Neural Group Inc.

FY2024 Q2 Financial Results Briefing Meeting

August 9, 2024

Event Summary

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[Venue]	Webcast
[Number of Speakers]	2 Roi Shigematsu — Chief Executive Officer Takashi Kisaka — Chief Financial Officer

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 Group Inc.'s financial results briefing for the 2nd quarter ending June 30, 2024.

Today's presentation will be based on the financial results presentation material disclosed on our IR site on August 9. 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 5:00 PM at the latest. Both Shigematsu, Chief Executive Officer, and Kisaka, 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.

Financial Results Briefing Material
7th term, Q2 ended June 30, 2024

Neural Group Inc.
August 9, 2024

Shigematsu: Thank you all for taking the time to join us today. I would like to present the interim financial results for our 7th fiscal year.

Financial highlights of FY2024 (7th term) Q2

- **[Summary]** Following the establishment of proprietary AI services in FY2023, both revenue growth and profitability strengthened significantly in FY2024. Business continued to expand steadily into Q2, with **profitability reaching the breakeven point**. **Profit generation is now in sight starting from Q3**
- **[Sales]** Q2 FY2024 sales reached **880 million yen** (**+14.0% YoY**), driven by partnerships with top domestic and international companies, enhancing both technology and services.
  - In June 2024, we joined NVIDIA's Partner Program, **"NVIDIA Partner Network"**. By utilizing NVIDIA's cutting-edge GPU servers (**NVIDIA DGX Station**), Metropolis software, JetPack SDK, etc., AI inference on edge devices has been significantly accelerated.
  - Launched the **"KizunaNavi"** 1on1 support service, jointly developed with Sony, utilizing edge AI and SaaS systems. By combining video/audio analysis AI and generative AI, the service helps solve 1on1 meeting challenges and supports employee engagement and growth.
- **[Profitability]** Sales of proprietary AI services led to significant efficiency improvements in R&D and sales expenses, quickly enhancing profitability.
  - **Reached break-even in Q2** (with **operating profit in June**). After about two years of business investment starting from Q4 FY2021, we successfully shifted to the **profit and cash generation phase** (investment recovery phase).
  - While sales grew by **14% YoY**, SG&A expenses were reduced by **144 million yen** (**576 million yen annualized**), significantly improving the break-even point.
  - Contribution margin exceeds **60%**, supporting profitability beyond breakeven and expecting **sharp profit increases** moving forward.
  - Exchange rate for imports and procurement of NVIDIA edge devices and LED components is assumed at **160 JPY/USD**. The recent yen appreciation is expected to be **a positive factor** for second-half results.
- **[Growth Strategy]** **From the second half of FY2024 through FY2025**, we will **actively pursue profit expansion** and strengthen our technology and business models.
  - Drive **profit expansion** through scaling of proprietary AI services.
  - Strengthen **recurring revenue models** and aggressively expand **SaaS businesses such as KizunaNavi**.
  - Integrate **cutting-edge AI technologies** in image and audio fields into our services and continue researching **generative AI**.

First, here are the highlights. To summarize, while the fiscal year 2023 was a major milestone for us with the establishment of our proprietary AI services, fiscal year 2024 has seen both strong revenue growth and improved profitability.

In the second quarter, our business continued to grow steadily and has now reached the break-even level. At the beginning of the year, we forecasted that we would start generating profits from the third quarter onward, and so far, we are on track to meet that expectation.

Sales for the second quarter of FY2024 totaled 880 million yen, a 14% increase compared to the same quarter last year.

There were two key drivers behind this growth.

The first was the partnership with NVIDIA, which we announced this June. Since our founding, we have utilized NVIDIA's Jetson series, and by strengthening this partnership, we will further accelerate AI inference on edge devices through products such as the NVIDIA DGX Station, Metropolis software, and JetPack SDK.

The second driver was the capital and business alliance with Sony, announced last year. The 1-on-1 support service *KizunaNavi*, launched this year, is progressing smoothly. The service, which incorporates a range of AI technologies, has been well received and is being actively used by our customers.

Next, regarding profitability. Since around 2022, improving profitability has been a major focus for us. Through the investment period, we succeeded in making AI services our core offering. As a result, R&D and sales expenses required to promote services have been significantly optimized.

This has greatly reduced the cost needed to generate and grow revenue, allowing us to reach the break-even point in the second quarter. Notably, in June — the final month of Q2 — we posted an operating profit, marking a solid first step toward achieving profitability in Q3.

Since Q4 2021, we had been in an investment phase for about two years, but with this quarter's results, we have now shifted into the phase of generating profits and cash flow — in other words, a phase of recovering invested capital.

While revenue in Q2 grew 14% year-on-year, we also achieved quarterly selling and administrative cost savings of 144 million yen, equivalent to an annualized reduction of approximately 576 million yen.

A key concern is whether such cost reductions could harm future profitability or business sustainability. However, we believe there will be no adverse impact. In fact, we have maintained a high contribution margin of 60%. Both selling and administrative expenses and cost of sales have improved significantly, and we believe this demonstrates strong profitability scalability.

This means that once we surpass the break-even point, profits will rise sharply alongside sales growth. We believe we have established a business model capable of delivering a high operating margin.

At the same time, recent foreign exchange market volatility is something to monitor. We have previously been impacted by exchange rate fluctuations during the pandemic. Our exposure mainly comes from two areas: procurement of NVIDIA edge devices and the import of LED components used in our LED vision products.

