

(Online meeting held on October 28, 2021)

Simplex Holdings, Inc.
Quarterly Financial Results Briefing Meeting for 2Q FY3/2022

Q&A

Q1 :

As for the revenue by service category, what is the current gross profit (GP) margin for the Strategy/DX Consulting? How much revenue do you expect Strategy/DX Consulting to generate over the medium to long term, or specifically for the next three to five years?

A1 :

The GP margin for the first half was 42.3%. Xspear Consulting, Inc. (hereinafter "Xspear") aims to record revenue of 1.0 billion yen for the current fiscal year, although it recorded no revenue during the previous fiscal year as the company was newly started this fiscal year. We hope to increase revenue from Xspear to about 3.0 billion yen in fiscal 2024, the final year of our medium-term business plan.

Q2 :

BayCurrent Consulting Inc. and SHIFT Inc. also provide digital transformation (DX) consulting services for enterprises. What are the unique strengths of Xspear?

A2 :

The Group's biggest strength lies in its employees who are proficient in both technology and business. Especially Xspear, as a consulting firm specialized in DX, provides consulting focused on themes such as blockchain, cloud computing and AI.

Meanwhile, Simplex Inc., a high-tech company, has a wealth of experience in implementing cutting-edge technologies including blockchain, cloud computing and AI in the finance industry, and we therefore believe that Simplex has a significant advantage in supporting Xspear's consulting business.

Q3 :

As for the revenue by service category on page 17, how will it progress during the second half and the next fiscal year? Could you explain in detail about the service categories whose revenue will change significantly from the first half?

A3 :

The Strategy/DX Consulting category recorded a year-on-year increase in revenue during the first half because the business was newly started this fiscal year. We would like to achieve the full-year revenue of 1.0 billion yen by increasing the number of consultants in the second half.

Of the Financial Solutions category, we expect the solutions for capital markets to continue to perform strongly in the second half like in the first half, whereas the solutions for retail will remain largely unchanged year-on-year like in the first half.

As for the Life/Non-life Insurance category, we are determined to focus on novel large-scale projects from the previous fiscal year to the current fiscal year, as we mentioned in the presentation material. We would like to first focus on enhancing Simplex Library during the current fiscal year and then improve the productivity for new projects we will win in the next fiscal year and beyond.

Revenue from the Enterprise DX category is leveling off and will likely decline in the next fiscal year and beyond by the amount of revenue from a largest-scale ERP package implementation project for a major general constructor as the system has already been put into service this fiscal year.

Q4 :

Could you explain what is strong about the amount of orders received during the second quarter and how it is sustainable into the future?

A4 :

The amount of orders received was driven mainly by the development of the Financial Solutions category as with the trend of the revenue by service category during the second quarter. We believe this trend will continue into the second half.

Q5 :

You commented that revenue from the Life/Non-life Insurance category declined because you refrained from seeking smaller projects to focus on large-scale projects. How do you assess the revenue of 1.47 billion yen during the first half? What are your revenue target and trend assumptions for the next fiscal year and beyond after the completion of the large-scale projects?

A5 :

In the Life/Non-life Insurance category, we intensively deployed top notch personnel into novel large-scale projects, and to this end refrained from seeking smaller projects. We assume similar trends will continue in the second half. After we successfully complete large-scale projects and enhance Simplex Library during the current fiscal year, we believe we can focus more on revenue growth in the next fiscal year. At present, we have received some inquiries which could potentially develop into large-scale projects.

Q6 :

About the systems you developed at the request of your clients, we believe the clients also want to hold intellectual property rights on these systems. How has Simplex secured intellectual property rights?

A6 :

We are aware that system developers who develop systems on a contract basis and retain the copyright of the source code of these systems are very few.

When our company was first established, some clients naturally voiced complaints, asking us why we as a system developer could retain the copyright of the systems they ordered. In many system development projects, users who have professional expertise in operations generally decide on specification requirements and desired functions and communicate them to system developers that have no professional expertise in operations. This often entails a lack of communication.

We, however, give clients suggestions about functions that should be implemented, for example, because Simplex has secured top tier personnel who have expertise in both systems and operations. For instance, in businesses we have operated since inception, such as trading and risk management, we first make proposals on math formulas for pricing functions which are based on complex financial engineering and then ask our clients to point out what do not fit what they want.

We believe that the level of our productivity meets the requirements defined by users. In compensation for such a high level of productivity, we have retained the copyright of the source code which reflects our proposal.

We, however, would like to retain only the general-purpose portion of the source code which can be shared across diverse clients, rather than the entire source code, and accumulate it in Simplex Library. We do not retain the copyright on the source code that is based on the unique know-how of clients and thus constitute the source of their competitive advantage.

In fact, our clients have consented to our retaining the copyright on general-purpose portion of the source code, and thus, we have reflected such consent in the basic agreements newly entered into with clients.

Q7 :

My question is about how to think about R&D expenses. I understand that you are focusing on expanding Simplex Library in the insurance domain during the current fiscal year. That said, is it correct to assume that R&D expenses will remain flat or decrease from the next fiscal year after the completion of the insurance library?

A7 :

The budget for R&D expenses for the current fiscal year is 1.8 billion yen. As indicated in the medium-term business plan, the profit target is based on the assumption that the amount of R&D expenses for each year during the three-year business plan is around 1.5 to 1.8 billion yen.

