SoftBank Group Corp. : FY21Q3 Global Conference Call Q&A

Speaker: Masayoshi Son, Representative Director, Corporate Officer, Chairman & CEO

Q1:
Could you give us an update on which of the global Vision Fund companies you think have the best chance to succeed in the Japan market? And I wonder, given Japan, quite difficult to enter, are you seeing any delays in rolling out those businesses into Japan?

A1:
I think this is still too early for many companies. COVID is of course making it harder for them to open up their offices in Tokyo. So I would say most of our unicorns, they're busy in their own mother country.

Q2:
I had a question related to the LatAm funds following Marcelo's departure. Can you give us a view, will you continue to invest in LatAm? What is the plan for those units?

A2:
We would definitely continue to invest in LatAm. So far the team is doing great. I've communicated with key managers. They are energized and they will continue to invest.

Q3:
You've been mentioning in your calls for quite some time that you would want to maintain a policy of LTV below 25%. You are at 22% as of the last quarter. And I think January for technology names was generally not so fantastic, so you could be approaching there. Will you maintain that financial policy of staying below 25% and how important is it for you to maintain your current credit ratings under your financial policy?

A3:
We will maintain below 25%. It's important.

Q4:
Can I ask you what drives that 25% number? What are the calculations that you would think of why 25% is an important number?

A4:
In a red zone, we think that we should not go beyond 35% for any reason. To avoid going beyond 35% at any disaster scenario, which we give no excuse, going to 35%. So that means, in a normal environment, we have to try to manage below 25% so that we don't need to give any excuse in unusual situations. If we are below 35% in an absolute abnormal situation, like the Lehman crisis, then we are okay, we can sustain it. And of course, we always keep the cash for two-year bond redemptions. So, if we have two-year bond redemption cash in hand all the time and in the Lehman crisis kind of situation, if we are still below 35%, then we are absolutely okay under any circumstance. And so, if that's the case, to give no excuse to ourselves, we have to manage below 25% in a normal environment.

Q5:
I wanted to ask you a couple of things about Arm. It's very exciting to see that the company is going to go public again and that we will have the pleasure to cover it. And I heard your comments earlier today about how you are still very optimistic about the business and of course, given the environment and semiconductors in general, it would be difficult not to be optimistic about the business. But my question is more about where the company stands today and how it compares to, when you get to discover Arm and to work on Arm in 2016 and get into that deal, you had a vision at the time and over the few years that have elapsed since, did Arm perform in line with what you were expecting or differently?

A5:
From day one, we've acquired Arm and I said, we would privatize it and we would invest in increasing more products for cloud, automobile, and IoT. So we will expand beyond smartphones. Of course, within smartphones, we were preparing Gen-9. With the Gen- 9, which is upgrading from Gen-8, that took almost 10 years. So it's a big improvement, a big jump from eight to nine. The nine products start shipping this year. Arm is going to receive a lot of upside starting from this year through to 22, 23, 24 and beyond. Arm will have the baseline of good increase in revenue and profit. On top of that, new products, such as those for cloud and auto, take four years. Two years designing, two years for the chips to come out and go to the handset or other products.

Right after we acquired Arm, I thought it would be four, five years later, that Arm is going to start a big jump for expanding product lines. That's why I said the next IPO would be five years from our acquisition, which is year 23, that's next year. That means within this fiscal year, we are planning an IPO. Actually, we are accelerating to shorten the period to half a year or so. I was thinking that would happen in the middle of next year or maybe by the beginning of next year, we can have the IPO of Arm most likely.

For Arm, investment is in hiring engineers. Because there is no factory, or no inventory. It's developing new products. That means hiring more engineers. That's how Arm invests for the products. That was done intentionally from the day of acquisition. And from late last year, the products started coming out. Amazon starts using them for their cloud services. Once that happens, Google, Microsoft, Facebook, all those guys have to start using them to compete against Amazon. All the cloud service will be there, in all the automobiles with heavy computation for autonomous driving, any electric vehicle has level two, three, or four, that kind of autonomous driving capabilities. To do that, you need massive computing power. And that will be all Arm base, I think, because it requires a lot of computation, but at the same time they want to save electricity. Only Arm architecture can provide that. I was anticipating that all those things would be coming as a product, and starting grooming from the late 2021 to 22, 23. Those will be starting as a great lineup of new products. And when we acquired, we had no guarantee that those new areas where Intel had big success, the dominance, could we really be able to compete? In theory, we were thinking of that, but we had no proof. Now we have proof. A domino effect starts happening this year. I think a golden age for Arm is really starting from this year onward. This year, next year, year after next, the next decade will be a golden time decade for Arm. That's why I think it will be a great IPO.