Currently, we are operating based on an exchange rate of 160 yen to the dollar. As the yen has recently strengthened, we do not believe this presents a significant business risk at this point.

In summary, for our growth strategy moving forward: From the second half of FY2024 and into FY2025, we aim to further expand profit margins and strengthen our technology and business model resilience.

One of the key priorities will be to increase revenue while maintaining and expanding profitability — in other words, avoiding margin erosion during growth. Furthermore, we aim to increase the recurring revenue aspect of our business.

For example, *KizunaNavi* is a subscription-based service, and we plan to actively expand our SaaS business in this direction.

In addition, as AI technology continues to advance rapidly, particularly in the video domain where we specialize, we will continue our research efforts and strive to stay at the forefront of global AI innovation.

Management team

Founder & CEO, Roi Shigematsu,

- Partner at McKinsey & Company .
- Led private equity investments at Bain Capital.
- Advisory Board of The Faculty of Engineering, The University of Tokyo (to present)
- Member of Keizai Doyukai (Japan Association of Corporate Executives) (to present)
- M.S. (Engineering), The University of Tokyo

Advisor, Yutaka Matsuo

- Professor, Artificial Engineering Research Center, Graduate School of Engineering, The University of Tokyo
- President, Japan Deep Learning Association; Expert Member, Council for the Realization of New Capitalism; Chair, AI Strategy Council
- Outside Director, SoftBank Group
- Advisor to the Company since 2018

Senior Executive Officer
Tsubasa Iwakiri

- Led various consulting engagements at Accenture.
- CEO of Neural Engineering Co.
- Graduated from Doshisha University, Faculty of Life and Medical Sciences, Department of Medical Engineering.

Senior Executive Officer
Masaaki Yamamoto

- Spent 15 years at Sony engaged in technology development and new business development.
- Earned a graduate degree from Tokyo Institute of Technology, specializing in Mechanical and Aerospace Systems.

Senior Executive Officer, CTO
Takahiro Mikami

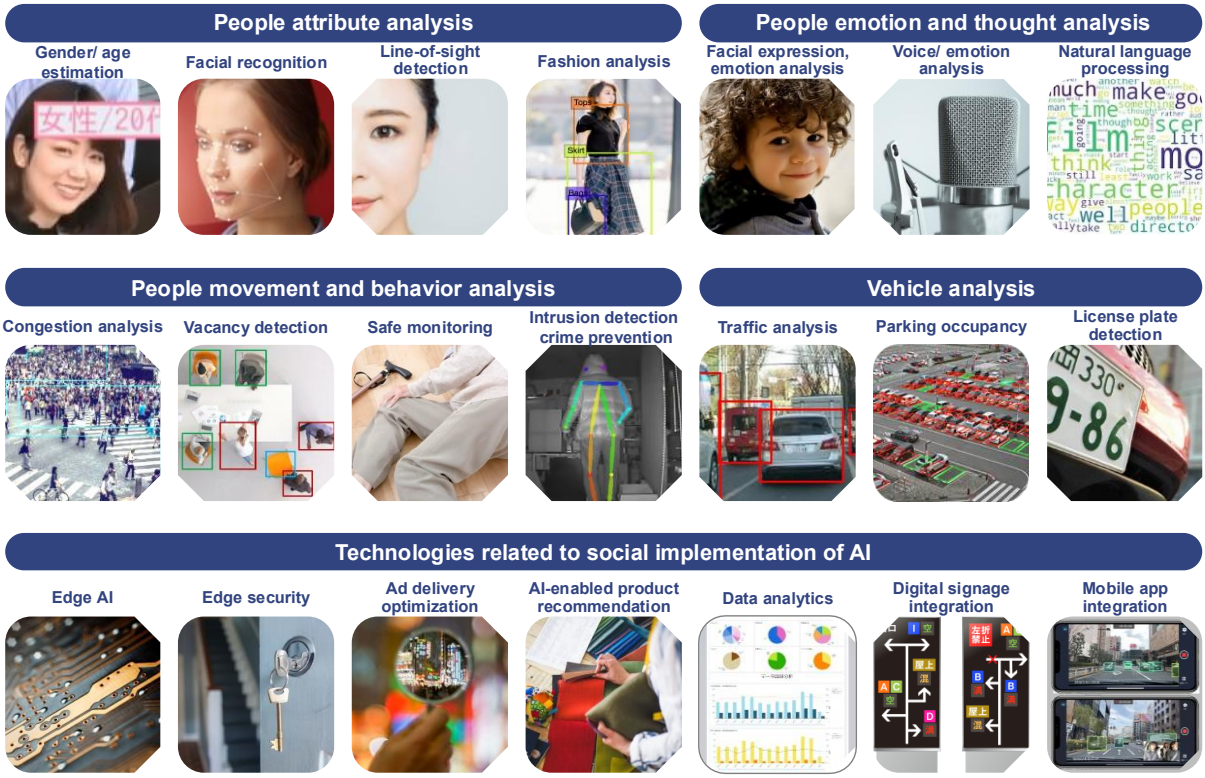
- Engaged in researches about image recognition (ResNet) and natural language (LSTM) models at Nomura Research Institute.
- Engaged in research on image recognition and natural language models at Nomura Research Institute.
- Ph.D. (Theoretical Physics), The University of Tokyo

Senior Executive Officer
Taro Hitokoto

- Engaged in policy planning at the MLIT, covering areas such as parks and green spaces, urban planning, and sports facilities.
- M.S. (Agricultural and Life Science), The University of Tokyo

This is our team overview. Our members come from diverse backgrounds, united by a shared mission to leverage AI to contribute to community development and bring enjoyment to people's lives. Our team includes individuals with experience in research, business operations, finance, government, and new business development at large corporations. Together, they are working closely with Professor Matsuo of the University of Tokyo to continuously refine and advance our technologies.

