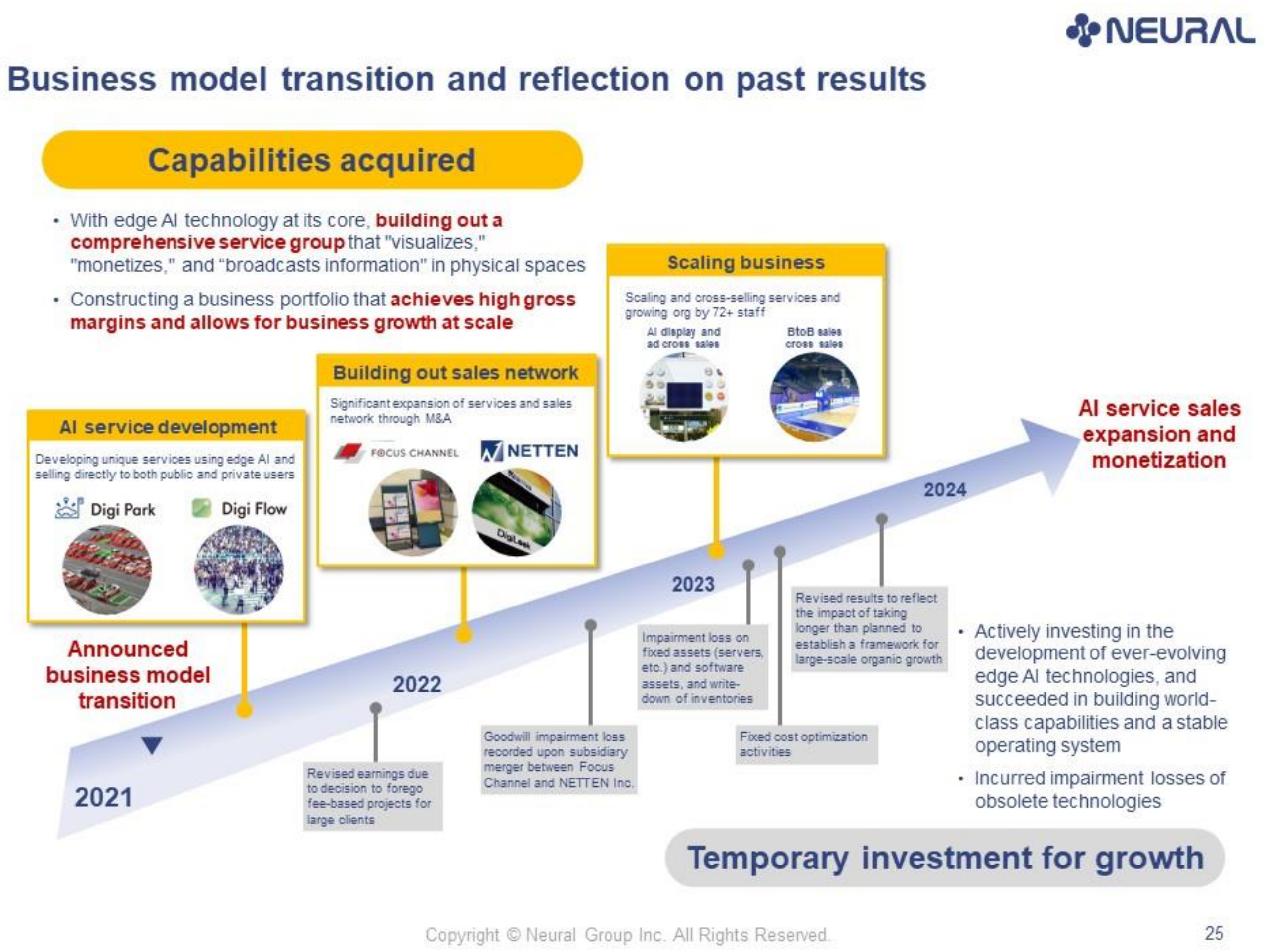


Here is a step-by-step of how we have been advancing that over the past six years.

In the first fiscal year, we basically provided licenses for everything, and in the second fiscal year, almost everything and in the third fiscal year as well, we went public in the third fiscal year, and at that point, fee-based income accounted for most of the revenue.

When we announced our listing in 2021, we had reduced unit-based sales to less than half, and in the 5th and 6th fiscal years, most of our business was unit-based, which is now more than 85% of our total sales. In other words, we have made a major change in our business structure.

In a sense, the outline of our business in the third fiscal year and the outline of our company in the sixth fiscal year are very similar in terms of the basic technologies and services we are trying to provide. The latter half of our society we are aiming for is very similar, but in terms of the actual business model, they are completely different.



In this context, sacrificing operating profit is not always a good thing.

As you can see in the lower right-hand corner, the increased uncertainty in the business has been quite turbulent in the short term until the end of this business model transformation.

Regarding the investment in human resources for this growth, as you have seen in past timely disclosures, we had to revise our financial results as soon as possible after the announcement in 2021.

There was one major project in which we had to forgo fee-based business, and it was a difficult decision as to whether we should forgo this or not, whether we should stick to it in the short term, or whether we should take investment growth for the future.

From the shareholders' point of view, we were told to take those investments and do them properly, but from our point of view, this may be fine for the period. Still, there were many shareholders who were expecting medium-term growth in the future, and it was difficult to sacrifice their expectations, so we had to make short-term investments.

