Neural Pocket Inc.

FY2022 Q4 Financial Results Briefing Meeting

February 13, 2023

Event Summary

[Company Name]	Neural Pocket Inc.
[Company ID]	4056-QCODE
[Event Language]	JPN
[Event Type]	Earnings Announcement
[Event Name]	FY2022 Q4 Financial Results Briefing Meeting
[Fiscal Period]	FY2022 Annual
[Date]	February 13, 2023
[Number of Pages]	29
[Time]	12:00 – 12:43 (Total: 43 minutes, Presentation: 35 minutes, Q&A: 8 minutes)
[Venue]	Webcast
[Venue Size]	
[Participants]	
[Number of Speakers]	2 Roi Shigematsu — Chief Executive Officer Ryosuke Tane — Director, Chief Financial Officer
[Analyst Names]*	Ryo Kobayashi — Mizuho Securities

*Analysts that SCRIPTS Asia was able to identify from the audio who spoke during Q&A.

Presentation

Moderator: It is time for us to begin. Thank you very much for taking time out of your busy schedule today to join us for Neural Pocket Inc.'s financial results briefing for the fiscal year ending December 31, 2022. My name is Toyoda, and I will be the moderator today. Thank you.

Today's presentation will be based on the financial results presentation material disclosed on our IR site on February 10. We will be sharing screens via Zoom, but if you are joining us by phone, please visit our IR website to view the documents. In addition, filming or recording of this briefing is prohibited.

Now, let me explain today's flow. First, Shigematsu, Chief Executive Officer, will give a 30-minute presentation on business overview and performance. After that, we will have a question-and-answer session until 1:00 PM at the latest. Both Shigematsu, Chief Executive Officer, and Tane, Chief Financial Officer, will answer your questions.

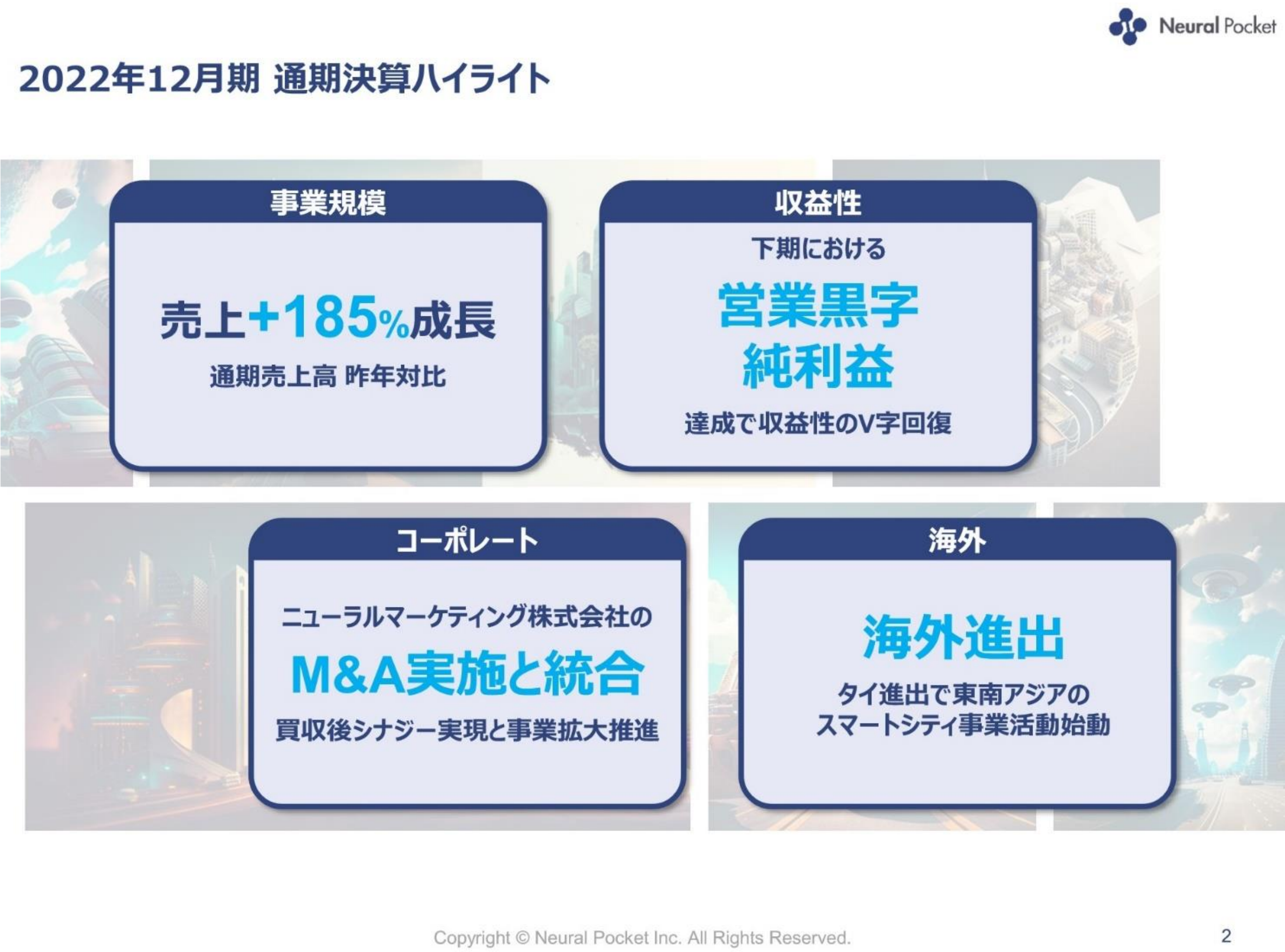
Thank you for your patience. Chief Executive Officer Shigematsu will now give an overview of our business and performance.

CEO Shigematsu, please go ahead.

Shigematsu: Thank you again for taking time out of your busy schedule to join us. As this is the annual financial statement for our company's fifth year in business, we have summarized our activities in this financial report as a milestone, looking back on how we have developed our business over the past five years since the Company was founded.

This year is a turning point, as it has been about 10 years since the emergence of deep learning in 2012. Looking back, I wonder if the commercialization of deep learning has rapidly begun to gain momentum in Japan and abroad over the past year or so.

The images on the cover of this presentation are based on the subject of smart cities and made with generative AI, which is a hot topic in the world today. Such generation technologies have been gaining momentum for about two years now. Similarly, I believe that the foundation is finally in place for AI in the field of video to permeate society. Today, I would like to explain the contents of the financial results, while also touching on these areas.



First, let me give you a summary of the results of our fifth fiscal year. H1 of this fiscal year was a year of major hiccups in the steps toward growth, but I believe that H2, Q3 and Q4, were quarters in which we saw a strong response.

We have been promoting service-oriented business for about two and a half years since we went public and have always emphasized that AI companies should be useful to society by providing services, rather than being a company that develops AI on consignment. We were able to create such a useful service for the world. We have also been able to ensure the stable operation of the system and its robustness to operate 24 hours a day, 365 days a year, and we consider this to have been a strong year in the sense that the results of our efforts have been widely recognized.

I have written four highlights that support this, here. The scale of our business grew by 185% YoY, which means that sales grew by approximately 2.85 times, or nearly three times.

In addition, in terms of profitability, we posted a significant loss in H1 and had to replace some businesses in the process of business development, but we were able to generate operating income and net income in H2. Moreover, this profit was not derived from the profitability of contracted development, but from business that we will grow sustainably as a service, and is completely different in nature from the profit that we have generated in the past one or two previous fiscal years. We believe that the earnings were strong.

Two M&A transactions were carried out in the corporate sector. After the M&A, we have integrated our businesses over the past year, and we believe that we now have a structure in place to organically conduct our businesses within the Neural Pocket Group.

As for overseas operations, we have moved ahead of schedule, and at the end of last year we entered the Thai market. The world is currently experiencing a boom in the use of AI, and we are working hard to make it a reality. We are determined to grow and succeed in Thailand and to aggressively implement our business in other regions as well, and I believe that the basic strength to do so has been formed in our business in Japan.

Highlighted here are some of our strengths.

As we have been saying since our founding, our focus is not on providing AI technology itself, but on selling AI services.

There were various elements necessary for this. Naturally, we must be able to provide a wide range of AI technologies to meet various social needs, and not only sell our own technologies, but also provide detection contents that match real social issues. We have widely developed such versatile and advanced AI technologies.

