SoftBank Group Corp.: FY23Q1 Global Conference Call Q&A

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Presenters:

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Speaker 1

Q1:

On the investing outlook. You say you are getting more aggressive. I assume we will see more private investments in the Vision Fund. How big is the pipeline that you are currently looking at? What kind of percentage hit rate do you assume? Are you looking at 100 companies or 200 companies?

A1:

(Govil) In terms of the pipeline for Vision Fund II, we are not going to comment on the specific number of companies we have in the pipeline, but I can elaborate on what are some of the criteria or what are some of the things that we look at.

For instance, we look at the quality of the technology stack of the company. We look at the size of the addressable market. We look at the unit economics. We look at scalability. So, if a company has a good technology stack, a large addressable market, positive unit economics, and it can scale, that makes it very attractive to us and it is a next-generation, AI-focused company.

Q2:

The second question is for the Arm IPO. In principle, will SoftBank Group be selling? If so, what are the potential uses of cash? Will this change the outlook for a share buyback or not?

A2:

(Goto) Regarding Arm and any offerings on the IPO, I have no comments. I cannot discuss that. Of course, it will be either the Vision Fund or SoftBank Group, but that is all I can say for the moment.

Speaker 2

Q1:

I am hoping to understand what kind of guardrails or protections that you set up around the investments that you are making going forward. The context of that is that you said, “We are shifting to offense, but we are going to be very careful.” I understand the metrics that you are looking at in terms of tech stack, etc. What I really want to understand better is the process in terms of investment committee, who is making the decisions, and things like that.

A1:

(Govil) As you rightly pointed out, the guardrails are those four things that I mentioned, which is the tech stack, the size of the addressable market, unit economics, and scalability. In terms of the process, we have investing teams that are led by various managing partners that focus on certain geographies or sectors. They are responsible for sourcing deals. We have pipeline calls typically that take place on Mondays where, once they have sourced a deal, there will be an initial discussion. Then after that, we typically have a number of internal reviews. There is diligence across various functional areas – legal, compliance, finance, etc. Then, we have what is known as a pre-investment committee (pre-IC) call where there is a robust discussion that takes place. Then, we have an investment committee call.

On the investment committee, depending on the size of the investment, we typically have a number of our investing managing partners that are part of that investment committee and have a voting on that. Depending on the size of the proposed investment, Masa is part of the investment committee as well.

Q2:

The second is a lot different. Talking about generative AI, I know you have talked about AI and there are different sorts of flavors of that, but generative AI is what has everyone excited. Your group companies are sort of taking a mixed approach. Z Holdings has signed up with OpenAI. They are using their API to develop tools that are being used internally. But SoftBank Corp. has created a company that is going to do the large language models in Japanese, so they seem to be taking more of an in-house approach as opposed to going outside for the application. What I want to understand is whether SoftBank is going to create a whole set of competitive generative AI tools, or at the very least understand, from the SoftBank Group perspective, where you sit in this and how you are guiding your group companies.

A2:

(Goto) Of course, we are keeping the same policy which is to focus very much on AI. The Vision Fund is the same as that. Generative AI is one of the areas of AI investment targets.

That is not the only one. The examples that I mentioned at the earnings for the last three months coincidentally relate to the logistics area, but that is not the only sector we are looking at. Actually, we are also looking at manufacturing and generative AI. AI itself actually redefines all the industries and sectors. That is how we look at it. Based on that, we will keep widely looking at the areas and select investments with a focus on how much value the company will create through AI.

Q3:
Just to follow up on that to make sure I understand, you are pretty much agnostic about what your group companies do with generative AI in particular. If Z Holdings wants to go out and pay for the tools, that is okay. If SoftBank Corp. wants to develop them in-house, that is okay. Am I right in understanding that?

A3:
(Goto) We are okay with that. Z Holdings and SoftBank Corp. are listed companies. They have their own independent decisions on investments or business developments. I think that is okay with us. SoftBank Corp. and Z Holdings are mainly doing business limited to the Japanese domestic market, and SoftBank Group is rather looking at a wider scope which is global. So, the size or the target may be different.