At the same time, last year, we recorded an impairment loss on the FOCUS CHANNEL M&A, and this fiscal year, we made revisions to our fixed asset and operating results.

On the other hand, on the right side, you can see what we have been basing our decisions on these investments and what we have been basing our rationale for making these investments upon.

Simply put, I think it is no exaggeration to say that we have invested in advancing this edge technology.

Around 2017 or 2018, around the time our company was founded, edge AI was starting to move a bit globally, from the research paper stage to the commercial stage.

It was around 2018 that there were some businesspeople who had heard of edge AI, which was rare. That was in 2018.

Nowadays, it is much less common for anyone involved in AI to be basically unaware of edge AI. In the past six years, edge AI's hardware part has changed considerably, although various companies, such as NVIDIA, have developed the hardware part.

The planning has also changed a lot. The types of models used, and the generations are changing rapidly. The cost of the edge AI equipment itself, in the beginning, around 2018, cost JPY30,000 to JPY400,000 per unit at the low end and about JPY600,000 at the high end. Today, it is commonplace to see them costing less than JPY100,000.

This speed may be in accordance with Moore's Law, or it may be faster, but it is very close to the early days of personal computers.

In the past, a personal computer was the size of a piece of cardboard. Still, today, we already have laptops and smartphones that have computer functions, so there has been a generational and technological evolution.

The technology of such edge AI itself has undergone a significant growth curve over the past few years, and we have developed all of these areas in line with the evolution of the various hardware and the models themselves.

In other words, our goal was to avoid the obsolescence of our technological capabilities due to a misjudgment of, for example, where the world's de facto standard would be.

As a result, we have developed many different types of AI models, and the language itself has been developed in various languages: we make them in Python, we use the C language, and we have also made them in C++.

As a result, Python is the mainstream language, but there was also a struggle for supremacy between the Western and Chinese-speaking worlds at that time.

As a result of such wide-ranging technological development, we have always been able to keep up with the world's most advanced edge AI technology.

What is important in keeping up with this AI technology is that, as a result, we are able to put our AI on the world's most advanced, cheapest, and highest-quality hardware.

Failure to do so is actually an innovation dilemma, as leading companies are often quickly overtaken by latecomers.

The reason is that sometimes, by continuing to develop in older generations, they are quickly overtaken by newer technologies. However, this is not always the case for edge AI. In the past, when we created various platforms like this in the past, it was technically impossible to create them. The reason why we have continued to do so is that over the past six years, we have provided various generations of hardware to our customers. Our achievements have already spread, so I think the key was to keep them in perspective.

For example, in terms of technology programs themselves, if you buy a piece of state-of-the-art hardware and work hard on it, you may be able to create a program using that technology in one or two years.

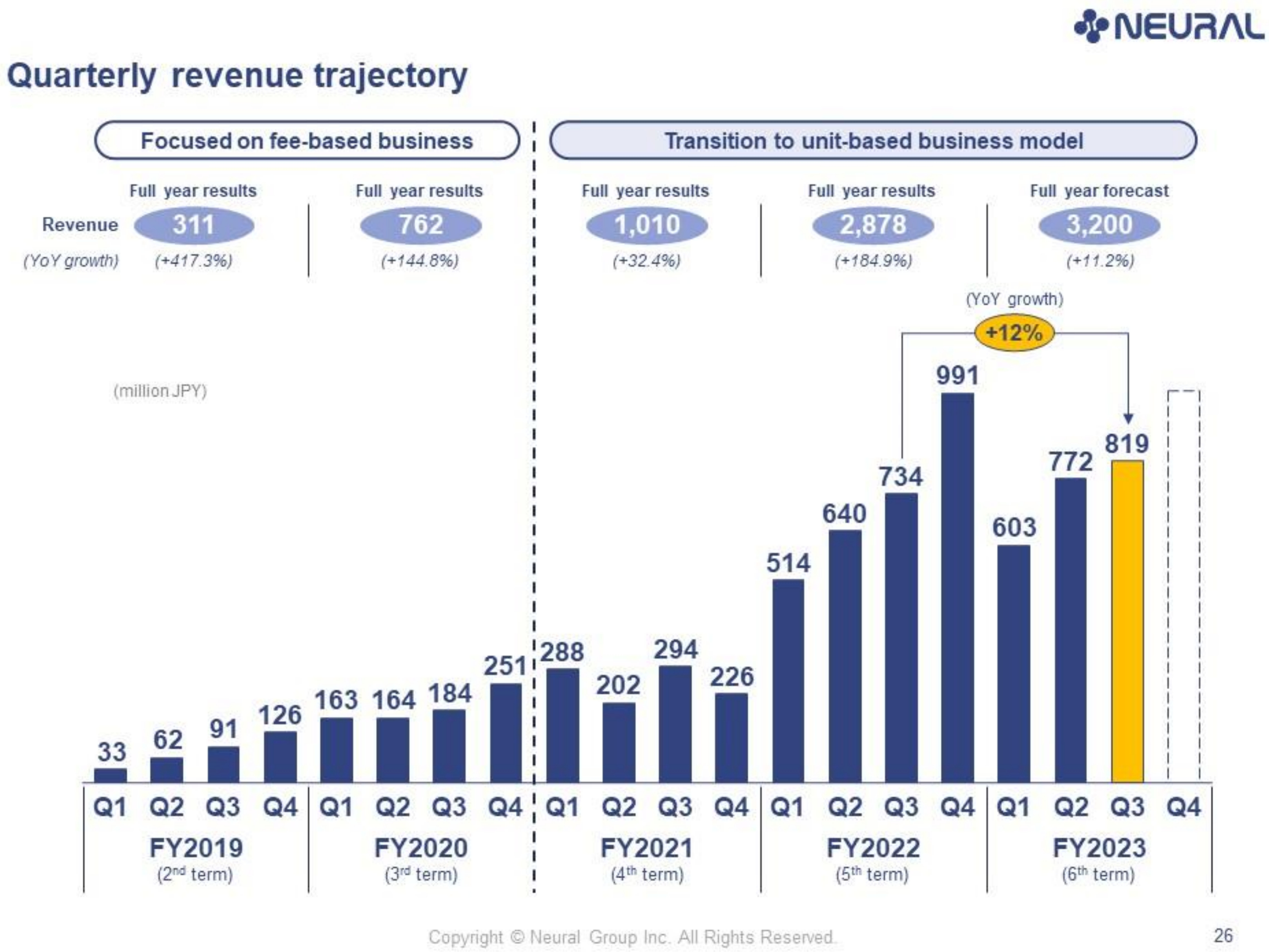
However, at that point, the next generation will emerge, and our own aspects will have already determined our company's sales performance to date, so it is necessary for us to become the fact standard in actual use cases in society, not in a technological sense. This was the key point for us.