In addition, it was important to achieve a 100% level of detection accuracy, and we have been able to achieve this. ChatGPT, which has been gaining popularity, is another technology that has been attracting a lot of interest for the past two years, but some people say it is not accurate enough and that it sometimes makes mistakes. So, much attention is paid to the ability to structure and write well enough to compensate for this. As it advances further, we are now talking about whether the accuracy can actually stand up to commercial accuracy. In the AI industry, the same thing happens over and over again, but I think that the 100% standard has become the norm in the video domain. At least we think so in our company.

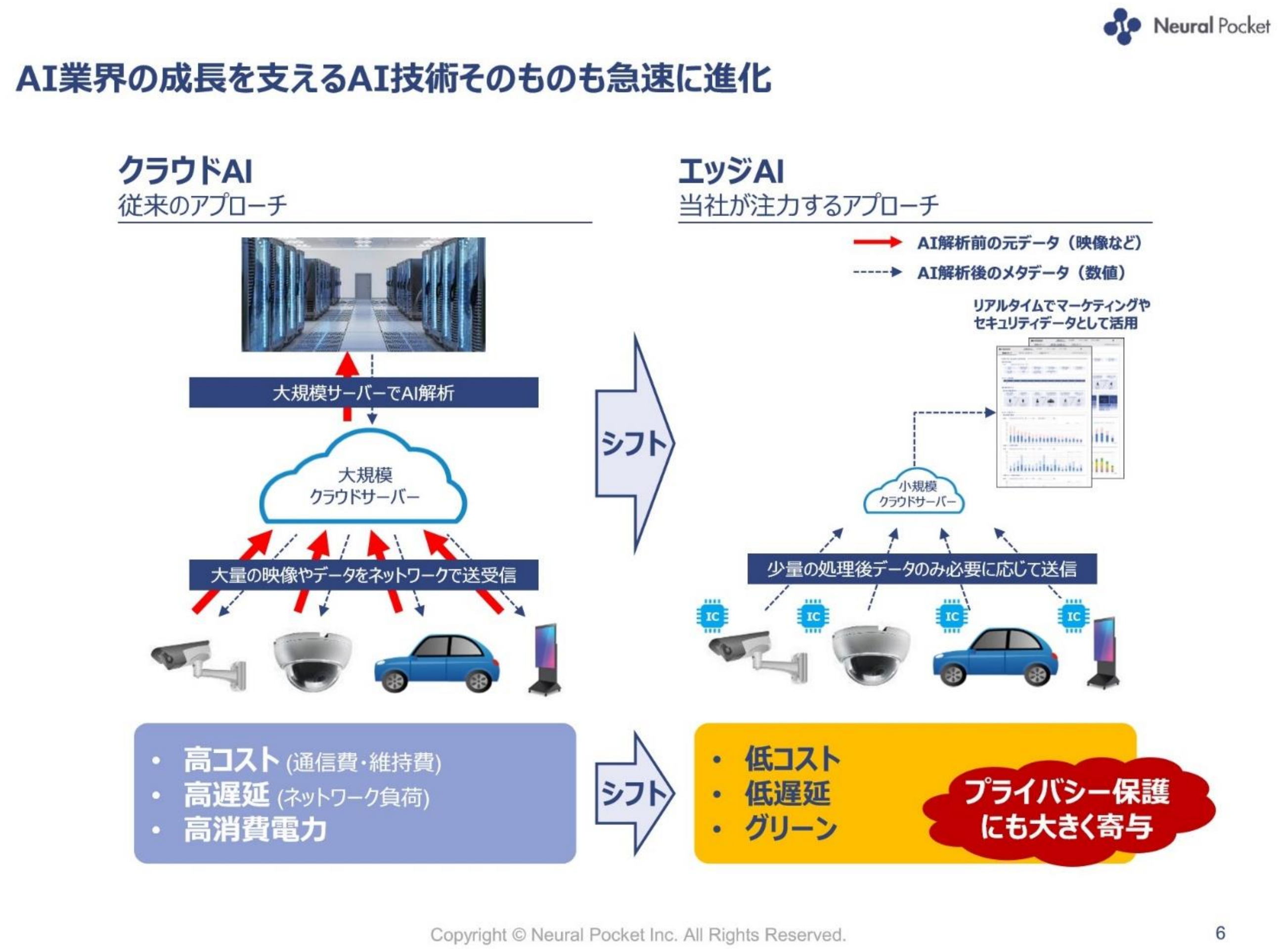
It continues to run 24 hours a day, 365 days a year, and furthermore, on the right side, the service scene has been specifically defined and expanded.

Below left, the analytical data provided within it is on a common data platform and can be used across various services to analyze the same data. I have been saying that it is important for this to be used to stimulate consumption, marketing, town planning, and urban development.

At the same time, the pricing is easy to introduce. A few years ago, it would cost JPY300 to JPY500 million or JPY500 million to JPY1 billion to introduce AI technology, but now it costs only a few million, or in some cases, a few hundred thousand yen to use AI technology. Moreover, we have come to the point where we use AI technology naturally without knowing that it is AI technology. The important thing is to offer products at price points that blend in with general consumer activities, and we have been doing this for a long time.

At the same time, security and privacy and whether the AI is developing based on training data obtained through the proper processes, this is a debate that's been going on for about five years now. These discussions are long over. Rather what is now being discussed is whether data taken by AI that is being operated in a stable manner is not at risk of leakage on the Internet. Is the data processed at the edge erased with anonymity on the spot? Is the information secure in light of various risk situations such as cyber security or physical theft? Will that personal information be protected? Due to these issues, we needed more advanced information security, and we have also built this over the past five years.

Last but not least, the effect of introduction. I'm really glad we used this. For example, using this in state facilities, they analyzed the citizens and guided them, for example, to the citizens they analyzed. Is it being used conveniently, is the information being shared among facilities, for example, and is it helping the next development? As these things spread, they will be primed and expand horizontally. This is what is important.



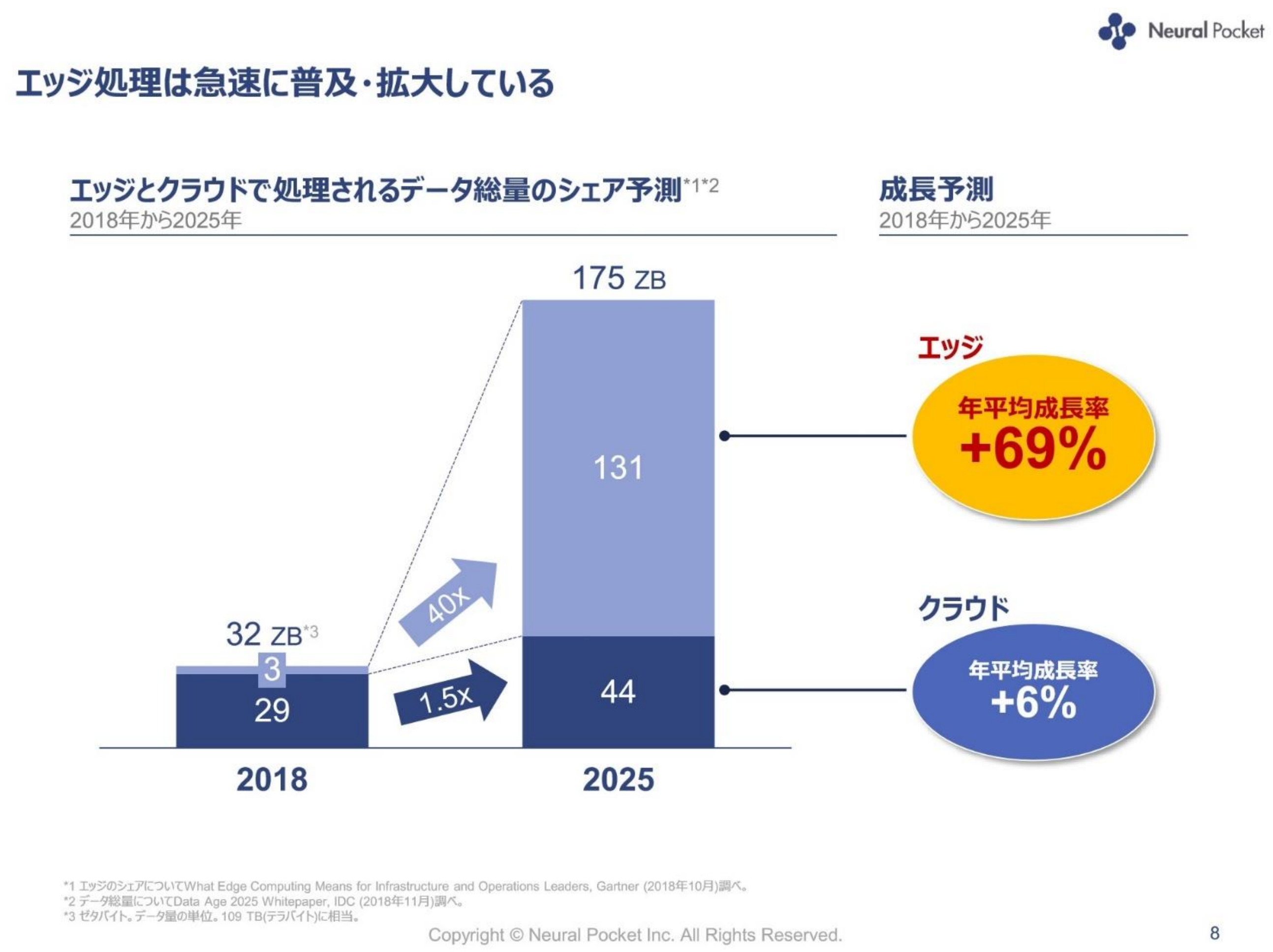
When that happens, I will just explain again. While cloud technology is undoubtedly a wonderful technology, we have been saying that edge AI is indispensable for processing such images.