We develop proprietary AI libraries/ edge-related implementation technologies to enable AI smart cities

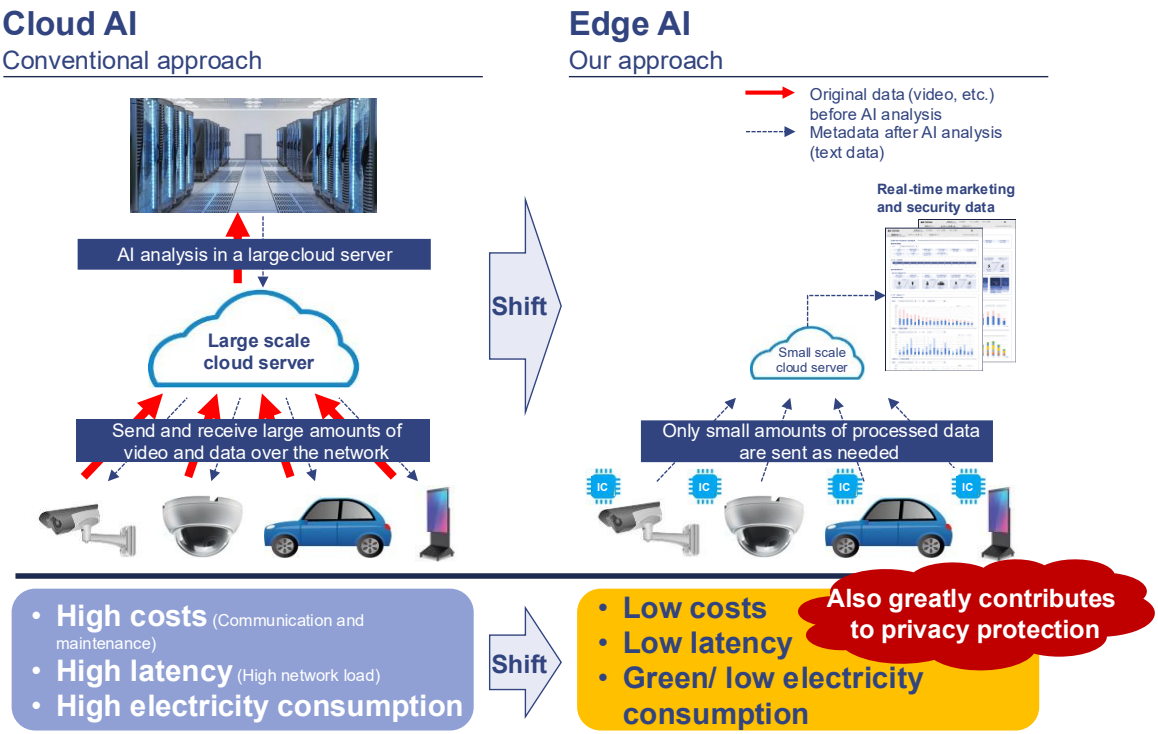


This section covers our technology. Our core expertise lies in various image recognition systems, primarily focused on the video domain. Our key services include analyzing human attributes, interpreting emotions and thoughts, analyzing movements and behaviors, and performing traffic control through vehicle analysis.

Equally important, however, are the technologies listed below, which relate to the social implementation of AI. While many companies around the world are capable of developing AI analysis technologies like those shown in the top two rows — with varying levels of sophistication — the real differentiator lies in the foundational technologies shown in the lower section. These supporting technologies are essential for implementing and integrating AI into society, and this is where we distinguish ourselves.

A good comparison is NVIDIA. While many companies can produce GPUs, NVIDIA's strength lies not only in the hardware but also in the backend systems and software required to run programs on those GPUs. Similarly, for us, while the algorithms in the upper and middle rows are important, equally critical are the edge AI technologies, security measures for edge AI, analytics technologies, and seamless integration with applications — including smartphone apps and web browser applications such as Google Chrome. These elements are just as vital as our AI technologies themselves and serve as the backbone that supports our solutions.

AI technology is evolving along with the industry's growth



Our company specializes in edge AI, and this diagram provides the clearest explanation of what that entails. Cloud AI, such as systems like ChatGPT, relies on large-scale server rooms. In this approach, tens or even hundreds of thousands of GPUs are procured, installed in offshore data centers, and used for massive inference tasks. The AI models are accessed remotely via the internet, where computations are performed in the server room, and the results are then returned to the user.

While this method continues to be extremely important, it requires significant upfront capital investment and incurs high ongoing costs. Additionally, cloud AI introduces latency due to data transfer and consumes substantial amounts of power.

In contrast, our technology focuses on edge AI, shown on the right side. A key characteristic of edge AI is that it does not require large server rooms. Instead, compact AI models are embedded directly into devices such as cameras or vehicles, where inference is performed locally on the hardware itself. Only lightweight numerical data — the analysis results — are transmitted to a small cloud server for storage. This enables programs to run at low cost and with minimal latency. These are the primary advantages of edge AI.