Speaker 3
Q1:
Navneet, this is a question for you. You mentioned that while investing, you will be applying the four criteria including technology stack, unit economics, addressable market, and scalability. Can you provide additional details as to which of these four were not being applied earlier? How is it different from before?

A1:
(Govil) It is similar to what we had been doing earlier. There are a couple of things that have changed over the last six years. If you look at Vision Fund I, we did have large, concentrated positions in certain areas like ridesharing, for instance, which we did not have in Vision Fund II. Now, when we look back at Vision Fund II, some of the entry valuations were quite high and a lot of those companies are growing into those valuations. But the overall criteria are the same. It has not fundamentally changed.

Q2:
(Speaker 3) The second question is also linked. It is about key takeaways and lessons over the years. I remember two years or two and a half years back when Vision Fund II became more active. The lessons that you mentioned from Vision Fund I were, firstly, you already mentioned lower concentration, etc., but secondly, you also mentioned actually

smaller-sized investments, so for most of the investments, the ticket sizes were much smaller in Vision Fund II. Now that you have some experience with Vision Fund I and II both, are there any additional lessons or takeaways for future investments?

A2:

(Govil) Yes. As I mentioned, in Vision Fund II, some of the entry valuations, when we look at it now in hindsight, they seem to be high. These are some of the things you only see sometimes in hindsight. It is not just us. It is other venture capital firms that were investing in 2020 and 2021. When a lot of these bull markets continue for a long period of time, you could argue there were some people in the firm who felt, when we were investing in Vision Fund I, that in 2017, 2018, and 2019, the markets were not high. But they did not peak in 2017, 2018, and 2019. They peaked in 2021. So, some of these things, you can tell in hindsight when you look back, but as I said, our portfolio companies in Vision Fund II are really good portfolio companies that are doing well. That is why I highlighted in our presentation and Goto-san highlighted in his presentation as well, how some of these companies in Vision Fund II are leveraging AI – companies like Picsart and PayPay and Jobandtalent. PayPay uses predictive analytics to analyze payment data. Jobandtalent is using AI chatbots to connect jobseekers with companies.

To broadly answer your question on some of the other lessons we have learned, when a company does well, we do follow-on investments. A good example is DoorDash. We did our initial investment in 2018 for 280 million. Then in 2019, we did a follow-on investment of 350 million. The MOIC on DoorDash is seven times. If you look at Coupang, our initial investment was in 2018 for 500 million. Then, in 2019, we did a follow-on investment of 1.5 billion. The MOIC on that is about 3.6 times. Goto-san talked about Symbotic today. As Goto-san mentioned, we did an initial investment in Symbotic. It is a company that has been doing great, so now we made a follow-on investment in a joint venture. Those are some of the things I think that we are focusing on and are some of the lessons we have learned.

Speaker 4

Q1:

We saw a slide this quarter that focused on the ecosystem flywheel potential of the portfolio and its various holdings. I was wondering if there are any particular pockets that you feel you are currently underweight in being additive here to the flywheel and having a greater “sum of the parts” essentially, and how that informs your investment process right now in terms of incremental investment and ramping up the offense mode.

A1:

(Govil) It is not about being underweight. We are not trying to allocate to a certain sector. We do not have sector allocations. We look at opportunities in every sector and we look at valuations in every sector. Quite frankly, for some of the companies that we have seen over the last 12 months in generative AI, we felt some of the valuations were quite rich, so we have not done that many investments in that particular space. So, we are not targeting sectors per se or looking to be underweight or see if we are overweight in any particular sector. We are just looking at compelling opportunities at the right valuations in each of the sectors.

Q2:

(Speaker 4) Is there a particular pocket of new tech where you are seeing your ecosystem flywheel effect be particularly effective right now? Is it AI or is it something else?

A2:

(Govil) It is absolutely AI. If you look at what Goto-san presented, some of the recent investments are in robotics and warehouse automation. We see those as some very promising areas.