What makes edge AI especially great is that you can process the footage you take immediately on the spot. It is converted to metadata and uploaded to the cloud without personal information, thus protecting privacy.

Furthermore, the cost is lower because it does not require a high-bandwidth network to transmit the video itself.

Furthermore, no delay is incurred. It takes a long time to transfer the images, process them on the server, and then send them back again. By processing the images immediately within a few frames of being taken with edge AI, the latest information is sent out without delay.

In addition, it does not require fans, air conditioners, or other air conditioning equipment to maintain the servers, so CO_2 emissions can be avoided. This is written as "green," but edge AI has these various advantages.

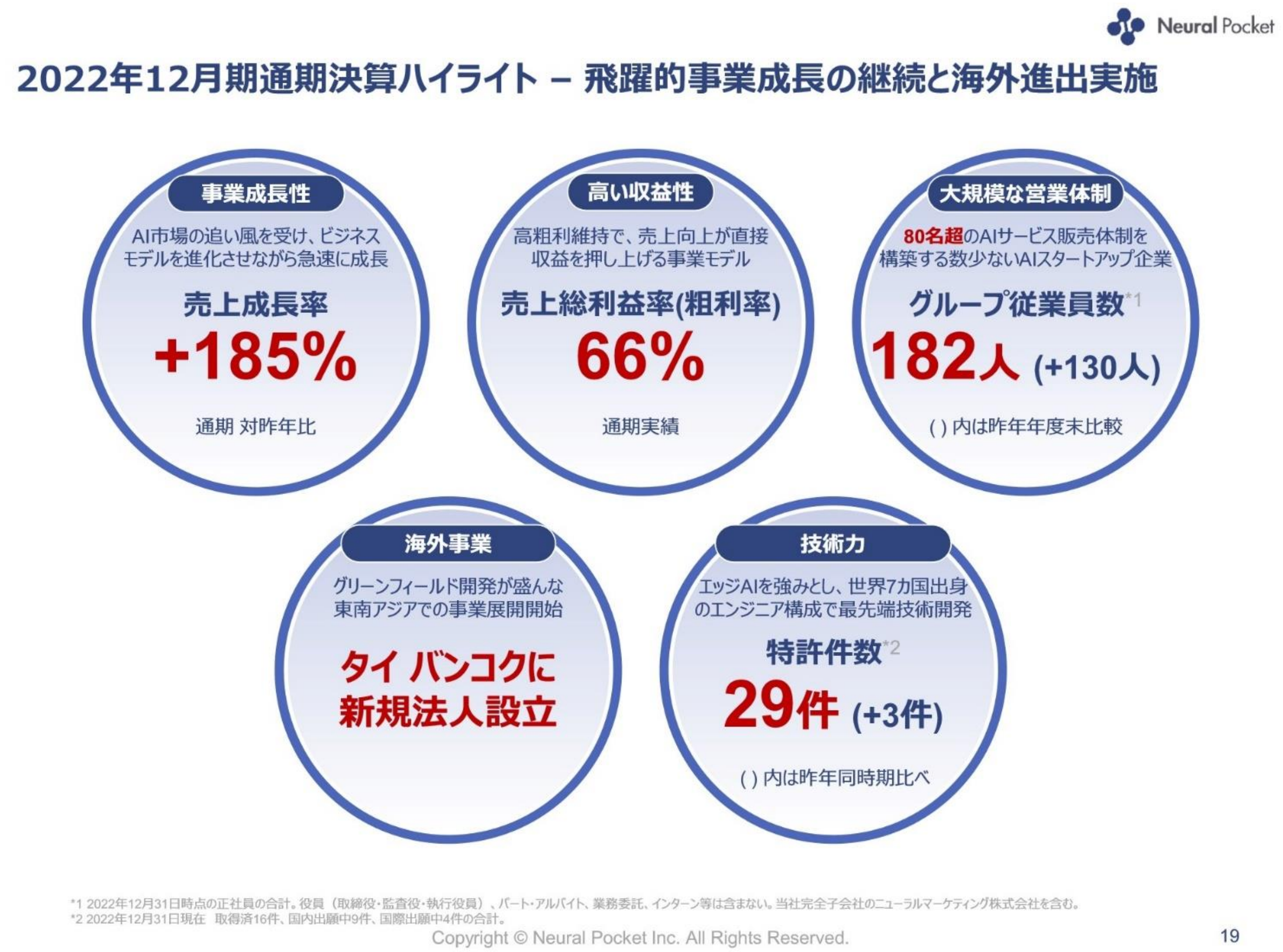


So while the cloud is said to grow at 6% per annum in the future, edge AI will grow significantly.

This is the last part of the outline. In this context, what is the business for which we are aiming? In a sentence, shown in the middle, we will create a society where data circulates. It is data taken in a variety of conveniences that will be circulated organically. It is important to run this on such a Neural Pocket platform and manage it all together.

The applications are to eliminate waiting in such a city and turn waiting into a pleasant time. In addition to that, as shown on the right side, we have been saying that it is important not only to analyze the AI, but also to have the convenience of being able to transmit and encounter information through actual consumption activities, new encounters, encounters with products, encounters with services, and experiences. These applications are being offered at this time.

From this year onward, there is a great possibility that we will develop new applications and acquire technologies through our organic development and, in some cases, M&A. In this context, we feel that we would like to grow our business while providing a wider range of services and being aware of the flow of such data circulating organically.



Now, I will skip a little bit to the highlights of the financial results for the fiscal year ending December 31, 2022.

As for sales revenue, it is as I mentioned earlier. The gross profit margin was 66%.