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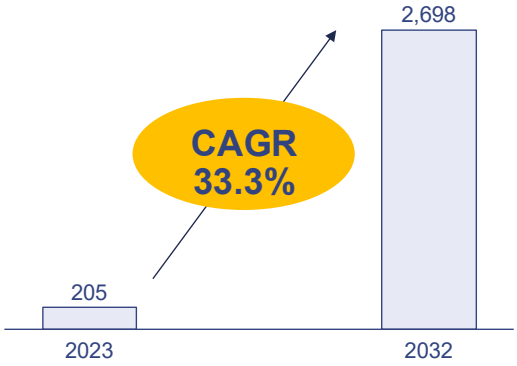
Edge AI has a large global market size and offers high growth potential.

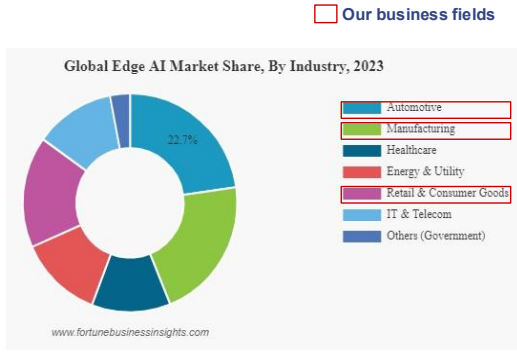
The Edge AI market is growing at an annual rate of 33.3%

Global: Edge AI Market, in USD billions



We operate in many of the key growth segments

Global: Breakdown of Edge AI Market by Industry (2023)



Source : https://www.fortunebusinessinsights.com/edge-ai-market-107023 (Last Updated: July 29, 2024)

While both edge AI and cloud AI are critically important technologies, here we focus on the outlook for edge AI. This slide shows projections from a global market report. Currently, the global edge AI market is valued at approximately 3 trillion yen. Over the next 10 years, it is expected to grow to about 35 trillion yen, representing an anticipated annual growth rate of around 33%.

The breakdown of this growth, shown on the right side, highlights three major industries driving expansion: automotive, manufacturing, and retail. These sectors are expected to lead the market for edge AI solutions. Our company is actively engaged in all three of these industries, and we are advancing our business with the belief that we are — and will continue to be — at the very center of this expanding edge AI opportunity.

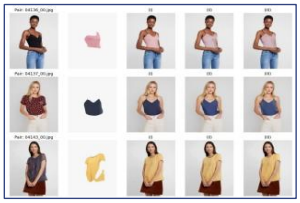
Our AI libraries operate on a variety of technical standards, contributing as an Edge AI Platform developer

These are six representative edge devices that we use. At the top are NVIDIA's Jetson series, with which we have a business partnership. Listed here are Jetson NX, Nano, and TX2, among others. Operating within NVIDIA’s platform ecosystem is one of the key characteristics of our solutions.

At the same time, our services are designed to run not only on NVIDIA hardware but also on various other platforms, including Intel, Qualcomm, and even iPhone and Android devices. Our approach to AI technology development is centered around creating solutions that can operate seamlessly across a wide range of hardware platforms.

Continuing advanced AI research: By continually integrating new technologies into our services, we accelerate platformization and generalization, while also contributing to building barriers to market entry.

Image generation AI model



- Fully internalized image generation AI model.
- Enables creation of diverse content, supporting more creative advertising production.

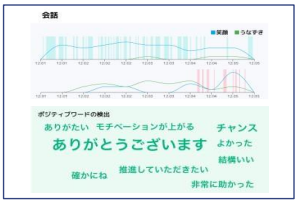
Multitask AI model

- Development of a multitask AI model integrating separate models.
- Reduced memory usage by ~50%, enabling faster AI recognition and miniaturization for edge devices.

Uncompromising AI accuracy

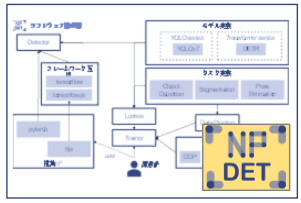
- Conduct AI accuracy research and apply results to commercial services.
- Achieved stable detection accuracy and robustness even in abnormal environments, especially in data parks.

Edge AI voice system



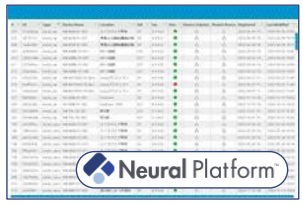
- Real-time analysis of user speech within edge devices.
- Natural language processing enables user feedback. Kizuna Navi development and release.

Accelerating next-generation AI model development



- Building an AI model development platform.
- Able to implement cutting-edge academic methods with less than 1/10 of the conventional effort.
- Speeding up the cycle of additional learning and application to commercial services.

Neural Platform



- Real-time management of numerous online-connected edge AI devices.
- Enables automatic program updates and AI model updates remotely.

- **Cutting-edge AI technologies**, developed in academia, are rapidly implemented and integrated into commercial services through **remote updates**.
- By standardizing AI models and core technologies **across services**, services are generalized, contributing to **lower implementation costs and improved company profitability**.
- These initiatives contribute to **higher entry barriers and enhanced customer retention**.

As mentioned earlier, supporting technologies play a crucial role in AI, and here are some examples of the outcomes of our research and development efforts. For instance, in the bottom right, our *Neural Platform* enables remote monitoring of our deployed edge devices, providing visibility into their operational status across different regions and detecting any potential malfunctions.