So, when various governments and real estate companies decided to use edge AI, cameras, and LED signage to monetize their businesses, we wanted to establish a difference in performance results at this point in time over the past six years.

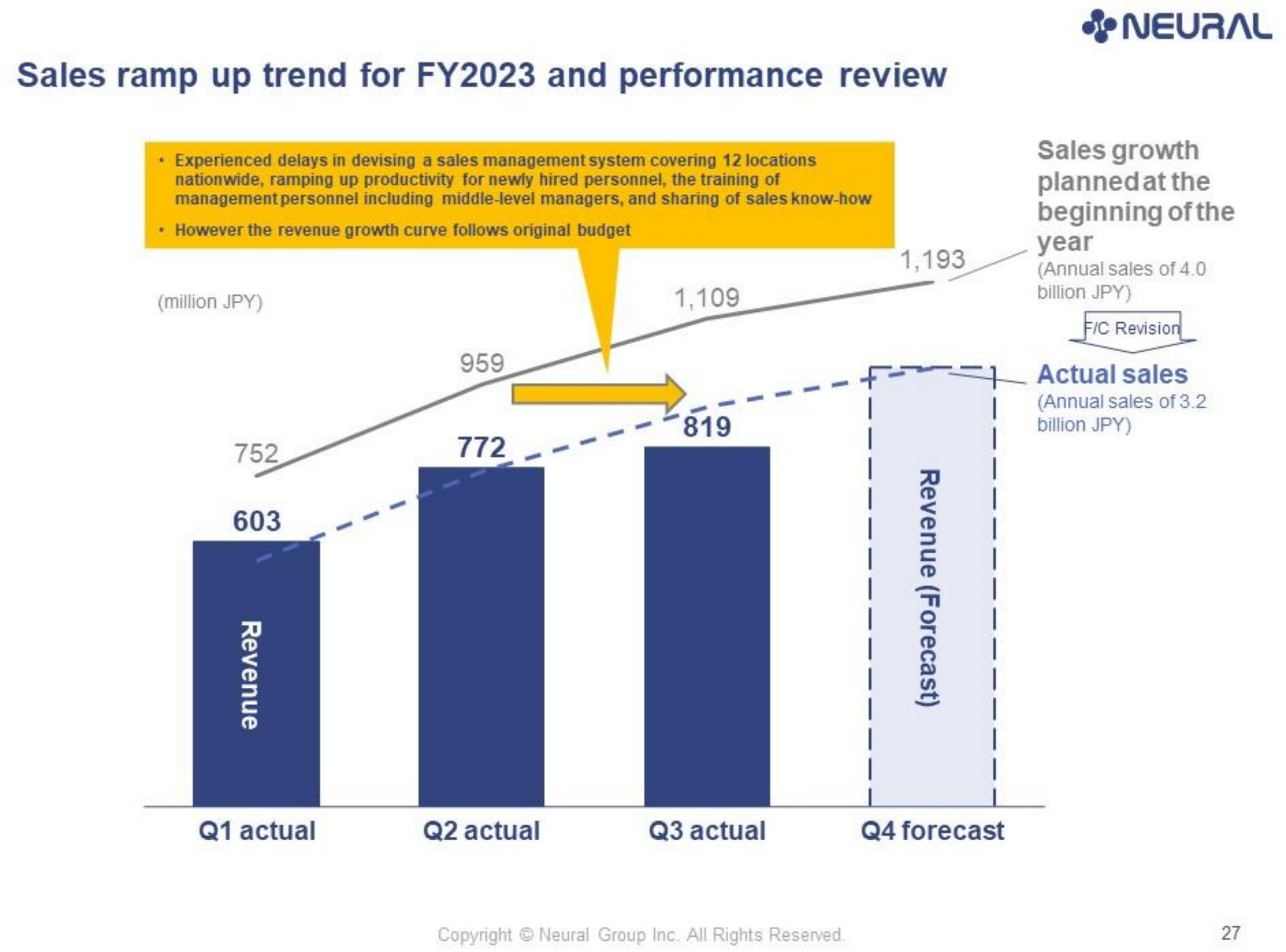
If you look at the left, you can see what kind of ongoing capabilities we have gained by making the investments I just mentioned all the way down here on the right.