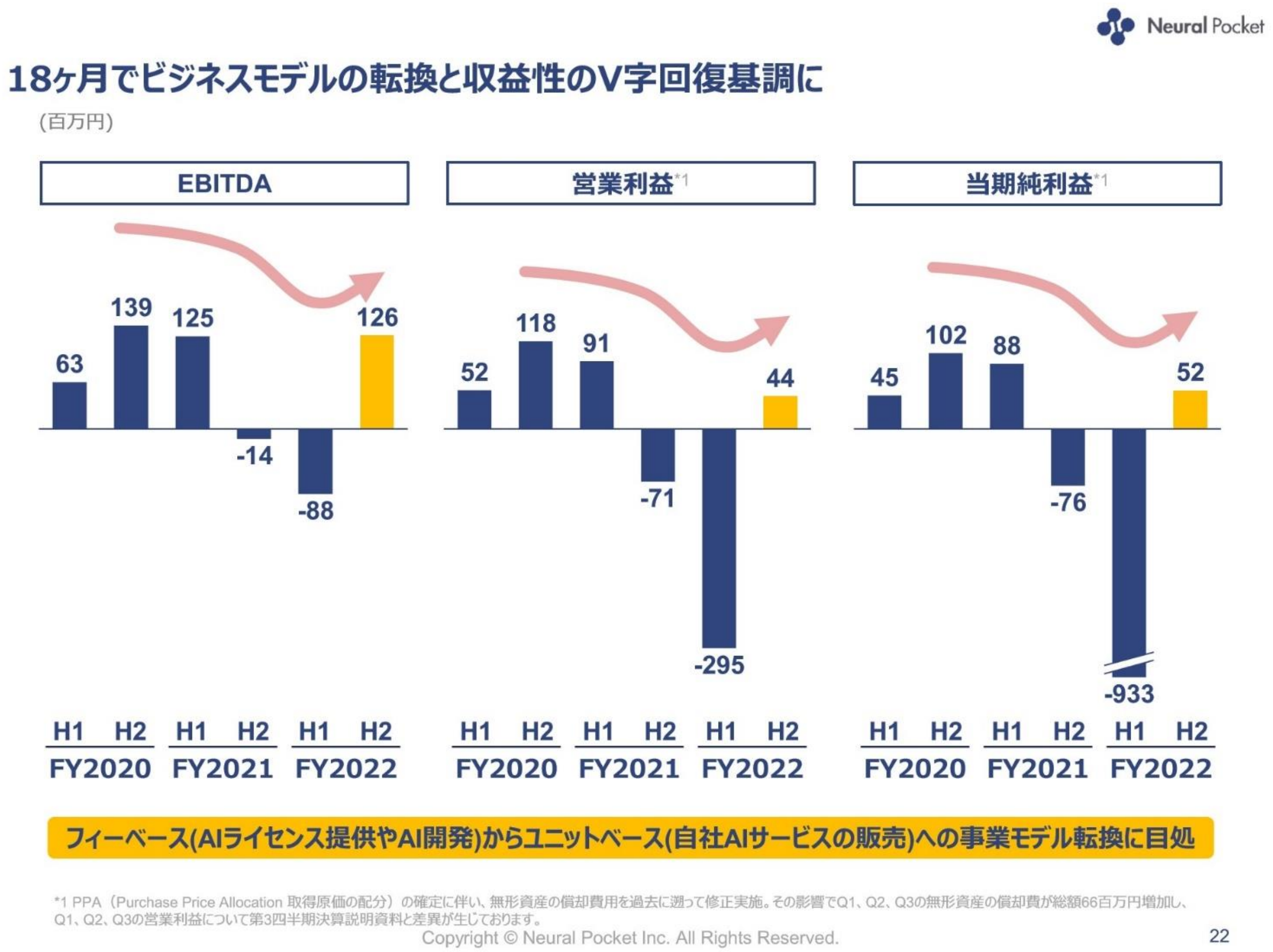
Regarding personnel growth, the number of employees increased by 130 to 182. This is conventionally disclosed on an employee basis, which does not include part-time employees, directors, and executives.

The Company has established a corporation in Bangkok, Thailand.

Sales growth is shown here from the second year.

Sales growth was about three to four times YoY. More importantly, I believe that the year has been successful in creating a stable and sustainable sales growth trajectory during Q1, Q2, Q3, and Q4 of this year.

With respect to this growth rate, we intend to continue to maintain a high growth rate.



This is the profit. Looking back to the last time we made a profit; I am very sorry to say that it was 18 months ago here. For the past 18 months or so, we have been implementing a shift in our business model.

As for what we were doing, though, in simple terms, it is more profitable AI license sales, which we call fee-based. A fee means a monthly fee. We call it a fee when we receive monthly revenue as a transient license, not in the sense that we receive a fee for each service unit, like a subscriber, but as a transient development of something, for example. These things are very profitable, but when you think about essential continuity, sustainability, and leaps in growth, they are not so appealing here.

The most important thing was that we could not solve the problem from the viewpoint of whether we were providing a service to society. From these profitable businesses, we will sell them on a unit basis, or as so-called services, as edge AI units. We have been selling our services as units for a long time. In the midst of this situation, earnings temporarily sank, and we had a difficult time, but we were able to gain the strength to generate earnings through unit-based services such as this.

These are the full-year financial results in this context. The amount for the current fiscal year was JPY2,878 million. We had projected JPY3.2 billion, and we thought it would be feasible. Last year, our company had sales of JPY1 billion, and with sales nearly 2.8 times that of that, it was honestly more difficult than we had expected with sales nearly tripling, especially when there are reception acceptance methods to meet accounting standards, and also we had to complete the work within the time frame. We revised our results downward because we did not complete acceptance inspections, postponed some operations to this year, and postponed some others.

Essentially, I think it is important to expand sales and business in a sustainable manner. We regret that our growth has been too strong during the current term. In light of this, I think it is important to ensure a certain degree of sustainability and flexibility in the budget for next year. Essentially, business growth is very solid, and I have a strong impression of the current general situation from the past six months to a year, in terms of our technological capabilities for society.

Next, the themes for the current term, 2023, are written here.

We were not sure whether to submit a medium-term management plan this time, but we would like to do so after one year. Based on the reflection that we were not able to achieve our business plan as budgeted during the last term and the one previous, I think it is more important to realize our plan for the next year for sure rather than to plan for the next three years in that context with regard to this year.

Therefore, although we have only a short-term plan for this year, we intend to make a strong effort this year in terms of content.

In terms of the entire Neural Pocket Group, the themes are at the top left. I think scale and monetization are the themes for this year.

This scale is in the sense of a firm development of organic existing businesses and services. Whether this will allow us to generate a stable revenue stream during the full fiscal year. Once this is achieved, it will be easier to achieve the next stage of growth, overseas growth, further M&A, etc. In this context, we have formulated an internal plan to implement the theme of scale and monetization and are proceeding with this plan.

In it, it states that the Company is operating in the black for the full year. We intend to make various investments upfront while generating an operating surplus. I think it is important to generate a surplus and strengthen our financial base.

In addition, I have a feeling that M&A is likely to be quite active in the market over the next year or two, as various companies are now considering M&A and sales in the market. Whenever there is a good business opportunity here, we will aggressively pursue it.

Top right is AI DigiSolutions. This is a basic AI service for parking, human flow analysis, etc. This track record is expanding, and horizontal development is progressing, and we are aiming for a cumulative total of 400 units in the current fiscal year. We would like to contribute to the development of both the private and public sectors, not only in Japan but also in Thailand and other Southeast Asian countries, with an eye to large-scale urban development in these areas.

Next is Neural Marketing. This is the marketing company of the Group, which sells DigiLook, Focus Channel, and AI DigiSolutions in the upper right corner. In this context, we are strongly feeling the tailwind of growth in the display and AI business market. We would like to hire a net sales force of about 70 people, although this is on a net basis.

In this context, I think it is important to expand sales methods of AI more widely, while expanding the sales system. I think it is necessary for AI companies to have such sales personnel themselves. We are considering adding six more locations to the current 12 in Japan, bringing the total to 18. AI technology is not bought as AI, but as a service. I believe that the use and enjoyment of this service is beginning to spread, and I wonder if we are now at the right time for this kind of regional expansion.

Next is lifestyle innovation. We have been working in the apparel area since our establishment, and while we will continue to promote our business in this area, I think it is important to develop new areas of business in-house as one of our focus areas for this year. Of course, we will be implementing areas that are in high demand, such as changing clothes on someone, related to apparel, but we will also be working on logistics in the midst of the considerable expansion of e-commerce in recent years. This could include the use of AI to automatically program the efficiency of container loading in the logistics domain, including land and marine logistics.

