SoftBank Group Corp.: FY23Q2 Global Conference Call Q&A

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Presenters:
Yoshimitsu Goto, Board Director, Corporate Officer, Senior Vice President, CFO & CISO, Head of Finance Unit & Administration Unit
Kazuko Kimiwada, Corporate Officer, Senior Vice President, Head of Accounting Unit
Yotaro Agari, CSusO, Head of Investor Relations Department & Sustainability Department
Navneet Govil, CFO, SB Investment Advisors & SB Global Advisers

Speaker 1
Q1:
First question is on Vision Fund. Could you explain a little bit more of how you are thinking about the pace of new investments and how any changes in interest rates might change that?

A1:
(Govil) There are a couple of points. In terms of overall approach to investments, we are very committed to investing in the next generation of AI companies across all industries. We have a very robust pipeline, but we are being very disciplined and opportunistic about investments. The bar for investment remains very, very high. In September, we invested in Tractable and Cato Networks. So, if we look across the entire AI spectrum, we are being very selective. We have ongoing dialogue with leading AI companies such as Anthropic, Cohere, CoreWeave, Lambda Labs, and a bunch of others. As you saw in my presentation, there remains substantial cash available in Vision Fund II. Goto-san also talked about the strong cash position that SoftBank Group has. So, we are ready to invest in the right opportunities at the right price.

When I say the investment bar is very high, what I mean is that we are paying very special attention to customer validation and product market fit, but there are also other certain risks that we need to look up to. We need to avoid emerging growth verticals. What I mean by that is there were a lot of early search engines before Google. It is harder to identify successful investments when the market is consolidating. The same is true if you look at food delivery. There were many food delivery companies before DoorDash. Also, just because there is a good technology, it does not necessarily become a good product like Google Glass. It did not end up becoming a very successful thing. So, we look at valuations from a financial investor perspective, and it is very different than some of the others in this space, especially in generative AI. If you look at Google and Amazon, and what they did with Anthropic, they had a strategic angle. We are financial investors.

I think the other question was about the interest rate impact. If you look at our portfolio of 475 companies, the vast majority of them have little or no debt. The conventional wisdom is that longer duration assets are hurt most by higher rate regimes. Investing in promised future growth and future cash flows will be worth less today with an elevated yield curve. But two things. One, our portfolio companies have little or no debt. The other is we are not macro-thematic investors. We are not trying to time credit cycles or business cycles. We focus on investing in the most disruptive tech companies that are leveraging AI.

The final comment is that, as you have seen from our results, the performance of the Vision Funds has now stabilized in the last two quarters. We had a gain in Q1, and then in Q2, a very small gain, so we remain very confident in our portfolio and how resilient and agile the portfolio is, given the macro-risks.

Q2:

The yen is still very weak. I mean it really seems to be quite extreme. How do you think about this? There are two questions I would like to ask in specific. One, is it actually making Japan more attractive as a potential investment area? We have not seen a lot of investments from SBG in Japan for some time, but it seems to be getting quite attractive. Two, are there any other considerations for the overall capital structure or financing side for SBG to be aware of?

A2:

(Goto) The ongoing discussion within our company about how to manage foreign exchange as a group is one that we have been discussing for a very long time, but basically, we do not take many actions such as hedging. We avoid adjusting the exchange rate by aligning procurement and investment in dollars on a dollar basis and in yen on a yen basis. Even with such measures, as a result, the level of foreign exchange can still have various effects on our quarterly financial results. However, we believe that fluctuations in numbers due to foreign exchange effects can be explained as long as they are unrealized gains or losses. Therefore, we try not to adopt strategies in which our business activities are influenced by fluctuations in exchange rates.

Q3:

The SVF segment reported a gain, but then the profit before tax level was negative. Could you explain the difference?

A3:

(Govil) For the SVF segment, we reported a gain of 0.3 billion. As Kimiwada-san mentioned in her presentation, because it is an intercompany transaction on Arm, the four billion on a consolidated basis gets reversed. That was the reason, on a consolidated basis, you do not have a gain.

A3:
(Kimiwada) That is correct.

Q4:
I would like to ask around the dividend. There has been a lot of talk on buybacks, but with the change in NISA (Japan’s Individual Savings Account) next year and more retail investors, I think you will get demands for higher dividend payments rather than buybacks. What is the company’s thoughts about dividends?