Q6:
My question is regarding Alibaba filing. Will SoftBank sell Alibaba at this price level? What's the longer term solution on Alibaba?

A6:
We have settled a tiny bit of Alibaba shares. We did an Alibaba collar trade when the Alibaba share price was close to $300. So I think we did a good collar trade looking at today's share price. We had a choice of settling with additional rollover of the collar trade or settling in cash. We happened to settle in shares a little bit. I think it's a good option for us in the balance, but over 90% percent, we still own Alibaba stocks. It’s just a tiny bit, and we are testing a little bit of the optionality. I think Alibaba is still a great company.

Q7:
Last week Alibaba filed 1 billion shares with the SEC. Did SoftBank request for a filing, or was it done voluntarily?

A7:
It was not a request by SoftBank. We were surprised. It was done by Alibaba.

Q8:
What time period would you expect SoftBank to become an AI investor only. With nothing else, as in no telecom? No, nothing, no legacy anymore. Just AI investments. Whether it's Vision Fund or Alibaba, which you could consider somewhat AI or Arm, is there a timeframe over which you'd like to transition the business away from legacy towards just pure AI growth investing?

A8:
Alibaba is one of the best AI companies in China. They use AI all over. SBKK (SoftBank Corp.) is a telco, but SBKK's vision and strategy, the direction is towards the “beyond carrier” strategy that they keep on saying. That means they use the infrastructure and customer bases of telecom and mobile customers, but they are migrating very quickly to provide so many AI services in Japan. As I kept on telling in Japan, are there any great AI unicorns? The answer is no, it's very small. Who has the most AI engineers in Japan? It's Yahoo Japan, LINE, and also SBKK. They now have lots of AI engineers. When you bring the Vision Fund unicorns into the Japanese market, who is the best partner to land their service into Japan? It's the SBKK group, including Yahoo Japan and LINE. So I think it will be a good incubation platform for AI services in Japan. Looking at Vision Fund companies’ expansion into Japan, PayPay is a good example. It could never have been successful without PayTM, which is e-payment in Japan by themselves. It has been very successful because it has partnered with SBKK and Yahoo Japan. Now LINE will be on top of that. I think PayPay has almost 70% market share for the e-payment in Japan in just three years. That's a great example. And more of those things will be coming because we have SBKK in our group.

Q9:
Except for the fact that there's a lot of capital tied up in infrastructure, which is not exactly the focus of the group. So arguably the capital that's tied up in the telecom infrastructure could be used for investments in more focused areas.

A9:
They have the cash cow situation. So they pay a high percentage of dividends, of which we are the recipient. We can utilize the dividend for our investment in Vision Fund. The company itself is a cash cow. As I said, they can incubate many AI unicorns in Japan. And look at PayPay, as I said, as an example. They

invest, Yahoo Japan invests, and we invest. It's a three-party joint venture. That kind of model can be expanded.

Q10:
I saw you have a new video highlight or comment on the results and in that you talk very enthusiastically about share buybacks. Could you talk a little bit about valuations? They seem to be quite depressed in the tech sector on a temporary basis, but with your long term investment horizon, that would suggest that now might be a time to accelerate buybacks. How are you thinking about any real risks for your companies at the moment?

A10:
I don't think we have any major risk. I think the share price has a very good discount and our LTV is at 22%. We have to carefully balance our share buyback, which we will continue. We have lots of public stocks, which we can utilize to liquidate some, to do buyback, but also we have private stocks of unicorns. In the next three to six months, I think the valuation multiple would be cheaper. We have all those opportunities, we have to keep the balance, look at the balance and then decide. But all these are great options for us. And when we have the Arm IPO, we'll have more dry powder for all kinds of those options.