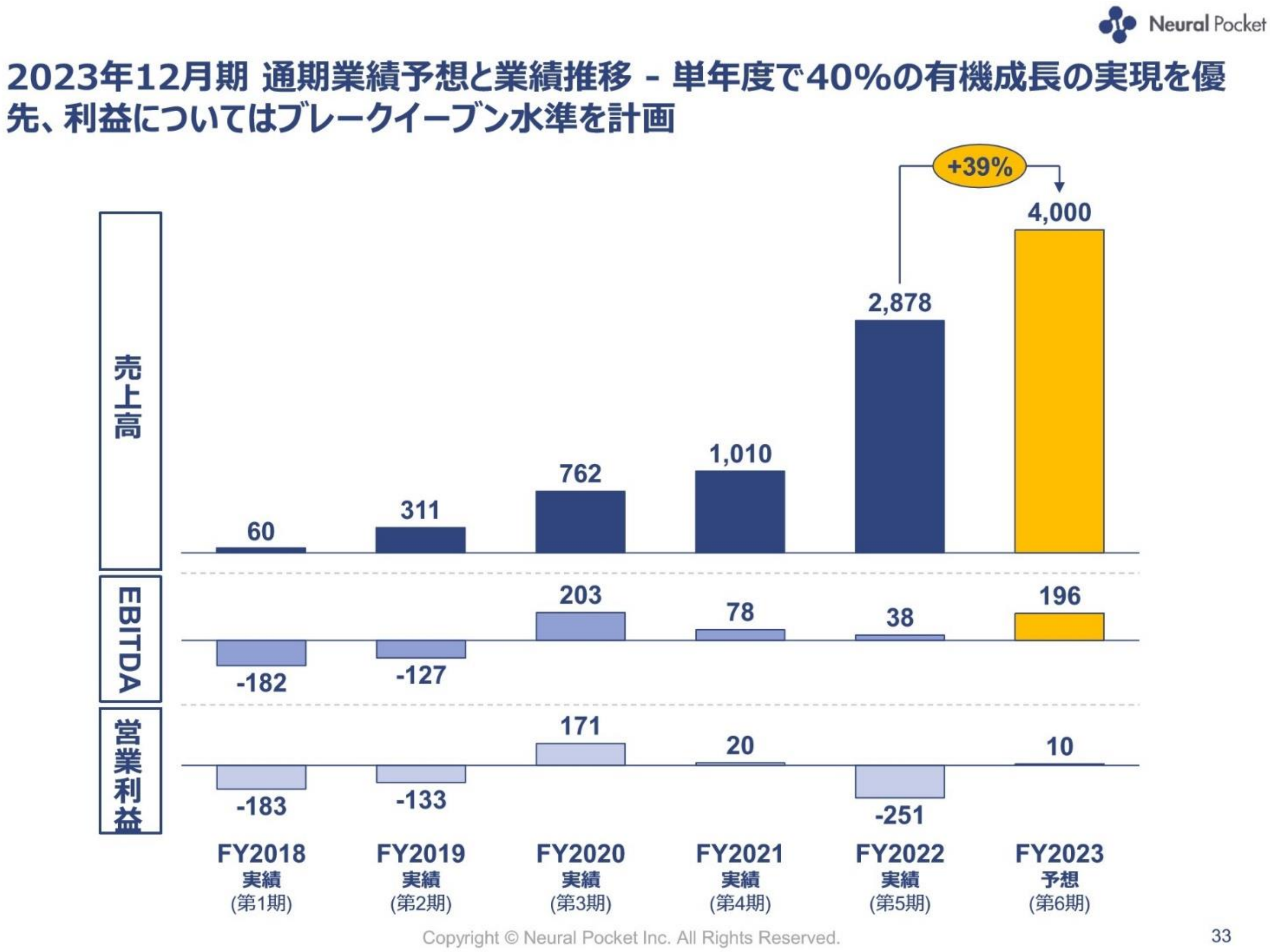
Then, there is the analysis of satellite imagery. Now, in the past year or two, the market has seen the price of satellite imagery photos become generic. It is said that satellite images, which used to cost hundreds of thousands of yen to buy a single photo, are becoming much more affordable. With satellite communications becoming more widespread, I think it is actually becoming possible to analyze various sites on Earth instantly from satellite photos, in addition to doing so on the ground with AI cameras.

There have been many satellites launched so far, but the companies that launch them and the companies that actually use them are quite disconnected. Disconnection means that the so-called network is broken, but we have never used such satellite information in our daily lives in society.

So, while we are contributing to these areas, we will use the information obtained from space in our daily lives. We are developing this area because we believe that our AI analysis technology can be used in such areas as disasters and macro analysis.

Lastly is the gaming area that utilizes AI technology. We have been using AI in smart cities for a long time, but in addition to such analysis in town or from space, I think it is also important to use AI in a virtual or fun way.

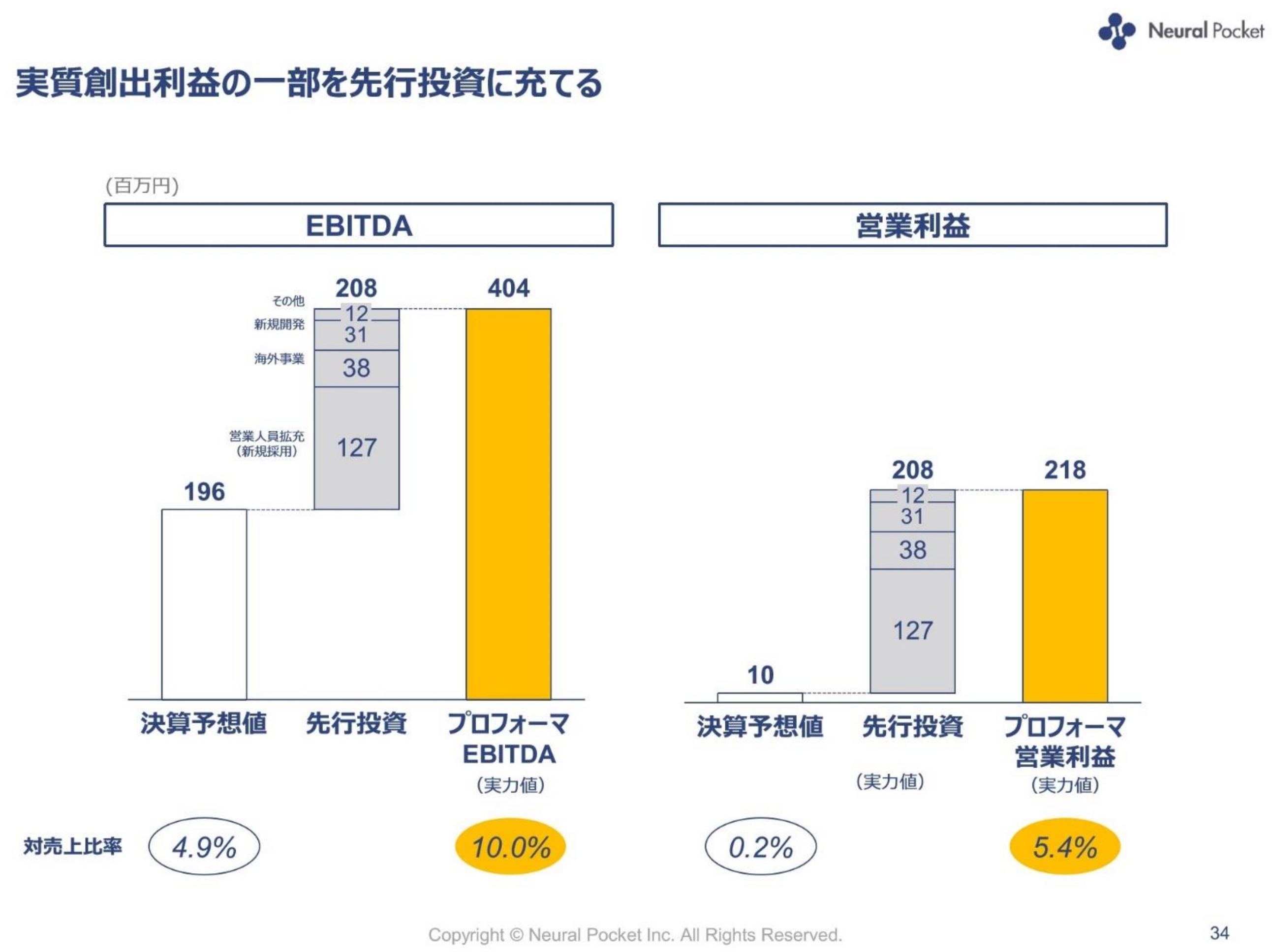
When you fight in an AI game, you may think you are fighting against AI, so in other words, it is an interesting game that you can enjoy without being aware of anything. The things in the virtual game space that we enjoyed can actually be consumed together in the real world. It can be seen in signage, and a smartphone can be linked using a QR code on the signage. I believe that this area of entertainment, where a series of enjoyable and convenient activities are connected, is one of the areas that we will be promoting in our company this year.



This is the earnings forecast. This year we have made the numbers with sustainability in mind.

As for sales, it is JPY4 billion. As for EBITDA, it is JPY196 million. As for operating income, we set it at JPY10 million.