In other words, we have acquired a comprehensive set of services, a track record, and a customer base in this series of businesses, which are centered on edge AI and the visualization, monetization, and dissemination of information in the space.

At the same time, the gross profit margin is high. Although 65% is slightly lower than that of contracted development, we believe it is extremely high for the profitability of a tech company, and we have been able to build up a scale of business services while maintaining such a high gross margin.



These are the numbers for the current quarter.



Unfortunately, we had to revise our financial results for the current fiscal year. However, we said that we would do our best in the third and fourth quarters and that we hoped to do better in the first and second quarters, but as it turns out, the growth curve itself was not as steep as we had envisioned at the beginning of the year.

However, in terms of future growth and growth from the next fiscal year onward, there was a slight delay in acquiring this slope. Still, in essence, we wanted to create the function of firmly building this curve, and I believe that we were able to establish this function itself.

So, this is a reflection and a review, assessing three factors in understanding the delay in the startup of the curve due to this delay.

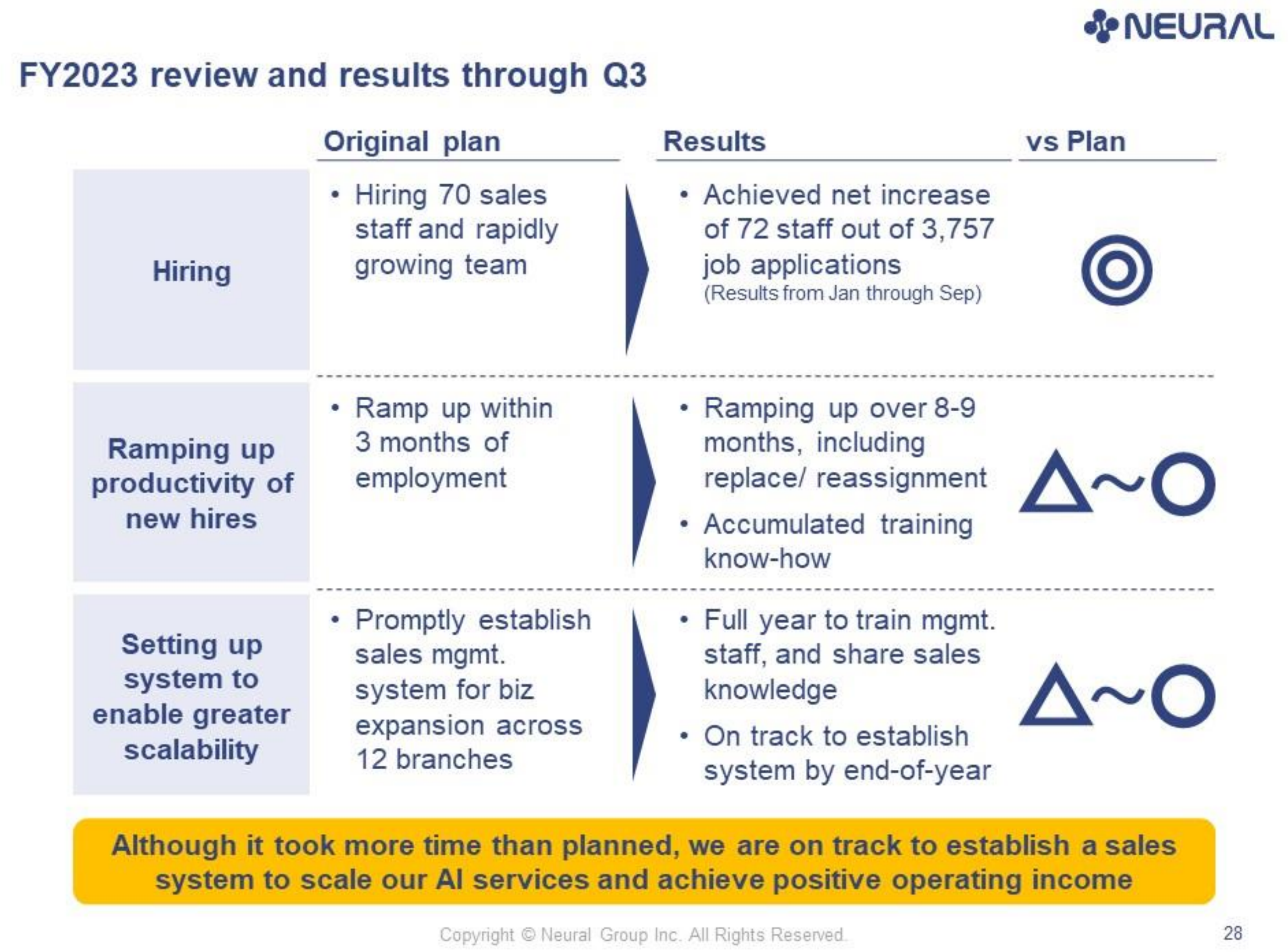
The first is how the personnel hiring itself went.

I am sorry, but before that, as I mentioned at the beginning, our management theme for this year is to build a comprehensive service group, which we were able to see in the last term, and the theme for this term was to create an organic growth curve without M&A.

In this context, we announced the hiring of 72 people at Neural Marketing as a theme at the beginning of the year. We did this to build a sales structure that can sell our services in every corner of the country, with about 12 offices nationwide, and to expand this sales structure further this year.