Q11:
If you are surprised at Alibaba's SEC filing, if not SoftBank selling the shares, I can only imagine it would be Jack Ma and the management selling shares. As the largest shareholder, are you worried, and what's your reading for their registration? Why are they doing that?

A11:
I have no idea. It could be some small number of employees or what. I just don't know.

Q12:
I want to ask how your companies feel about perpetual bonds. How do you view the callability of the bonds? Do we expect the company to call back the bond on the first call date, or it will be pure economic-based analysis?

A12:
Regarding hybrid and perpetual bonds we will be calling at the first call as promised. Regarding the issuance, looking at the environment, we see some interest rate hikes. We would like to see the market and demands and decide. At this moment, we don't have any specific decisions or the plans to issue, but we will consider.

Q13:
With regards to the management's co-investment in Vision Fund 2 and LatAm funds, in the release, it says that the participation by members of management, other than yourself, was undecided on January 31st, however, such participation is planned for the future. Could you clarify which management members will likely participate with you? What are you waiting for and what is the hold up? What is the situation with if that could be going forward?

A13:
I would like to bring Rajeev as an example. He has contributed a lot. Most other key managers have the

programs we already have. But I would like key managers to have some risks, but good rewards. I take most of the risk. I'd like to invite some key managers to get incentivized, to have a success of the investments. If you look at the typical venture capital, which we are competing with, in Silicon Valley, there are famous venture capitals, they usually take 2% management fee and 20% or 30%, good ones taking 30% or 35%, of carry. We operate Vision Fund as a corporate fund. So we are not distributing 20% carry. We have some incentive programs, but the key managers like myself or Rajeev, and so on, we need to have incentive programs as we are not delivering carry. Instead, we are taking risks to invest. So I think it's like a co-investment. It's a good thing to align the interest with taking the risk at the same time.

Q14:
Would you expect them to commit their own capital or would SoftBank help facilitate the commitment of capital?

A14:
First, I am taking a 100% risk myself. I want some of the executives to take some level of risk. I want them to take some risk, not the full risk, the short of the risk I cover for them. I take 100% if they take some risk, I will support the remaining risk so that they don't have to take full risk. I want them to take some risk,not the full risk. The short of the risk, I cover for them. But from SoftBank shareholders' point of view, it's fully risk taken by the management. So I think it's the most fair incentive program from the shareholders' point of view, considering that usually management takes 20% carry with zero risk.

Q15:
Could you share your view on investing in China in this environment? I know that for new investments, you are more focused on B2B pivoting away from consumer oriented areas, but I was wondering, based on your recent conversations with portfolio companies in China, have you gotten any more clarity on what Chinese government is doing and what the rules are rolled out going forward in terms of investing and also within B2B and non-consumer that you're focusing on now, what sectors do you see as most promising going forward?

A15:
I don't know any details about the Chinese government policies. I'm waiting for a little more clearance. Meanwhile, there are so many great young entrepreneurs in China. The technology on AI is fantastic. So we are investing in some safe areas. I think that's B2B, medical, and robotics. They have no data security issues. The domestic business in China has no major Chinese government issues as a subject. That's what our local management in China suggests. So there's no question of the risk and much safer for us to invest. And those are usually much smaller companies, not the massive consumer services. So our ticket size is smaller but they are growing very quickly. They have very good technology and very good entrepreneurs. So it's not gigantic, but I think we will make a healthy return on investment.

Q16:
I have a slightly different question about the overall market situation and conditions. Some people say we are in the middle of a tech bubble, but having experienced the ups and downs and having navigated a lot of them in the past, how are you advising your teams and how would you advise a startup company? What things to avoid and what things to do? When everybody is chasing the same tech companies and investment ideas, how would you go about it?