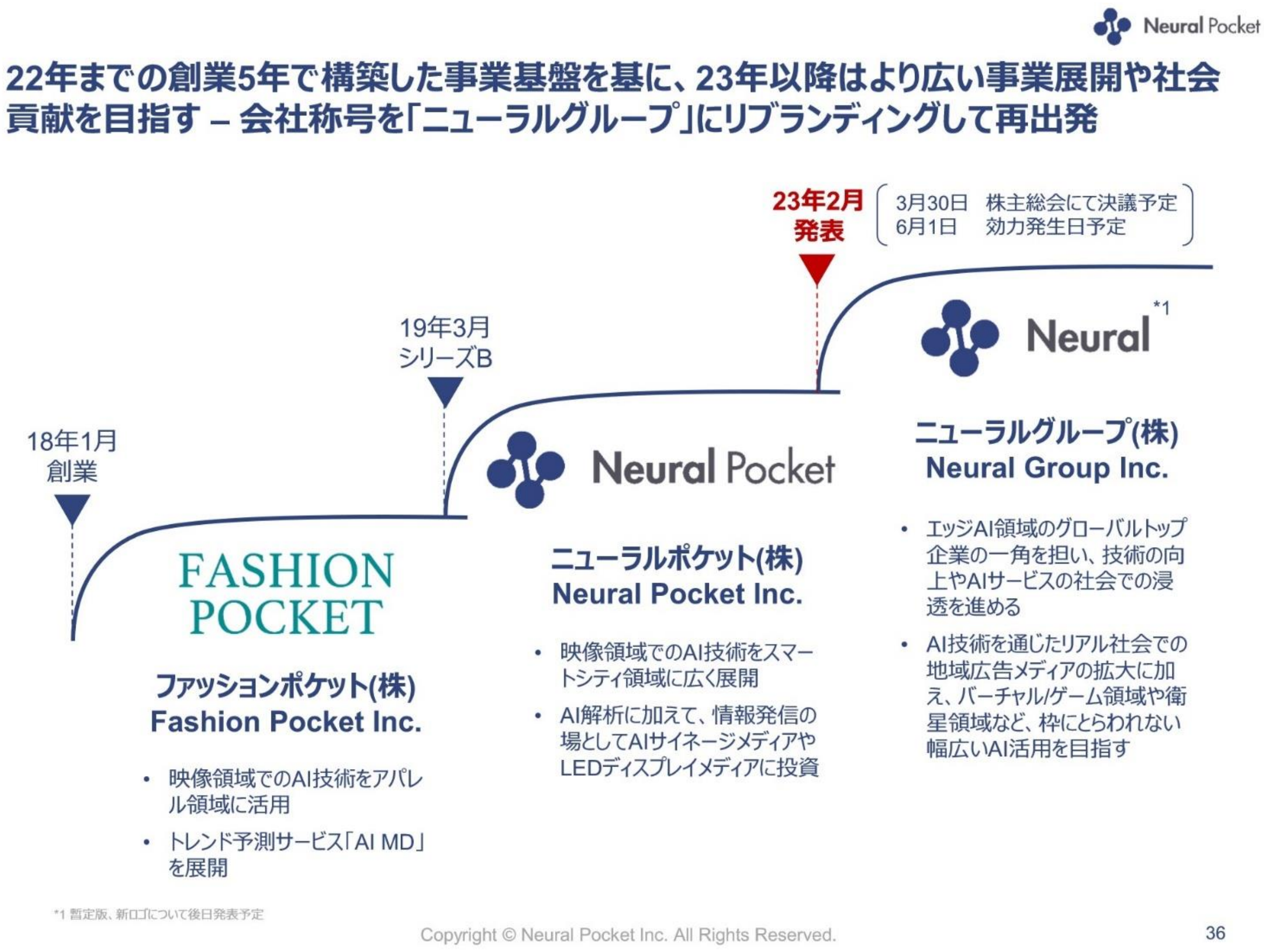
Based on the budget accomplishments of the past two years, this year we will be a little more flexible in our budget so that we do not have too many expectations in terms of numbers, and also so that we do not cause any more concerns. We hope that you will be able to judge the actual situation in this area in the course of reviewing our future financial results.



This one is pro forma for upfront investment.

In particular, while it is of course important to generate a certain level of profit, we are now in our sixth year of operation, and I do not think it is necessarily important to generate significant profits at this point in order to maintain a balance between growth and profit for our company. In order to meet your expectations, we will aggressively make upfront investments from what we can generate in profits.

With regard to the areas in which we are investing ahead of time, we believe that the most significant is the expansion of our workforce. We hire personnel and assign them to sales or to development. Also, I would like to spend some time improving such skills without necessarily expecting them to contribute to sales at the beginning. Although they do not contribute to sales during those few months, we believe that investing in such things will lead to a competitive advantage later on, so we consider hiring for this fiscal year to be an upfront investment.



Finally, we would like to have another resolution here at the general meeting of shareholders.

That is why I have mentioned the history of our company's growth in the past. Five years have now passed and, I repeat, we are feeling a positive response.

When we went public, two years and seven months ago, we had already established ourselves as a company, the seeds of our services were beginning to sprout, and we were generating a certain level of revenue. However, the social contribution and the actual utilization of the services were not to that extent.

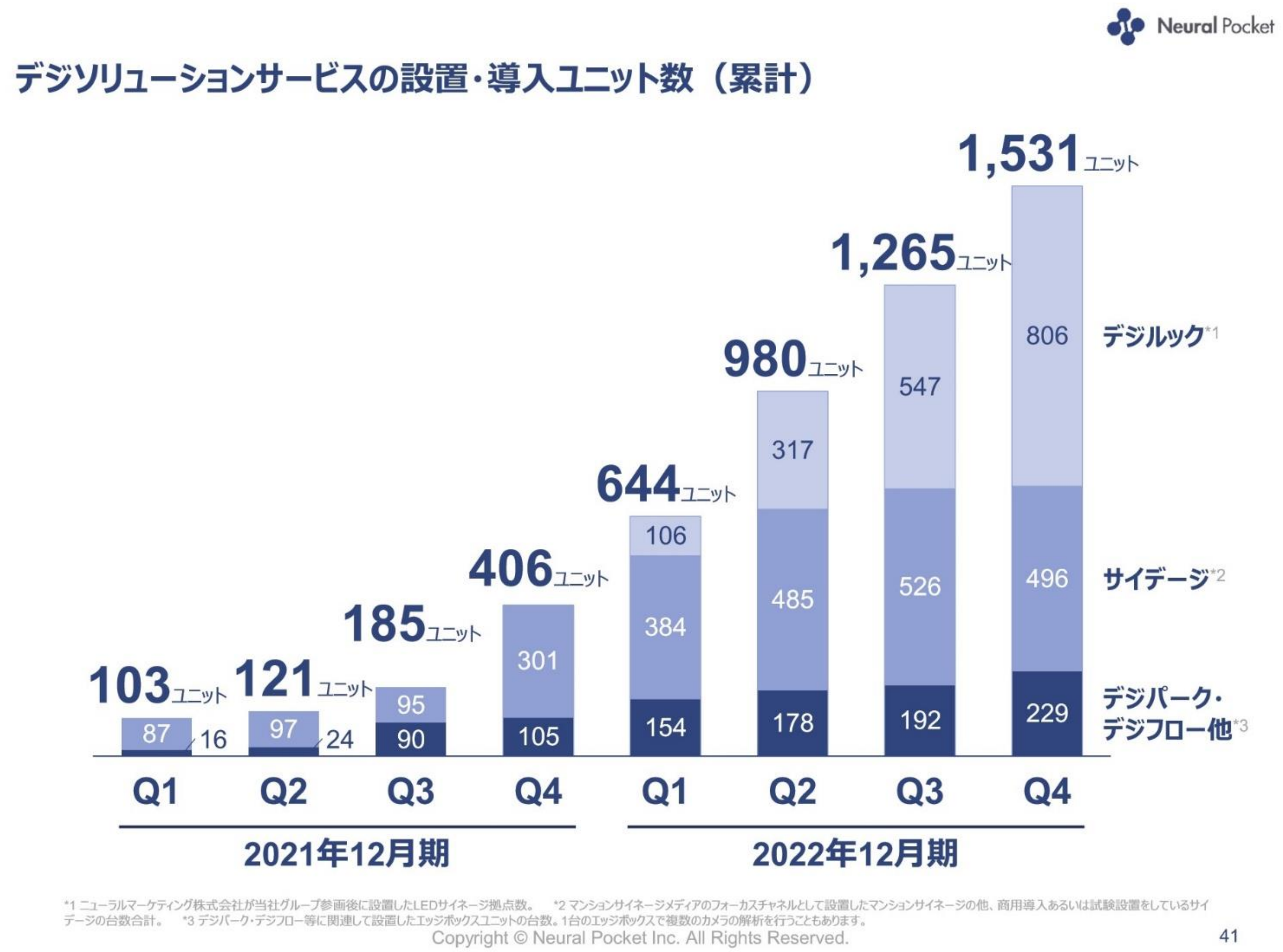
In the past two and a half years, we have been able to expand our services and generate revenue on a unit basis. We have become widely involved in smart city and town development, and I believe that we have created a company that will contribute to our ability to sustain and rapidly grow.