A4:
(Goto) We understand that dividends are as important in terms of shareholder return measure as share buybacks. On the other hand, I believe investors might be more pleased if we allocated the funds needed for increasing dividends to buying back our own shares, rather than increasing the dividends. Of course, in general, there are many who hold stocks for their dividend yields, but I think that our type of business is somewhat different from stocks that are bought for their dividend yields. We consider our dividend yields to be on average levels compared to companies in similar industries. Therefore, while there is room to consider raising our dividend, we generally think it is preferable to allocate funds to share buybacks. However, if our company's financial position becomes even stronger in the medium to long term and our management continues to be successful, I believe that not only share buybacks but also further improvement of our dividend policy will become a topic for consideration.

Speaker 2
Q1:
I understand that in the Vision Fund, specifically SVF2, broadly there are about more than 200 companies which the group has invested in. If we were to categorize what percentage of these would still be in the concept stage and still in the growth stage, and how many of these would be more towards the maturity stage, can you just give us an idea there?

A1:
(Govil) In my presentation, there is a slide that talks about the top-25 investments. I shared with you the top-10 public investments and the top-15 private investments. Those 25 investments represent 57% of the fair value of the funds. What you see there is that these are companies that have demonstrated past and future success by four key themes – AI leadership, strong product market fit, strong execution, and sustainable financial performance. That is really the key thing. What we are seeing is what has happened, given some of this macro-uncertainty, is that our private portfolios have very quickly pivoted to what we call capital-efficient growth. It is really balancing growth with profitability.

Your categories that you were talking about, I think what is more important is, when you look at our portfolio companies, two-thirds of our portfolio companies by fair value have annual revenues that are greater than 250 million dollars. That shows the scale of these companies. The second thing is, despite the macro-headwinds, more than half of the companies by fair value are growing revenues by more than 25% year-over-year. Then, I know your question was about Vision Fund II, but in Vision Fund II, we invested in earlier-stage companies compared to Vision Fund I, but in general, we invest in mid-to-late-stage companies rather than seed or earlier-stage companies.

Q2:
Now that Arm has been listed, the proportion of listed portfolio is now higher than 60%. Are there any ongoing discussions with the rating agencies, particularly S&P, about getting an upgrade on ratings?

A2:
(Goto) The ratio of listed stocks has indeed increased and now exceeds 60%. This should be viewed positively by the rating agencies. However, the rationale behind SBG's initial downgrade was far from logical, making the current lowered rating seem unjustified. Despite the listed stock ratio now being over 60%, and actually reaching 70%, we find ourselves in a prolonged dialogue with these institutions, which seem reluctant to upgrade SBG's rating. I believe that the investors who are actively investing in our company and analysts recognize the error in the rating agencies' perspective.

Speaker 3
Q1:
I believe, last quarter, the late-stage fair value tranche was around 37 billion dollars' worth of fair value across these late-stage companies. Now, that number has fallen. I believe the number you provided in your presentation was to 29 billion. I guess I wanted to get a better sense of whether that was Arm or if there were other puts and takes within that bucket.

A1:
(Govil) You are right. Regarding to the late-stage IPO pipeline, the primary difference between last quarter's number and this quarter's 29-billion-dollar number is Arm.

Q2:
We have seen a significant drop in the overall portfolio in terms of equity value of holdings and exposure to China relative to other regions. I was wondering if there was anything to say in the context of ByteDance and how much it represents in your portfolio's strategic positioning with that, as well as how you might approach this new investment period and the China geopolitics in the context of that.

A2:

(Govil) On ByteDance, I am not going to comment on the particular company and the valuation. Other than, ByteDance has been performing extremely well, both in terms of the topline growth and profitability. In many ways, if you look at other social media companies, especially Meta, the numbers are very comparable to Meta's numbers in terms of quarterly revenues, profitability, and things of that nature, yet it is exhibiting a lot more growth.

Having that said, we are not going to get into the specifics of where that is valued and how much it makes up. I think part of the reason you are seeing the China number less than some of the others is because if you look at the overall portfolio, there is growth in some of the other regions more so than in China. Then, as you know, DiDi is a fairly large position that we have. That fair value has been significantly impacted, so we will see when it will relist and that will have hopefully an impact. But we continue to see China as the second-largest economy with continued opportunities there. If you look at it in terms of AI, between the U.S. and China, those are the two powerhouses.