What would be great if we could do this is that our salespeople would be able to sell our difficult AI services more and more on their own. They will then pass it on to the next generation of salespeople, who will then expand sales.

We not only have our own salespeople but also make use of agents, which we are promoting simultaneously. We also want our distributors and partners to deepen their understanding of our services and sell them, and we want to achieve this by maintaining and acquiring this kind of sales scale this year.



Looking back on the results in three areas, first of all, how was the hiring process itself? The recruitment of 72 people was the most important point at the beginning of this project, and I believe that we were successful in this regard.

We ended up hiring 72 people for this Neural Marketing Company, and the number of applicants was 3,757, which is approximately 50 times as many as the number of applicants.

For a venture company like this, we received 50 times the number of applications and hired one person out of 50 people. We are grateful that so many people found our technology and services attractive and applied for the position, and we believe that we were able to build a top-class sales force.

On the other hand, there was a slight delay in the process of hiring these excellent people, training them, and creating a system that would enable them to actually sell products, which, at the time, we thought would take about three months, but it took eight months.

In fact, there were quite a few members who were up and running in three months. They were able to make a lot of progress even if we left them alone. Still, for some of the other members, we were less aware than we thought regarding the need to develop a certain level of understanding of the products and the technology.

As a result, it took us about 8 to 9 months to complete the project, based on actual measurements.

As for what we will learn next year, we will not be hiring on such a large scale, but we were able to establish an in-house personnel training program.

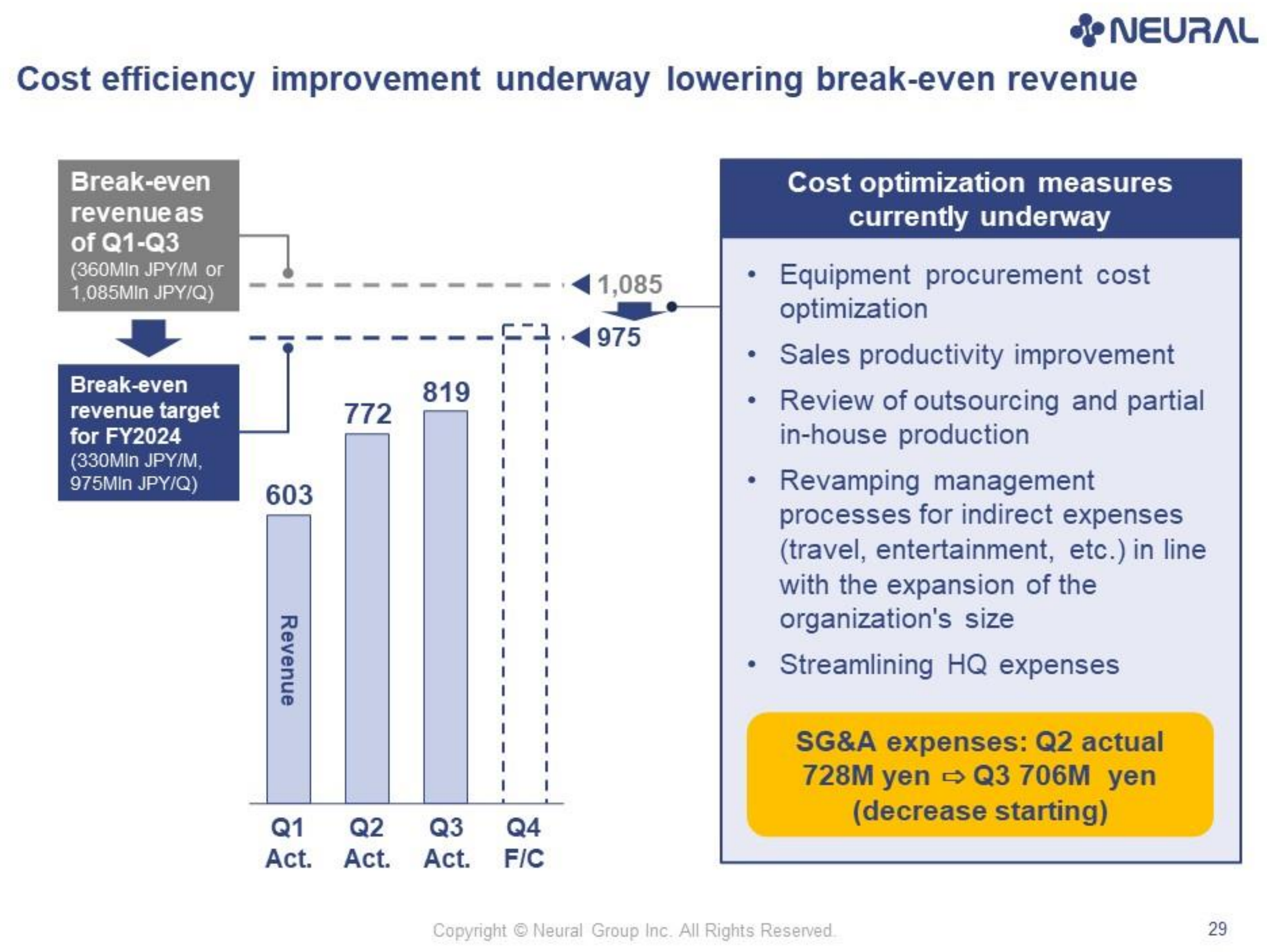
The more important point was that once we had trained our sales staff in this way and were able to sell our products, it was important to create a nationwide sales management system.