In this context, we have been calling ourselves Neural Pocket. I believe that we have come to be able to conduct a wider range of business beyond the area of AI and smart city companies and the area of linking signage with AI. At the upcoming general meeting of shareholders on March 30, we would like to discuss a change to a new name, the Neural Group.

We are looking forward to the expansion of edge AI, and there is no doubt about this, but we are not sure if we can become one of the top global companies in this field. In this context, in addition to remaining on the cutting edge of the world in terms of technology, can we continue to implement these AI services where they are truly used and have penetrated in society? When I think about whether this service will still be in use 10 years from now and whether it will be commonplace in society, the first one is to aim for that.

The second is the real society within such a smart city. Naturally, we have been creating local advertising media in the real world since Neural Pocket started, but in addition to that, I think we are required to utilize AI in a wider range of areas, such as virtual games and satellites. We would like to take on the new name, the Neural Group, in the sense of a company that provides services utilizing neural networks in a broader sense. That's all.

Across all services, DigiLook, SignDigi, DigiPark, and DigiFlow all showed solid growth.



The number of units is 1,531, but some may say that edge AI has not penetrated society with 1,500 units, but I think this is an achievement in the sense that the number of units has been expanded to over 1,000, whereas in the past, the use of such edge technology was limited to what was seen in demonstration experiments.

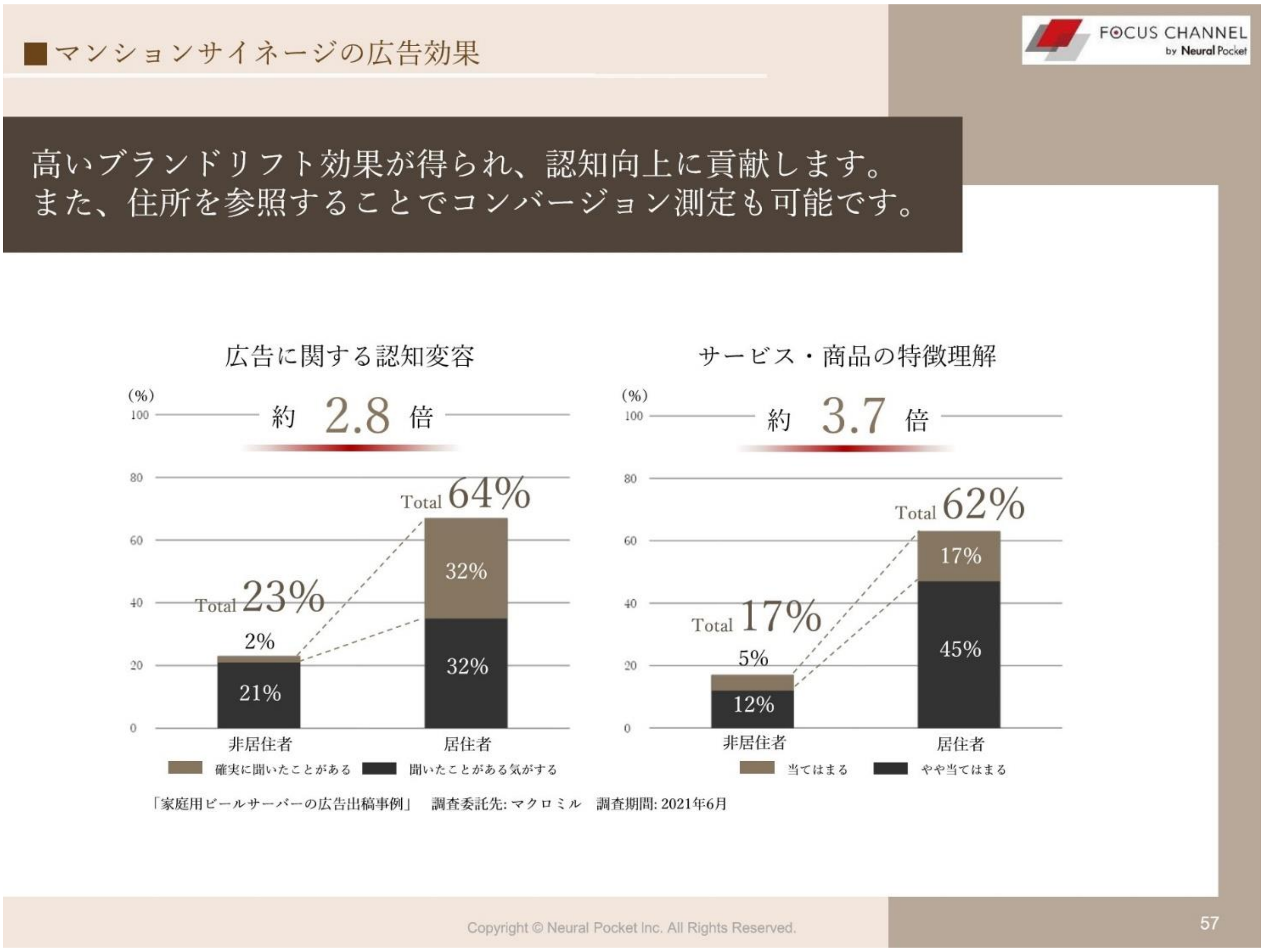
There is much town planning in this context. The program covers every corner of Japan, from Hokkaido to Okinawa. What is noteworthy about the program is not only its geographical spread, but also its content.

Some of them are disaster prevention areas, such as Sendai City, and others, such as Huis Ten Bosch, which is in Kyushu, are places of entertainment, supporting customers so they enjoy their visit to the amusement park. There is Muroran City. This has always been the case, but I wonder if a wide range of services, such as AI signage to encourage new consumption among citizens as the population declines, are being used to meet the respective social issues and social needs.

This is DigiLook. Such LED signage will also stimulate new consumption. We have always had signage for small businesses and government agencies, as shown on the right.

What we have been expanding recently in the Neural Group is the use of larger scale displays. On the left is an example of an advertising screen in a soccer stadium, and in Japan, scoreboards in sports facilities are naturally connected to the Internet, so that a variety of information can be provided in real time. We would like to put more effort into providing such real information for consumers to enjoy and connecting it to entertainment.

This is Focus Channel. Focus Channel condominium signage. The number of installations is currently 420 in metropolitan areas. We also feel strongly about this area, and we have received a reputation for the strong brand-lift effect of advertising through the Focus Channel.