A16:
First your vision should be right. Your strategy should be right. Your business model should be right. Your team assembly should be right. Your morals should be right. When you have all those great things, you have a good chance of success. However, unexpected things always happen. The market conditions drastically change or competition drastically changes. The technology could drastically change, or you could have accidents in the company. There are always some risks that you don't know. Are you anticipating those accidental risks for whatever reason? Are you always thinking of that? And when a tiny symptom of such a thing comes, can you change direction? Can you stop immediately without fear, without considering the momentum of just continuing? Can you decide to lose your credibility, your faith issues, your pride issues, your all kinds of other issues? And can you escape? Can you stop the damage? People call you a coward and say that you have no patience. People criticize you a lot when you try to escape. Can you still escape? Two years ago, as an example, when COVID-19 started to hit, many people said it's just another form of flu and underestimated it, but I was very scared for the worst case to happen. So I said we have to escape. We have to protect. We have to prepare for the worst case scenario because this could be a disastrous pandemic. That's why I decided to have liquidity of $40-45 billion. I decided and I even decided to sell Arm, which I didn't want to sell at all. It was my passion. But even with my most important crown jewel, I decided to sell. I committed to selling all kinds of assets and have liquidity in 12 months, which I overachieved in six months. I also overachieved the amount by 50%. So, when you have some small symptom of feeling of danger, you should not be afraid of people calling you a coward or losing credibility to the employees or the customers. In Japan, people are especially concerned about face issues, but I would say that as long as we are alive, it is not the problem. Many of my competitors could not survive when the net bubble crashed, or in the Lehman crisis in the last 40 years. More than 90% of my competitors are either gone or became irrelevant. We survived and continue to survive. That's why I'm checking our LTV four times a day every day. Because I'm a coward. I would say the brave man should be a coward at the same time. When you are prepared for the worst case scenario, you can also step on the gas like F1 drivers who put both feet on the acceleration and the brakes at the same time and step on so many times. They know how to put the brake, so they can put the acceleration.

Q17:
You did execute the asset sales quite fast. But I was more surprised with how you managed to get out of T-Mobile because there were some restrictions on how long you had to hold it. But even then you managed to negotiate and get out of that was quite remarkable.

A17:
Yeah, that's a great example. Even though on the surface we have limitations, we can always negotiate. We give them something that they want, so that we can still negotiate to have more liquidity. We'd be very creative to achieve our target. As I said, in my last 40 years, many of them, especially Japanese companies, have had pride issues. My only pride is that I have to survive for the next 300 years and continue to succeed for the next 300 years. That's only my pride. Whatever is put on my face, I don't care as long as I survive.

Q18:

Now when the Fed is raising rates and people are worried about inflation. There are lots of uncertainties about tech valuations, which have corrected a lot in the last few months versus what happened in 2000. In investor sentiment and valuation, what are the similarities and dissimilarities you have noticed since?

A18:
People say a company with high growth is more volatile. In the volatility, you may not be able to survive. But look at the reality of the last 20 years. Which company actually went bust? Surprisingly, it's not that many technology companies. It's really all the incumbents. They became obsolete and they are basically gone. When their business model becomes so old, that's when they cannot survive. The multiple may change drastically for growth companies, but you fluctuate and then you still grow. If you don't have that much fluctuation yet going down steadily -which one has a better chance of surviving or success? And if you have only three companies or 10 companies, less fluctuation, slowly going down, and some of them survive. And you may call it safer, because it's slowly moving, you can decide to escape. Maybe you characterize it as slow, safer, because you can jump off. But very often, when you jump off, you are actually losing by jumping off. And if you have only 10 companies in the high growth company, it's so volatile that actually four or five, six of them may not be able to make it. But if you have 100 companies, if you aggregate the fluctuation plus fractionation, but in total the group is growing vs total bunch is going down, which is safer? I say only one thing about Internet companies in the last 20 years. The share price and multiple went up and down, but the total traffic of Internet usage never went down in any single year. It only went one direction, up, up, up, every year. There is no single year it went down. And it exponentially grew. Internet traffic, number of users, and activities only went up. It's like a shadow of your body. You know, at 9am, 12pm, 3pm, the shadow of the body changes. To me, it's like a stock market price. But the actual body, three -five-seven-12 years, every year you're growing to be bigger. The shadow size does not matter, as long as your body is actually growing. That's the growth of the internet to me. It's safest that you can predict the use of the Internet only going one direction. Use of AI is only going one direction right now. Only one direction. That's the safest bet I would say.

Q19:
People will also consider lots of other companies which did not have genuine business models which went bust. But as you rightly said earlier on a previous question you said you'd need to make sure they have the vision and the strategy. They have the team, their morale, they should have a business model. So even now a lot of people do question rightly so a lot of these facts which have come up some of them randomly. So the fluff is still there. We can see valuation fluff in a lot of companies right now, somewhat similar to that time. There are worries about that also getting reflected into SoftBank investee companies and then into SoftBank stock price as well indirectly.