Speaker 5

Q1:

Mine is about the balance sheet. You are running obviously now with a very large cash balance and very low net debt versus a year ago. It looks like the outlook of the economy is somewhat more predictable, and it is a very expensive time to run with such a high cash balance. I am wondering from a treasury perspective, how you think about that with regard to capital allocation. Does it make sense to pay down more gross debt, or do you think it is just a matter time until that cash is deployed for investments or shareholder returns? Any way you can help us think about how you balance that, or are you just thinking now SBG should run with more cash and a lower net debt balance than it has historically, if that is the best way to run the business from a risk management perspective?

A1:

(Goto) Our current balance sheet I believe is in a very safe position at this moment. Rather, I should say it is too safe. The loan-to-value is now 8% which is not good because, as an investment company, we are not doing our job. We are sending a message that we are shifting to offence mode and resuming investment activities. Depending on the pace of the investments, I believe LTV can be a bit wider gradually, but still, we would like to manage that within a safe level. That is something that I can show.

On top of that, shareholder returns are one of the important agendas for the senior management of the company. Looking back at the history, in the past five years, a huge buyback of 4.5 trillion yen has been executed. I believe that is quite a large amount compared to the rest of the world. A balance sheet improvement has been also executed in the past two years. Gross debt has been reduced quite largely. About two trillion yen of gross debt has been reduced in two years so far. Probably, the buyback of bonds and anything in the market would be the only option that we have to reduce the gross debt at this moment. That is how we believe that we have been executing the reduction of debt so far.

From now on, a balance needs to be maintained with the equity investors and shareholders, as well as the credit investors. In addition to that, we would like to consider and look into new investment activities which will contribute to the enterprise value. Therefore, we would like to make the best mix and balance of those three – share buybacks, financial improvements, and new investments.

Speaker 6

Q1:

Just at the AGM, Masa talked about how he was focused on inventing and that he had done some 600 inventions and was filing patents. Goto-san, is that still happening? Is that what he is focused on from here on in as well?

A1:

(Goto) That is his job. I think it is beyond a hobby, but this is something that he is very good at. Of course, whenever there is an opportunity for a patent application, including business model patents, probably we should go ahead and apply for it. As for whether or not we have an effective patent for the business, we believe it is not a high possibility, but at the same time, we believe we always need to keep in mind that it is kind of Masa's entrepreneurship which is something that we should show respect for.

Q2:

(Speaker 6) I suppose it relates to the earlier question. Is he spending his time on doing the new risk-on investments to Vision Fund II, or does it really sound like he is not that involved?

A2:

(Goto) Well, he has been involved in Vision Fund II investments. As he is a member of the investment committee of Vision Fund II, he is deeply involved in that too.

Q3:

(Speaker 6) Just to clarify, I read the slides on WeWork. Am I right in understanding there was a further investment in some debt instruments to WeWork in the quarter? Is that correct? If so, I am trying to rectify that with Masa's previous statement saying he would not put any more money into WeWork. Is that incremental capital?

A3:

(Kimiwada) I believe that you are referring to credit support, if my understanding is correct. Actually, everything is already signed and agreed. It is not a new thing or a new support, but debt restructuring for WeWork has been conducted at the beginning of the first quarter. Based on that, there is some support.

Q4:

(Speaker 6) So, there is no extra capital that is going into the company?

A4:

(Goto) Your understanding is correct. At the very least, SBG has already made its stance clear that it will not provide bailout investments.

Speaker 7

Q1:

As the company turns back into offensive and investments will focus on AI, I wanted to ask the progress on the AI ethics policy development and also how this informs the investment decisions going forward.

A1:

(Goto) We have been very careful about setting such AI ethics at this moment. In our board of directors, we do have Dr. Matsuo who has a full knowledge of AI. Therefore, as for what kind of policy the company should have for AI ethics, because generative AI is in progress and under development, we would like to hear various angles and opinions of scholars, experts, and government officials so that we will be able to structure and build the best AI ethics for the company.

Speaker 8

Q1:

Can you give us more color on SVF1? We believe there are some unrealized gains related to Arm and there are other unrealized losses, so can you quantify the two?