In the center bottom, we have technologies for accelerating AI models. Once new software is developed, it can be quickly implemented across various systems, enhancing deployment efficiency.

AI models themselves continue to evolve as well. The top left showcases some examples of this, including technologies for automatic video generation, such as creating virtual clothing and avatars. In terms of AI-based detection, we have developed multitask AI models capable of simultaneously detecting people, vehicles, and other objects with a single model. Additionally, as shown at the top right, we are improving AI accuracy to ensure detection remains possible even under extreme environmental conditions. Moving forward, we intend to continue advancing research and development across all of these areas.

Neural Group solves social issues in cities through Edge AI and enhances spatial value.

Here is a list of the services we have announced and are offering as of 2024. Unlike in our earlier days around the time of our listing — when our primary business model involved selling AI licenses directly — we have now shifted away from that approach. Today, our strategy focuses on integrating our AI technologies into various proprietary services, which we sell directly or jointly with our partner companies. This framework was established last year, and we are now actively executing on it.

At the core of our service strategy is the application of edge AI to smart cities. Examples of these services include Digital Park and DigiThrough (shown at the top left and below it), which provide vehicle control and license plate recognition solutions, and Edge Alert, a solution that leverages edge AI for traffic management and vehicle guidance. Traditionally, traffic control at parking lots or facility entrances required multiple personnel using hand-held lights to guide vehicles — a practice becoming increasingly difficult and costly due to labor shortages. Our service aims to automate this process. By using AI cameras to detect vehicles and pedestrians, and by providing alerts on LED displays, we offer solutions that help prevent accidents and ensure the safety of both drivers and pedestrians.

In addition to mobility-related services, we also offer *KizunaNavi* (center of the slide) to support workplace reform — a SaaS model service, which I will explain in more detail later. Other services include solutions utilizing generative AI, and *NeuralVision*, which supports retail marketing. Together, these offerings represent Neural Group's current service lineup.

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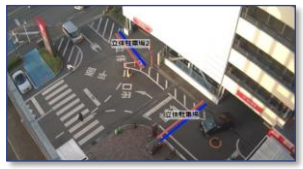
Providing services for smart city development using AI cameras. Digi Park

For outdoor flat parking lots, a single camera can capture over 100 parking spaces.



Congestion analysis based on line counting at parking lot entrances and exits is also available.

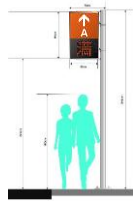
1 Real-time availability management system for facility managers.

Parking space availability data is utilized to improve operational efficiency and enhance the customer experience.

2 Linking data to the facility website.

Customers can check parking availability in advance on their mobile devices.

3 Guiding drivers on-site to streamline traffic flow within parking lots.



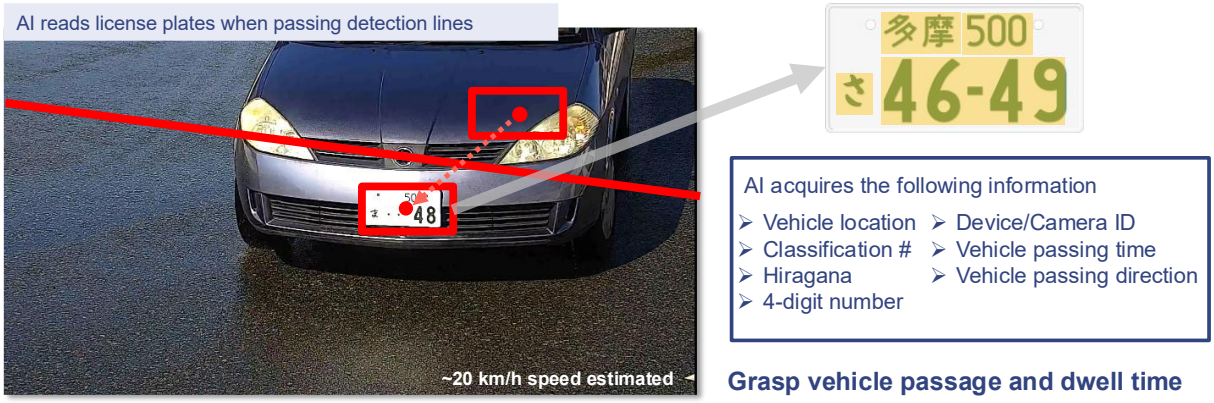
Real-time on-site traffic control.

Let me share a few examples of our services, starting with *DigiPark*, one of our core offerings since the company's founding. This service is designed to significantly streamline parking management systems, which traditionally relied on physical devices like flapper gates to control occupancy.

By installing AI cameras above parking lots, DigiPark uses multitask AI processing to monitor availability in real time and guide vehicles to vacant spaces.

Compared to conventional systems that require physical gates and equipment, this solution greatly reduces costs. Moreover, since everything is monitored via cameras, parking operations can be managed remotely from a control room, providing additional convenience and efficiency.