In terms of geopolitics, we are seeing some signs of improvement. I think President Xi is going to be visiting San Francisco later this month, so we will continue to monitor that. California Governor Gavin Newsom was in China recently, so we will continue to monitor the situation closely.

Speaker 4

Q1:

I have a question about WeWork. My understanding is that the receivables and other assets will transfer from SoftBank Group to Vision Fund, but I am trying to get the sense of how much exposure in terms of loans, or if there is any equity share exposure to WeWork for Vision Fund, or if there is any other thing remaining in SoftBank Group.

A1:

(Kimiwada) There are none remaining in SoftBank Group.

Q2:

How about to the Vision Fund? How big is the loan exposure on WeWork?

A2:

(Govil) It is just the equity exposure. It is about 100 million dollars. That is what the equity price of WeWork was on September 30. The rest has been written down. The debt has been written down to zero, and where WeWork was trading at September 30 was about 100 million dollars.

Q3:

Two quarters ago, talking about from a defensive to aggressive investment in terms of AI, what is the investment pace you are looking at for the first half of next year? Do you think next year will be better for the IPOs, including ByteDance that you listed as a potential IPO from Vision Fund?

A3:

(Govil) As I mentioned earlier, investing pace is not just about the dollars that we have put in investing. When Son-san and Goto-san talk about investing pace and going on the offense, there are a couple of things. Number one, we are very actively looking at AI disruptors. We are looking at this space in terms of generative AI. I talked about some of the criteria that we look at and how we are different as financial investors from other strategic investors. We are very much engaged with a lot of these companies. I mentioned Cohere, Anthropic, OpenAI, and all of these. There is ongoing dialogue. Son-san has been talking to Sam Altman and others, and he is very much engaged in this space. That is one. It is looking for AI disruptors.

The second thing is we have a portfolio of late-stage companies, 29 billion-plus, that is ready to IPO, so supporting them, the way we supported Arm. We have a lot of companies, and I mentioned some companies in my presentation like PayPay, Vuori, and Fanatics. We will support these companies as they IPO. You mentioned ByteDance. That is also a company that at the right time will IPO. After the Arm IPO, we saw some green shoots in the IPO market like Instacart, Klaviyo, and others. We do not expect a lot of IPOs for the remainder of 2023, given that we are approaching the holidays, but we remain cautiously optimistic for 2024 listings, especially for high-quality companies that balance growth and profitability. For our portfolio, we think of IPO readiness. This is a track record of capital-efficient growth, positive unit economics, and the ability to forecast, so when they became public, they can give guidance and beat and raise every quarter. That is how we think about it.

Speaker 5

Q1:

In your disclosure on the cash balance at the different entities, it looks like the cash at SB Northstar went up considerably in the quarter. Can you explain why that is the case?

A1:

(Goto) Regarding SB Northstar, we began our investment several years ago and faced various challenges. However, as of now, we have liquidated our positions in securities and other investments. Nonetheless, with over 10 years remaining for investment period, we are utilizing the Northstar entity to invest in fixed-income bonds and other securities. The figures as of the end of September should reflect this.

Q2:
The cash at SB Northstar is now over a trillion yen. Why is the cash there, and why did that change in the quarter?

A2:
(Goto) The primary role of SB Northstar is to manage funds on behalf of SBG. Northstar serves as a position to be entrusted with the management of the funds as SBG. While we handle a portion of our liquidity reserves in-house, we also delegate some management responsibilities to Northstar to enhance operational efficiency. As previously stated, our primary investment focus is on bonds. It's my belief that the temporary increase in cash and deposits is a result of adjusting our positions at the end of Q2. Importantly, the cash held by Northstar is readily transferable to SBG accounts whenever necessary.

Q3:
On your investments year-to-date, you provided a useful slide which shows the breakdown of investments via the Vision Fund segments and then what you call SoftBank Group “other.” Can you provide some context about how you think about what investments go to the Vision Funds, the LatAm Funds, and “other”? What is in that “other” bucket year-to-date? It is a little over two billion dollars.