During the current fiscal year, we are focusing on enhancing the insurance library. Still, in the next fiscal year and beyond, we would like to make investments that will contribute to the expansion of other domains in order to accelerate the pace of business growth.

Q8 :

Could you explain the synergies between Simplex, which specializes in system development, and Xspear, which provides Strategy/DX Consulting?

A8 :

Xspear was newly started in the current fiscal year, and it has been operating smoothly, thanks to the large network of contacts that Simplex Inc. had built, including financial institutions. Simplex had been receiving consulting requests from clients for some time, but since Simplex's policy is to cover the full cycle of a project and engage in all phases from upstream to downstream, we had been declining requests for consulting services alone, not including system development. It is partly against this background that prospects in the pipeline are flowing to the new consulting firm that we started this fiscal year.

In addition, in our current consulting work for financial institutions, we are often asked for advice, such as on how financial institutions should deal with the shortage of DX talent and engineers, what governance approach they should take for their system subsidiaries, and how they should recruit good engineers and train them.

When we proceed with such consulting work, the question turns to how to fill the lack of IT talent. This has created some opportunities for Simplex, which has extensive experience in system development, to receive new orders.

As the prospects in the pipeline are flowing to Xspear, and the new needs created through consultation are flowing to Simplex, more synergies are being generated than expected.

Q9 :

What is your medium- to long-term revenue target for Xspear?

A9 :

By fiscal 2024, we would like to achieve revenue of 3.0 billion yen to establish a certain presence. If we can successfully develop a brand here, we will be able to hire consultants more smoothly and speed up the process further.

Q10:

What measures do you plan to take in order to increase mid-career hires? Also, what measures do you plan to take in order to reduce the turnover rate?

A10:

Although we did not mention it in our presentation, we have been focused on hiring new graduates for some time and hired more or less 100 people every year. This fiscal year in particular, we set a target of 200 new graduates and conducted recruiting activities accordingly. As a result, recruitment was successful, with 220 prospective employees who will join us next spring. In the market for recruiting new graduates, the Simplex brand is recognized to some extent among the top 10% of students.

As for mid-career hiring, our normal process was that we met with candidates introduced by agents and hired the best of them.

We started focusing on mid-career hiring last year in preparation for the launch of Xspear, and we have since learned a few things. First of all, we showed a proactive stance to mid-career hiring agents by emphasizing that we were actively recruiting mid-career talent. As we continued to hire candidates, mid-career hiring agents introduced excellent talent more often than before. With this outcome, we are gradually becoming confident about mid-career hiring.

On the other hand, in order to reduce the turnover rate, we would like to launch a thorough revision of labor income share. For the current fiscal year, we have already factored in the payment of a special bonus (totaling 600 million yen) in our full-year forecast. We are currently having internal discussions with a view to reflecting that bonus in the annual salaries of employees from the next fiscal year onward. In addition, to reduce the turnover rate, we believe it is important to not only improve remuneration but also allow a diversity of work styles. Internally, we are actively discussing necessary measures, as well as the system.

Q11:
How do you describe nature of your R&D expenses?

A11:
Basically, there are two types of R&D expenses.

The first type is those spent for cases where we promote development in advance of launching a new business or service.

The second is those spent for cases where the first project of a new client is one of strategic importance like four corners of Othello in expanding our business in the relevant area. R&D expenses in such cases are spent to pre-emptively develop some functions that can be shared with projects expected to follow in the area.

Q12:
I would like to know your KPIs from the perspective of investment. Is that the number of engineers or order volume?

A12:
First of all, the gross profit margin is a KPI that measures the productivity of the Simplex Group, the quality of our engineers, and the degree to which we are valued by our clients.

Next, regarding the outlook for future revenue, we would like you to look at the indicators mentioned earlier in our presentation, such as the current revenue and balance of outstanding project orders.

Also, we have disclosed our annual plan for SG&A expenses. We would like to explain at an IR meeting like this one each time there is a major change.

In summary, if you can grasp the three indicators—gross profit margin, revenue and the balance of outstanding project orders, and SG&A expenses, you will be able to understand the status of our business performance.

Q13:
Under what market conditions would revenue from subscription services fluctuate?

A13:
We have a two-tiered fee structure for our subscription services (SaaS). In addition to a monthly fee for system operation and maintenance, there is a pay-for-performance fee for the front office systems that we provide for clients in the areas of online securities, FX, and cryptoassets. We are in charge of the entire system, from development to operation, on a

fully outsourced basis. Therefore, the pay-for-performance fee is linked to the degree of contribution of our systems to their revenue.

At present, revenue from the pay-for-performance fees are roughly 1.0 billion yen per year and 0.5 billion yen per half-year, and they have not fluctuated significantly. For online securities and FX, there is an upper limit to the contingent fee under the contract as their services have already taken root. In fact, the fee is roughly at the upper limit, so there is little room for a further upturn.

We also charge crypto asset clients a pay-for-performance fee. Crypto asset businesses have been growing significantly over the past few years, but the trading volume of cryptoassets in Japan is still lower than that of FX. Revenue for crypto asset exchanges, our clients, is still limited; thus, the pay-for-performance fee to us is almost at a floor. In the future, if the trading volume of cryptoassets grows to the same level as FX, thereby increasing clients' revenues, our revenue from pay-for-performance fees may also increase further.