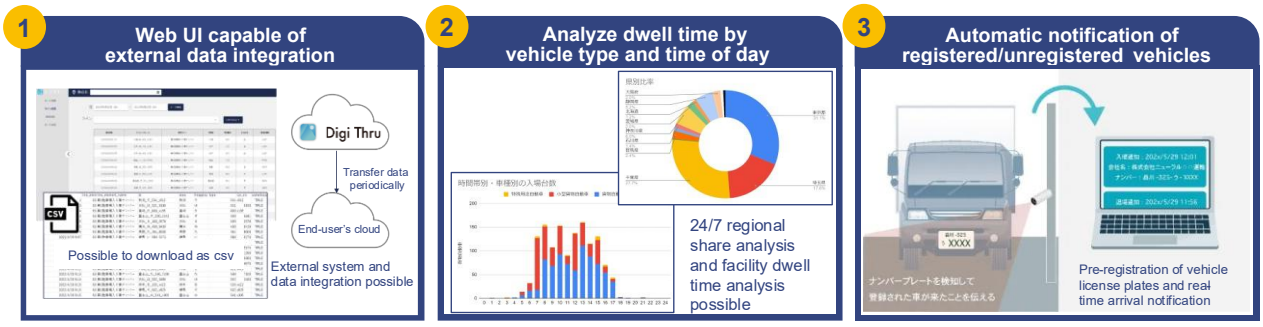
Visualizing vehicle movement and stay information through license plate analysis of moving vehicles.



AI acquires the following information

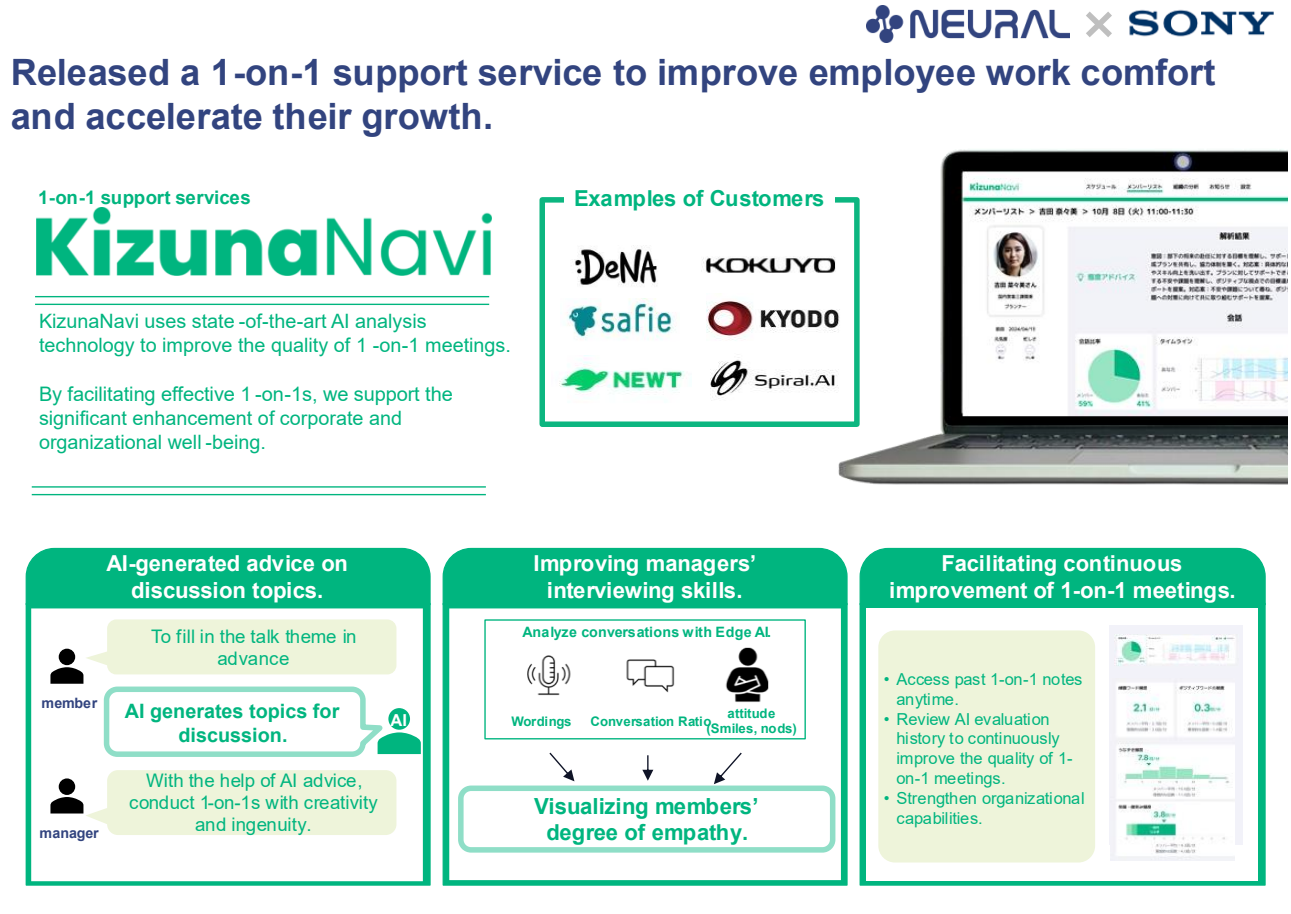
- Vehicle location
- Classification #
- Hiragana
- 4-digit number
- Device/Camera ID
- Vehicle passing time
- Vehicle passing direction

Grasp vehicle passage and dwell time



This service focuses on license plate recognition. By using license plates, we manage vehicle control, detect re-entries, and guide cars accordingly. This system is designed to help smooth and optimize the overall traffic flow.

This service is designed to reduce the need for on-site traffic guides. For example, when a pedestrian approaches an entrance, a warning message such as 'Pedestrian Approaching' is displayed to drivers. The system then immediately detects the movements of both the pedestrian and the vehicle and triggers an alert as needed. By automating this process, the service can reduce annual guide labor costs by approximately 10 million yen per facility. Given that the cost of the service itself is much lower compared to these savings, adoption has been steadily increasing.