A19:
So, in the year 2000, the same discussion was there. It was a bubble. Internet company bubbles, and unexplainable multiples of revenue as the valuation. None of them were making profit, none of them were making free cash flow. So people say this cannot be explained. And it's a bubble and many companies actually went bust but the one that survived actually increased the value by 100x 1,000x. So in the total group, the value, from the peak of the net bubble of the year 2000, today is 50 times bigger in most companies. So I say you have to still see the big trend and if you are investing into the early stage companies, it could be more dangerous because you cannot see many. You are seeing only the business model, business plan, and the management team. You cannot see the track record of that logic and say, Oh, by the way, can you really deliver the customer, and can you deliver revenue and gross margin. If you are investing into early stage companies, it's very difficult to see. That's why we have focused on the late stage company where we can check the track record of actually how many customers they got, what is the revenue, what is the gross margin and are they sustainable, what is the churn rate, what is the net retention rate? What is the customer's lifetime value over customer acquisition cost? What is the

multiple? We can check all those kinds of things matrix to see if this investment makes sense or not. We can much more scientifically decide instead of just hunch.

Q20:

Could you share your goals for Arm before they go public? What, in your opinion, do they need to accomplish operationally, strategically, maybe on the cost structure side in 2022 to have a successful IPO in early 2023?

A20:

Year 2022 for Arm would be a great year in terms of revenue, profit, and product line. Year 2023 would be even more exciting, that we can already see. One good thing about Arm is that a customer signs the contract two to three years before the product actually comes out. So we have visibility for the next two to three years of revenue. We have the visibility of the royalties we are getting for the next two - three years. Once you win the design, let's say in the data center or cloud, once you win the design of the next generation of the facilities, you almost know how much royalties you are receiving. When we sign the license agreement, we already win the design for the next handset, for the next cloud, for the next electric vehicle. So we now have lots of visibility for the next several years. And that's why I confidently say that the next decade is the golden years. Arm will be a fantastic company. I have a strong confidence about that.

Q21:

Could you give some guidance as to how you're thinking about the broad SoftBank portfolio, whether you are seeing more opportunities for new investments or you would look for more opportunities to divest stake and use that cash for improving the capital structure? How should we see your balance sheet evolving?

A21:

We have so many companies that have already gone public and we have so many IPO lineups in the pipeline for Vision Fund. So we have many options. We will be definitely selling some of the assets. Which asset and by how much? It all depends. We will definitely be selling a good chunk of assets. We have divested some assets in this fiscal year and also in the last fiscal year. So we will continue. As I said, we have already sold $30 billion worth of assets in Vision Fund. We have sold the T-Mobile shares and original Sprint shares and many other assets. We have even sold some shares of SBKK. We would continue to sell our assets in the public market gradually, steadily and in an ordering manner so that we don't shock the share price. And then we would do the share buyback. We would do the new investment and so on. As I said, Arm is having an IPO. So we have additional liquidity from that angle also. So how much we invest depends on our LTV. It also depends on our pace and the size of share buyback. But as I said, we always watch our LTV every day and respect that first. It is our first priority. We must have cash for two-year bond redemptions, which is a lot of cash that we reserve. So our top priority is the cash covering two-year bond redemptions and LTV below 25%. When we sell our assets, we utilize the proceeds to protect those financial numbers. Whatever is left over, we can invest for the share buyback. Share buyback to me is one investment. We do share buyback and new investment in Vision Fund opportunities but those are only left over from the first protection. On top of that, as I said, the Arm IPO is coming to give us additional liquidity.

Q22:

In the past, you've always mentioned that share buyback is a way of returning cash to the shareholders and also mentioned that it could be linked to asset monetization. Now, the Arm-NVIDIA transaction didn't go through unfortunately, but now that you're going for the IPO. How should we think about the timing of share buybacks from here? Is that going to be linked to progressing Arm IPO or whether it's going to be linked to other SVF, et cetera, related monetization that you could be doing?

A22:

Now I'm feeling comfortable enough that our share buyback that we have already announced is going to happen within the period. So, regardless of Arm IPO timing, it's happening. The Arm IPO would only help additional options.

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