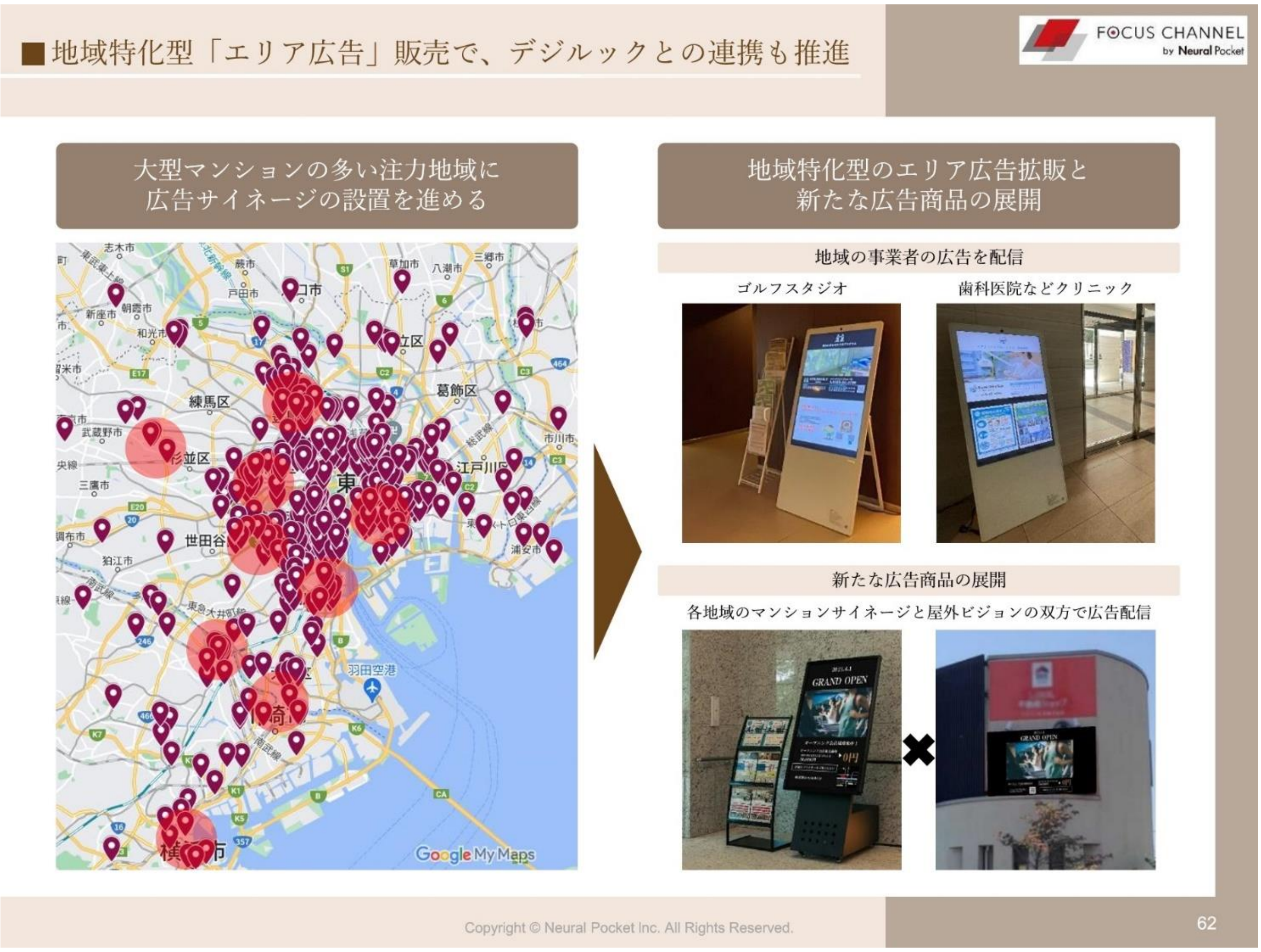


When you look at ads, you will see that brand awareness is about 2.8 times different between people who do not live in the condominium and those who do, as well as a 3.7-fold difference in understanding of services. So, we are actually using AI to analyze and watch the trends of the residents and feed those things back as well. While the use of AI is one thing, the most important thing behind this is that brand recognition and consumer awareness are connected and spread through such displays.

In the past year or so, we have been able to have a great number of companies and organizations advertise with us.

The nature of condominium advertising differs from taxi-like advertising in that it is full of B-to-C advertising. What information do you want to know when you go home or spend your holidays at home? The concept of the Focus Channel is to encounter new information that will enrich our lives, such as local advertisements, or information on regional hometown tax payments, which is not available in this area.

In such a situation, information on local specialties, local food, delicious, barbequed meat, other delicious food, Pilates, which has recently become popular, new exercise information, and golf information are being broadcast as advertisements in the condominiums. Residents recognize this as enjoyable information. This will have the effect of brand lift.



This year, we are installed at 420 buildings, and we would like to add about 50 additional buildings. In addition to the condominiums shown in the upper right, we would like to install outdoor advertising screen such as the one in the lower right.

So, that was last year's results and this year's forecast. If you have any questions, please do not hesitate to let us know.

Question & Answer

Moderator [M]: We are now moving onto the question-and-answer session. Shigematsu, Chief Executive Officer, and Tane, Director and Chief Financial Officer, will answer your questions.

Please state your affiliation and name before your question. We will limit the number of questions to two per person.

Well then, Kobayashi from Mizuho Securities. Please go ahead.

Kobayashi [Q]: Thank you for the opportunity to ask a question. This is Kobayashi of Mizuho Securities. I have two questions.

I am sorry to say that the first question is short-term, but I believe that delays in acceptance inspection occurred during the past quarter. This is probably due to very high demand, which in itself is not a problem, but I would appreciate a brief follow-up on why there was a delay in acceptance inspection.

I am not sure if there is a good way to put this, but is there some confusion in the field during the PMI process? Or I am wondering if there is another circumstance, etc., so please, this is the first question.

Shigematsu [A]: PMI is actually going very well, but one thing we have learned is that it is quite difficult for non-listed companies to undergo listing audits.

For non-listed companies, sales are made the moment they are considered to be sales, but for listed companies, internal controls are also quite important, such as evidence of various conditions that can withstand such sales, or the systematization of such sales.

In addition, I think we have eliminated a lot of the remaining training for acceptance inspection, but the scale of sales growth required of our company is quite high. From the investor's point of view, it is only natural that we should be able to do so. In fact, from the point of view of the members who are working on this operation, it is quite a challenge to triple the Company's sales, both for the Company after the acquisition of PMI and for the management structure of Neural Pocket on its own.

There is no confusion for PMI or anything like that at all, but it would have been nice if everything had gone more perfectly than expected in that situation, but there was a slight delay, but I think it is an essential issue. As for this one, I would be happy to promptly receive and inspect the remaining portions.

However, in the financial results, for example, it may or may not slightly cross December, or Q4 may have become Q1, etc. These may appear to be big problems from a numerical point of view, but from the point of view of the members who are conducting the operation, I think they were not big problems, to use the right word.

Kobayashi [Q]: Thank you. Regarding the second question, what is your sales structure?

You are planning to increase the number of employees by more than 70 this fiscal year. From my own perspective, from the outside, I think that the two mergers and acquisitions that have been taking place over the last year or two, have resulted in the number of people in the current sales structure. I am not sure if this is the right word, but I would like to ask for more details about the background behind the increase of the number of employees to over 70. That is all from me.

Shigematsu [A]: I think it is safe to say that the sales structure, if I may put it directly, will continue to be added to for years to come. Our goal is to achieve the scale of operations of Softbank or Uniqlo, for example.

Then, how many SoftBank salespeople are there? It is extraordinary. How many Uniqlo clerks are there? There are 800 stores now, and when you actually talk about the clerks in those stores, this is nothing compared to our company.

We expect our business scale to reach JPY4 billion in sales this fiscal year, but we are aiming for 10 times or even 100 times this amount, and we are looking to hire 70 people in the first fiscal year. We are not at all willing to say that because we completed it last year, we will finish it now, and that we will start from JPY3 billion to JPY4 billion, and then from JPY4 billion to JPY5 billion next year.

To be more specific, I think this is basically related to our business model, the way we do business, as I mentioned earlier. If we are talking about delivering services worth several hundred million yen centrally, we don't need this kind of sales structure.

We are aiming for sales in the hundreds of thousands to low tens of millions of yen in every corner of the country, and we envision that we will be able to sell this through AI services. In this context, we will expand our sales structure. We will take on a marketing firm.

In this context, there is a company called Neural Marketing, and we believe that the stronger this company is, the longer it will be in business, so I would like you to think that we are hiring 70 people for the first year.

Kobayashi [M]: Thank you for your detailed explanation. That's all from me.

Moderator [M]: Thank you. Does anyone have any other questions? Since there are no additional questions, this concludes the question-and-answer session.

Thank you for joining us today for Neural Pocket's financial results briefing for the fiscal year ending December 31, 2022. We will now end the meeting.

[END]

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Document Notes

1. *Portions of the document where the audio is unclear are marked with [Inaudible].*
2. *Portions of the document where the audio is obscured by technical difficulty are marked with [TD].*
3. *Speaker speech is classified based on whether it [Q] asks a question to the Company, [A] provides an answer from the Company, or [M] neither asks nor answers a question.*
4. *This document has been translated by SCRIPTS Asia.*

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