A1:

(Govil) A couple of things on SVF1. Actually, we have a slide in the presentation. I am going to tell you which one that is. It is slide nine which gives you the breakdown of SVF1. 102 billion is the fair value. We invested 87.8 billion. Of that 102 billion, 44 billion has been exited which includes companies like Uber. There is 20.5 billion which is public, and that is companies like DoorDash and Coupang. The private portfolio is 37.5 billion, and that includes companies like Arm.

Q2:

(Speaker 8) My question is, there is a gain related to Arm and there are unrealized losses related to some other investments, so I wanted to get a quantity of both. How much is the unrealized gain related to Arm specifically in the quarter? If you exclude that, what are the unrealized losses on other private investments in this quarter?

A2:

(Govil) On this quarter, we show it on slide 11. On slide 11, you will see that Arm is in Frontier Tech. In the Frontier Tech sector, we show an 800-million gain, so a lot of it is driven by Arm. Proptech has about an 800-million loss which is primarily WeWork. Logistics is about a 200-million-dollar loss which is primarily Nuro. Then, you can see the others are very small.

Q3:

(Speaker 8) Just on Arm, one more question. It was a bit surprising to see a valuation mark-up, given the results, because you had an 11% decline in sales and a 19% decline in royalty revenues this quarter. I understand that you are using other listed companies as a benchmark. I just wanted to understand the dynamics there. Also, can you give us roughly an idea about which companies you are using as a benchmark?

A3:

(Govil) Yes. As Goto-san said earlier, given that Arm is going to be filing for the IPO and we are in the quiet period, I cannot get into too many details about that. I think you are going to see a lot of that when the filing comes out. You will see what the competitors are. It is going to be named in that. But in general, what we saw in the June quarter was an expansion of multiples in that sector and the relatively strong performance of Arm. It was a modest gain in valuation that we recorded.

Q4:

(Speaker 8) When you said a “relatively strong performance of Arm,” as the numbers show, Arm’s performance is not strong, right?

A4:

(Govil) Well, as Goto-san mentioned in his presentation, the sector was down in general. A lot of the other companies in this sector reported top line coming down, so it is relative to that.

Speaker 9

Q1:

This is a question for Navneet about the private companies in Vision Fund II. I think they moved up slightly. I know it has been a very tough time, but could you comment a little bit on the feedback you are getting from founders around taking new rounds of funding? Because I recall before. That can be an important valuation marker, but many of them were cautious about taking down rounds. Any thoughts on how the increase in the public markets has affected their ability or interest in taking more funding?

A1:

(Govil) There are a couple of things. If you look at our portfolio, 93% of the portfolio has a cash runway greater than 12 months. That means that not that many companies need to raise money or do follow-on rounds. Having said that, ultimately the strong performers, if they need to, they can raise follow-on rounds. But your general comment is still true that founders do not want to do down rounds for a couple of reasons. Number one is that it creates dilution. The second thing is that it is bad for employee morale. Having said that, some of the companies in our portfolio that have wanted to do follow-on rounds have been able to do that at good valuations.

I can give you a couple of examples. GetYourGuide did a Series F round at a two-billion pre-money valuation. Klook did a Series E round at a pre-money evaluation of 1.6 billion. Mapbox did a Series E round at a 1.3-billion valuation. There were a couple of others – eFishery, Kigen, Paack, and TigerGraph. Some of these companies did follow-on rounds. Jusbrasil in our LatAm Funds did a follow-on Series D round. So, there are follow-on rounds taking place, and as I said, some of these companies, because they have been performing well, have been able to do rounds at higher valuations.

Speaker 10

Q1:

Hi. Thank you. I was wondering if we could get an update on the sale of Fortress, or maybe a better way to put it is just your thoughts on what a CFIUS review means for the timing and potential sale of that asset.

A1:

(Goto) Currently, the process for the sale is moving, but because it is under CFIUS review, how much time it will take is not something that we know of.

Q2:

(Speaker 10) Is there a step, where maybe you have approval or you understand approval is coming, that you move that to a sort of non-performing asset or an asset held for sale because it is kind of older or it is not part of your business anymore?

A2:

(Kimiwada) Once we receive the regulatory approval and when we close the book, it is going to be moved to an asset held for sale. Whether that is going to be discontinued operations or not is up to the materiality overall, but I am expecting that it will not.

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