This is *KizunaNavi*, a service we jointly developed and launched with Sony. As the effects of COVID-19 gradually subside, different companies are adopting various working styles, with some employees continuing to work remotely and others returning to the office. This shift has raised new challenges in building relationships between employees and managers, and fostering internal communication.

Furthermore, export-oriented companies, which have gained attention recently amid yen appreciation, often face difficulties in maintaining close communication between their headquarters in Japan and overseas branches. This has led to increasingly fragmented employee networks across borders, which has become a major issue in the current work environment. Against this backdrop, investment in human capital has become a growing trend. More companies have begun addressing this in their IR activities. Understanding each employee's communication and growth needs and leveraging them effectively has become increasingly important.

KizunaNavi offers three key features. The first is supporting regular one-on-one meetings between managers and members.

Before the meeting, members can enter themes they would like to discuss, such as how they want to grow, what challenges they are currently facing, or what kind of support they need. When this happens, some managers may immediately know what to say, while others may not. This often results in inconsistent communication skills within the organization. To address this, the system uses AI to provide advice and sample questions aligned with typical discussion topics. Managers can refer to these suggestions—not necessarily following them exactly—but they help ensure that the conversation touches on what the members really want to discuss.

The second feature is about analyzing the quality of the 1-on-1 meetings. When a good meeting takes place, it is important to understand not only what questions the manager asked but also how the member reacted. For example, did they nod, smile, or appear hesitant? AI cameras capture these reactions, and the data is analyzed to generate feedback. Managers can later review this and realize, for instance, that while some questions were well-received, others caused the member to seem uneasy. This provides valuable insight, allowing managers to refine their approach for future conversations.

The third feature addresses the importance of continuity. Without regular and ongoing 1-on-1 meetings, these sessions tend to become mere formalities. When they are conducted only once a year, for example, most of the time is spent recalling previous discussions, which makes them far less meaningful. To avoid this, *KizunaNavi* records the history of past meetings in the cloud. Managers and members can easily review what was discussed, along with AI-generated feedback from prior sessions. This ensures that each meeting builds on the last, creating a cycle of continuous improvement.

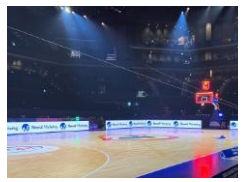
By visualizing past discussions and areas for improvement, the service aims to strengthen employee communication. Ultimately, this helps reduce turnover and increase employee engagement and sense of belonging, which are the key values that *KizunaNavi* offers.

Top share in Japan with more than 12,000 LED signage installations

NeuralVision

- **Unparalleled installation track record**
  Experience in a wide variety of industries, including large corps, government offices, commercial facilities, and merchant stores.
- **Unparalleled track record of stable operations**
  Stable operating track record throughout Japan, including cold, hot, and humid regions.
- **Flexible contract forms**
  Flexible purchase formats such as lease agreements and credit/cash purchases.





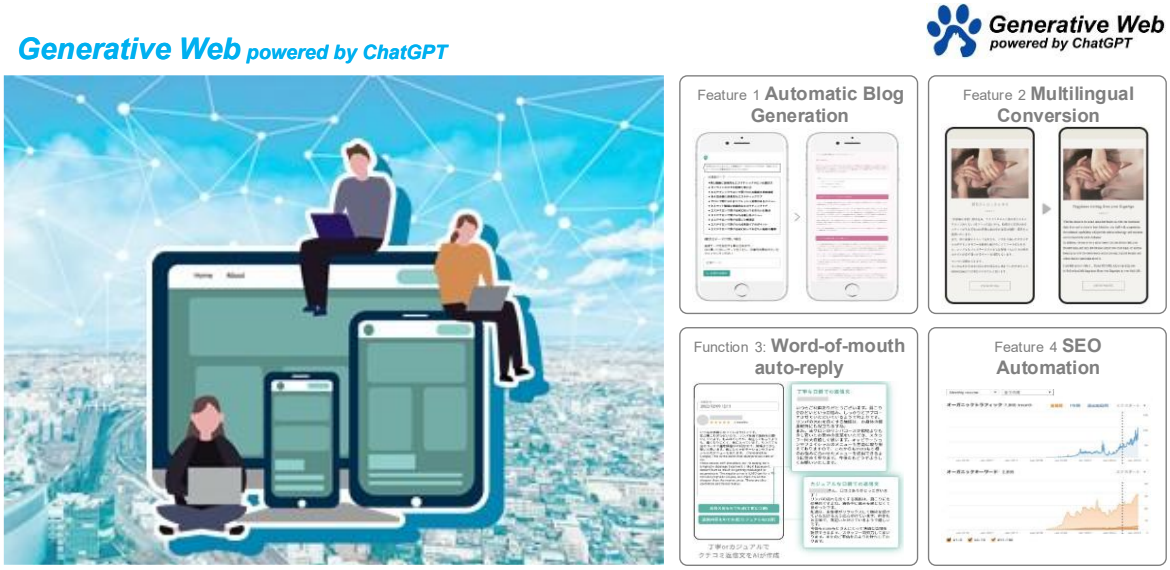
The next service is *NeuralVision*, which consists of LED vision displays that have already been installed at 12,000 locations nationwide. While we have long provided LED display technology, we are now focusing on enhancing content creation support through our generative AI capabilities.