(Goto) I assume you are asking about how we differentiate between investments made by SBG and those made by SVF. If we were to make a distinction between the two types of investments, strategic investments crucial to our future AI strategy are typically undertaken directly by SBG, while investments aimed at financial performance within the traditional fund investment framework are executed by SVF. However, this distinction isn't always stark. In general, fund investments are focused on achieving specific performance targets within a certain timeframe, whereas in terms of direct investments from SBG, there is not a particular rule. Our goal with SBG's direct investments is more about leveraging the investment to enhance the overall value of the company. We recognize these as two distinct types of investment approaches.

Speaker 6
Q1:
I assume you must pay around 12 billion dollars to Vision Fund I for the Arm stake. When I go through your balance sheet, I cannot find that liability anywhere. Is it because you are consolidating Vision Fund and basically the liability at the SoftBank level becomes a receivable or an asset at the SoftBank Vision Fund level?

A1:
(Goto) That is correct.

Q2:

In the Arm prospectus, as well as some of the recent documents, you have mentioned that there is a prior contractual agreement between SoftBank and Vision Fund to buy out the Arm stake at 16 billion dollars. When was that contractual agreement signed, and why was it not disclosed to shareholders?

A2:

(Goto) You are indeed correct that the transaction price of $16 billion for ARM was pre-agreed upon by both parties. Regarding the disclosure, since it was not predetermined whether the sale would result in a profit or loss, or provide a benefit to either the seller or buyer, the details of the agreement were not disclosed.

Q3:

I recognize this as a very material transaction. 16 billion dollars is more than one-fourth of your market cap. So, given that it is such a large transaction, I thought shareholders should have been informed about that, especially when the purchase price was so much higher than the sale price.

A3:

(Goto) Our stance is that as the contract involves a confidentiality agreement between SVF and us, we generally do not intend to disclose its contents. Furthermore, it should be noted that the contract is not unilaterally disadvantageous to SBG. Therefore, after consultation with our legal team, we have concluded that there is no legal obligation to disclose this information.

Speaker 7

Q1:

I was just wondering whether you have any thoughts about the satellite industry in general and especially about Eutelsat, given that you own 10% of the company.

A1:

(Goto) We have invested in OneWeb for a long time. While OneWeb has faced challenging times in this period, the situation has ultimately been settled through a share exchange with Eutelsat, a resolution we have come to accept. However, given that our current investment emphasis is on AI, we do not hold a particularly strong interest in the satellite business as an investment target.

Speaker 8

Q1:

In the June quarter, you mentioned that you saw room to increase your LTV ratio. I believe at the time it was around 8%, but now it is indeed around 11%. I was wondering, how do you feel about your LTV today? Do you still expect it to increase further, or do you think that this is the right level of net debt at this point, considering the market circumstances?

A1:
(Goto) Even with our current Loan-to-Value (LTV) ratio at 10.6%, I consider it to be somewhat too low. As an investment company, increasing our investments and aiming for a slightly higher LTV ratio, I believe, would bring us closer to optimal operation. The LTV ratio is not a metric where lower is always better. Therefore, we aim to diligently manage our assets within a safe 25% LTV range, in an effort to yield the best possible performance.

Speaker 9
Q1:
A question related to the Vision Fund. I believe that last quarter you disclosed that around 10% of your Vision Fund II portfolio has less than 12 months of cash runway left, and that the same goes for the LatAm Funds. You have been very selective when it comes to new investments with the Vision Fund. How does that caution extend to the companies that you are already invested in? Are you more prudent than you were, say, a year ago when it comes to follow-up rounds? Could you remind us of the criteria that needs to be met before you invest in follow-on rounds?

A1:
(Govil) At the end of September, 92% of our portfolio companies have a cash runway of 12 months or more. In the June quarter, that number was 94%, so it has gone from 94% to 92%. Then, in terms of criteria for follow-on, we look at a couple of things. One is that the portfolio company has performed well since we made the initial investment and that it has proven out our investment thesis. The second thing is that the valuation for the follow-on round is attractive. The third is that the portfolio company is on a path to or improving profitability. So, when we see the right opportunity at the right price, we will invest.

If you look at the companies, going back to your earlier question about the cash runway, I mentioned 92% of the companies have a cash runway of more than 12 months. The other 8% that have a runway of less than 12 months are proactively cutting their cash burn and are already engaged in fundraising discussions. Those fundraising discussions are not necessarily equity rounds. In some cases, it is debt like convertible notes. But as Goto-san has said many times, we do not do bailouts and we do not lose sleep over any single-name risk.