It was also important to develop middle management, top management, and regional heads of each region so that each salesperson could set the direction of which services to sell.

In other words, a series of cross-sales of services, in which a large number of salespeople, or excellent salespeople, should be asked what they should sell and how they should sell it.

We have spent almost all of this year thinking about how we can best monetize visualization and information dissemination and where we can best focus our sales efforts. We have learned that it is impossible to run an organization with more than 250 to 300 employees unless we are able to control this.

When the company was first established, there were about 6 people, and now the number of employees has increased. Moving to a large company like this requires more structure than I had expected, and I am very embarrassed to say this, but we were able to develop this kind of knowledge through this term, and as a result, delays became apparent.



At the same time, although we achieved the growth curve, we also focused on cost optimization in the latter half of the year to achieve the same sales at a lower cost, which is a major achievement.

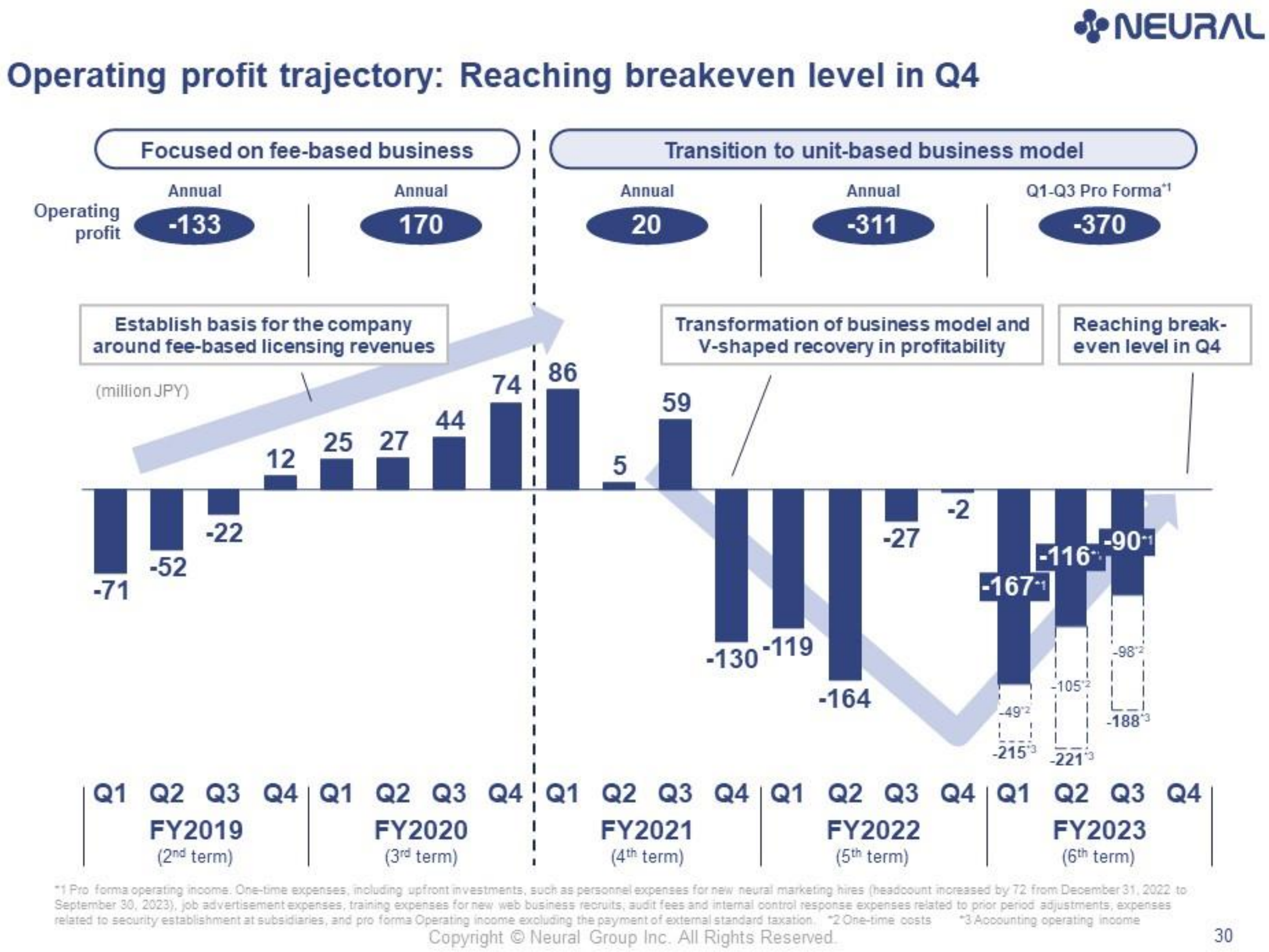
One of the ways to do this is to reduce external outflow costs as much as possible.

It is important to negotiate with suppliers and form strategic partnerships to procure so-called equipment, such as edge devices and LED devices, and to build sales productivity. In addition, as mentioned earlier, we have gradually made progress in building sales productivity, which is directly related to the efficiency of sales expenses.

Despite these various activities, I think it is a great achievement that the SG&A expenses themselves have already entered the [inaudible] category in the third quarter, with Q2 now being the maximum point in the second quarter.

Naturally, sales are rising in the second and third quarters, but as sales rise, we are able to lower SG&A expenses.