Speaker 10
Q1:
I want to talk a little bit about returns to shareholders to share buybacks. I am not going to

ask when you are going to announce one. But I am interested in how you think about how you can pursue a share buyback but avoid the share price discounting and the asset value expanding once the share buyback is done. Do you have any thoughts about how you can structure a return to shareholders so that maybe it is more consistent but the discount does not ever have as much volatility?

A1:

(Goto) The status of the discount, is certainly one of the factors in the decision to buy back shares. But that is not the only factor in the decision-making process. We discuss shareholder returns in conjunction with several other topics, including the state of our financial distributable income and our anticipated financial activities over the next few years. As a result, we have completed a 4.5 trillion yen share buyback over the past five years. We aim to continue producing results so that investors recognize us as a company proactive in share buybacks. However, I am pleased to hear your comment at the beginning 'I am not going to ask when you are going to implement share buybacks.' We are very grateful for that flexibility from you.

(Agari) Can I clarify with your question? Looking back, when we do a share buyback, the discount may be reduced, but once we complete the share buyback, the discount may come back again. Your question is how we can avoid it?

Q2:

Yes, how you can manage that cycle, because doing the buyback is great. The share price goes up, people buy it, and then the buyback is done, and then the share price falls back again.

A2:

(Goto) You are right. It is a technical action, and as can see from past examples, many of the stock price increases resulting from share buybacks tend to be temporary. Therefore, I believe that the company should not solely rely on share buybacks to eliminate the discount. Instead, it is crucial for the company to focus on its investment strategy and improve investment performance, which is of utmost importance. I think that the company as a whole needs to make efforts to eliminate the discount in these fundamental areas.

Speaker 11

Q1:

I just want to confirm the lockup period in the Arm IPO for SoftBank. This expires after six months, and there is no explicit statement like in the case of SoftBank Corp. where SoftBank Group management has made it clear that as of now it has now intent of selling that stake. I am just checking if there is any other statement that we should be aware of with regards to SoftBank’s stake in Arm and the lockup period.

A1:
First of all, the lock-up is, as you mentioned, a 6-month lock-up. As for the equity, we have sold 10% and now own 90%. I will not comment on what we will do with the listed shares, but I can say that Arm is our most important strategic subsidiary at the moment.

Speaker 12
Q1:
I would like to ask for an explanation of page 64 in the Appendix of the Earnings results briefing presentation materials. You always disclose capital allocation, but in the section labeled 'Others' for Q2, it was -0.4 trillion yen, whereas in Q1, it was +0.1 trillion yen. I understand that this indicates a net cash outflow of 0.5 trillion yen in Q2, excluding investments. Could you please explain some of the major items contributing to this, if possible?

A1:
(Agari) In Navneet's presentation, I believe there was an explanation that the debt was reduced at the SVF. It is categorized under 'other,' but this figure represents the indirect flow of funds from SBG to SVF2, intended to reduce debt at the SVF level.

Q2:
Understood. So, does this mean that the transfer of funds from SBG to SVF explains the situation?

A2:
(Agari) Yes, your understanding is correct.

Speaker 13
Q1:
About NAV, am I right that with Arm, what you have done is to only include a quarter of the 25% stake that has been sold from SoftBank Vision Fund to SoftBank, and then over the next 24 months or over the other three payments, the other proportion will be added into the NAV and likewise the cash will be reduced? Is that the right mechanism when thinking about the changing of NAV?

A1:
(Goto) Paying the outstanding amount does not change the NAV. This will result in an increase in net debt, as well as an increase in assets.

Q2:
Okay. But SoftBank has been investing about a billion per quarter over the last two quarters at a much faster pace than Vision Fund. Is it right to think that that pace of about a billion per quarter will continue?

A2:
(Goto) No, we do not have a clearly defined budget for investments. First and foremost, we are currently very conservative and stringent in selecting the necessary investments to carry out, with the Investment Committee continuing to make these decisions. I believe this cautious period will persist for some time.

Q3:
Okay. So, we are not going to see a five-billion-dollar investment, or a 10-billion-dollar investment occur?

A3:
(Goto) I cannot comment on that. We do not have such a project at the moment. However, if such an opportunity arises in the future and it proves to be an excellent proposition, we may need to consider it seriously. To reiterate, we do not have such a pipeline currently.

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