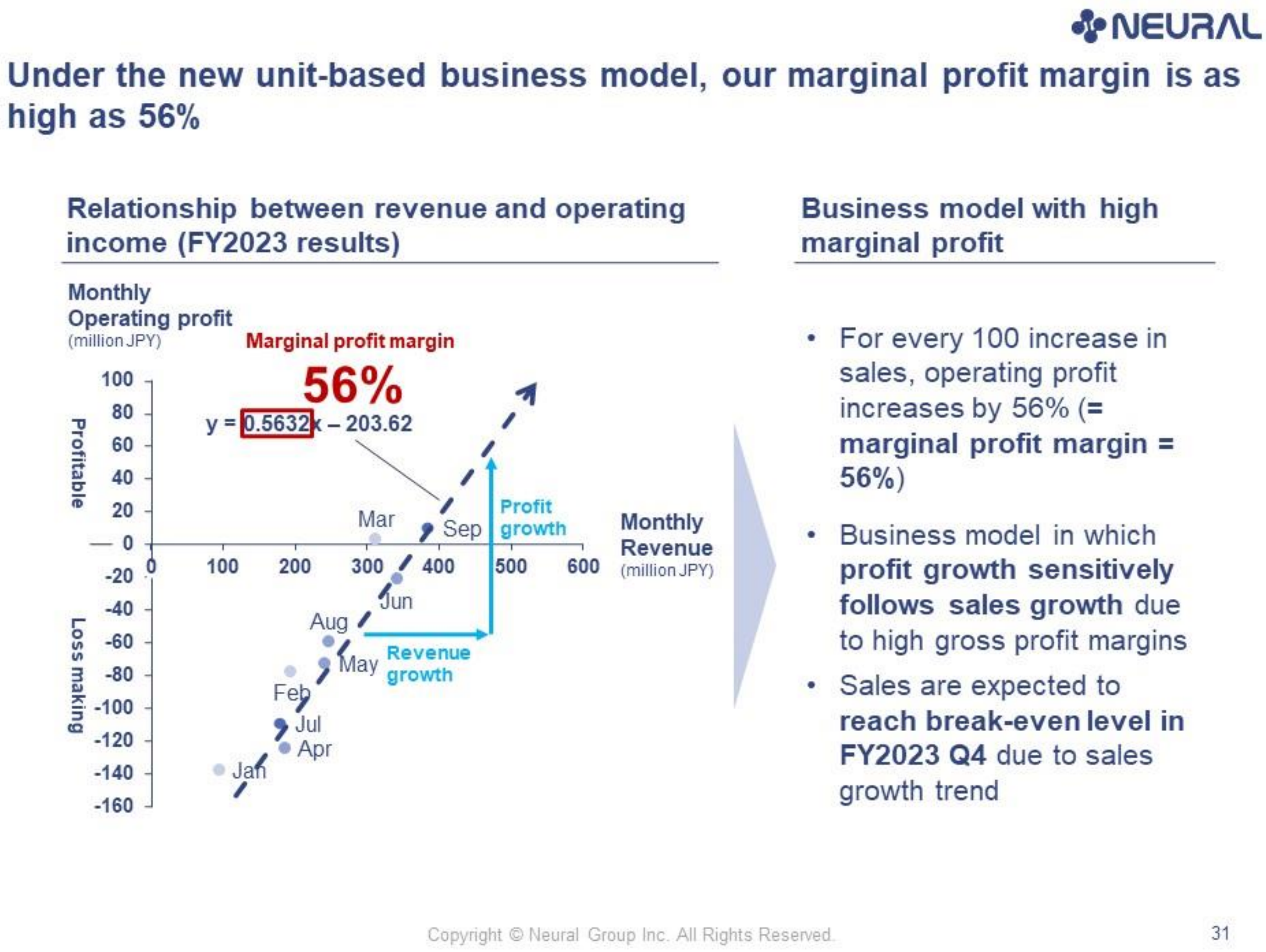
As I mentioned earlier, we will maintain the gross profit margin, but we have begun to work on strengthening profitability.



This year, this is the headline figure for operating income, which I believe will be the main management indicator for the next fiscal year and beyond.

We have been presenting this from the second fiscal year, but for the second and third fiscal years, operating income will mainly be fee-based, and the more license fees are provided, the more operating income will increase. This is a matter of course.

However, as a result of the business model change and the promotion of the 20% reduction in gross profit margin, as I mentioned earlier, operating income temporarily declined. We expect the operating profit to be around the break-even level in the fourth quarter of the current fiscal year. Rather than being a one-time event, I believe we are approaching this sustained profitability level.



On the other hand, operating profitability after reaching the break-even point is an important indicator for measuring our future profitability, and this is the result of our bi-monthly measurement in 2023.

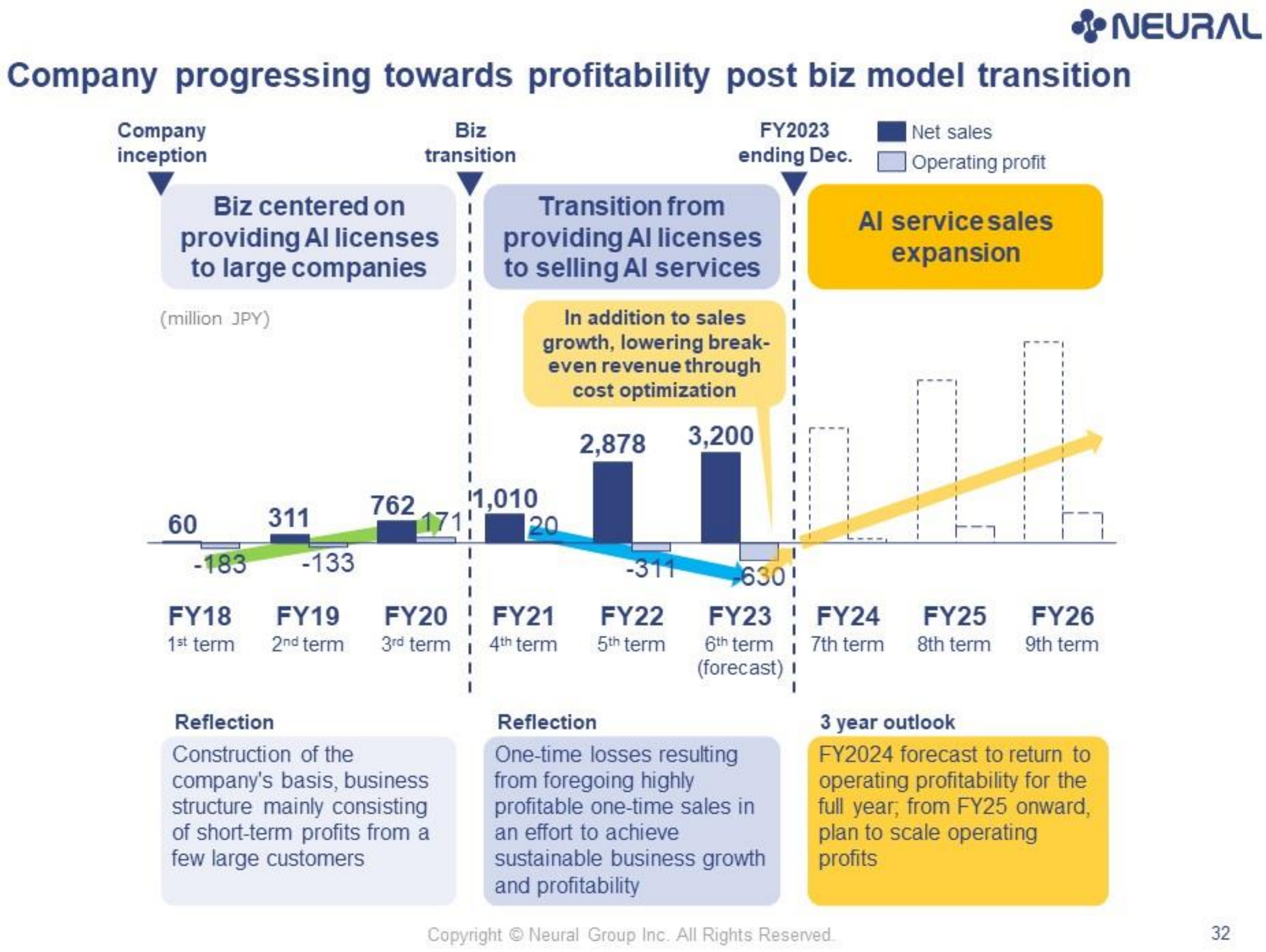
We have continued to use this indicator internally for the current fiscal year, and we have disclosed the results this time.

If we look at this on a single-month basis, we can see how much operating income increased or decreased when sales grew.

This is now 56%, which means that the marginal profit margin is 56%. What this means is that after the break-even point is reached, for example, if sales increase by JPY100 million, then, theoretically, an operating income of JPY56 million will be generated.

This is a simple way of thinking. In other words, we have actually been able to measure that the business model is one in which an increase in sales leads to a steep increase in operating income.

Again, as shown in the lower right-hand corner, we believe that we will be able to achieve the break-even level of sales in the fourth quarter of this fiscal year based on the sales increase trend, optimization of SG&A expenses, and optimization of the cost of sales.



Here is the outlook for the future. As I mentioned earlier, operating revenue has risen and fallen and started to rise. Still, from the next fiscal year onward, the budget for the next fiscal year will be disclosed in the February notice of financial results, but the direction and guidance are as shown here.

The year 2024 is at the bottom right, and we do not plan to make any drastic hiring or business transformation in 2024.

The reason for this is that we would like to show whether we can generate operating revenue for the full year by promoting the current structure that we have built over the past three years.

If we can show this, we will be able to scale up, and, as I have just disclosed, the marginal profitability if we can ride this growth curve, the business model and technologies that we have developed will naturally permeate society.

Yes. Apologies for the long explanation. If you have any questions, please do not hesitate to ask.

Question & Answer

Moderator [M]: We will now move to the question and answer session. Both Chief Executive Officer Shigematsu and Director and CFO Tane will be available to answer your questions.

If you have any questions, please let us know by pressing the raise your hand button on Zoom. We will nominate someone in turn.

After you have been selected, you will be able to speak, so please unmute yourself and mention your affiliation and name before speaking. Each person may ask up to two questions.

If you have a question, please press the raise your hand button.

Shigematsu [M]: May I?

Yes. Well, I would be happy to talk with you all again at the individual investor interviews. Otherwise, thank you very much for your time.

Moderator [M]: Thank you very much for participating in the FY2023 Q3 Financial Results Briefing Meeting of Neural Group Inc., which spanned for an extended time.

We will now adjourn the meeting.

[END]

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