Naturally, we continue to create content ourselves, including 3D and 2D content. However, what is even more important is that our users can now produce their own display content using generative AI software. This means that each of the 12,000 users across various locations can autonomously create and manage the content they display outdoors in city spaces. We believe this ability directly contributes to the digitalization of community development and local information dissemination.

In addition, we are strengthening our efforts in the large-scale corporate business segment. For example, we provided LED vision displays at the Japan venue of last year's Basketball World Cup. Increasingly, we are focusing on supplying large-scale, symbolic LED vision installations and generative content to major facilities, whether for private companies or public institutions. These displays often serve as the face of events and venues.

Moreover, by integrating these LED displays with AI cameras, we are able to analyze how viewers respond to the information shown. We can observe behavioral changes, track viewing patterns, and provide feedback to optimize the content being displayed. By combining visual presentation with data analysis, we are committed to advancing both aspects of this solution.

Expanding AI-driven web businesses with ChatGPT.



- Leveraging the extensive sales network of Neural Marketing Co. (a wholly owned subsidiary) and our AI development capabilities, we launched a new web page business.
- Started sales in May 2023, quickly commercializing generative AI beyond just research and development.

We are also actively utilizing tools like ChatGPT. One of our initiatives involves leveraging such technologies to enhance and modernize our website.

NEURAL

Partnered with many public and private organizations to promote AI services through an extensive network.

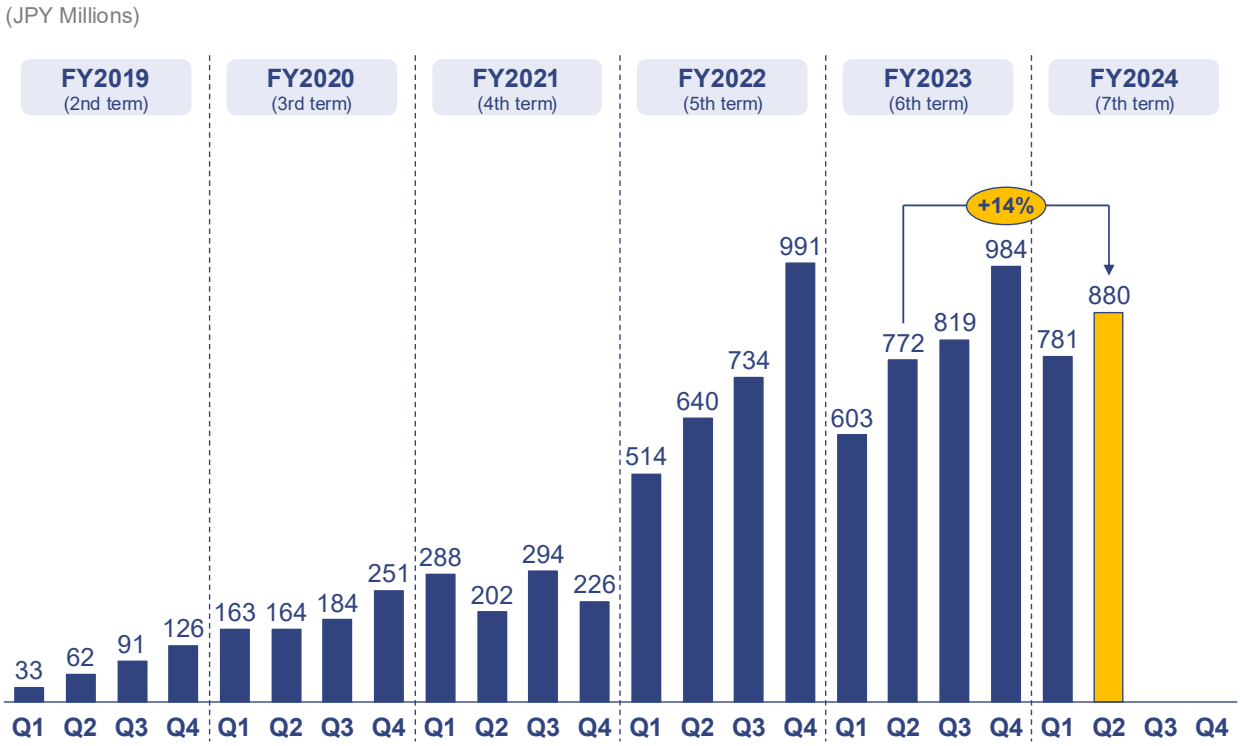
Realizing smart cities through AI is at the core of our service philosophy. In line with this vision, we are actively participating in various smart city initiatives across both the public and private sectors, as well as engaging with industry organizations. By collaborating with a wide range of partners — including leading Japanese and global companies such as NVIDIA and Amazon — we aim to further strengthen our position as a leading edge AI company in Asia.

Consolidated financial results for the Q2 ended June 30, 2024 – Profitability recovering at a rapid pace

(JPY Millions)	FY2023 Q2 Actual	FY2024 Q2 Actual	Increase/ Decrease	Change in Percentage
Revenue	772	880	+108	+14.0%
Gross profit Percentage of revenue	507 *65.7%*	579 *65.8%*	+72	+14.2%
EBITDA Percentage of revenue	-177 -	31 *3.6%*	+208	-
Operating profit Percentage of revenue	-221 -	-5 -	+216	-
Net income Percentage of revenue	-172 -	-35 -	+137	-

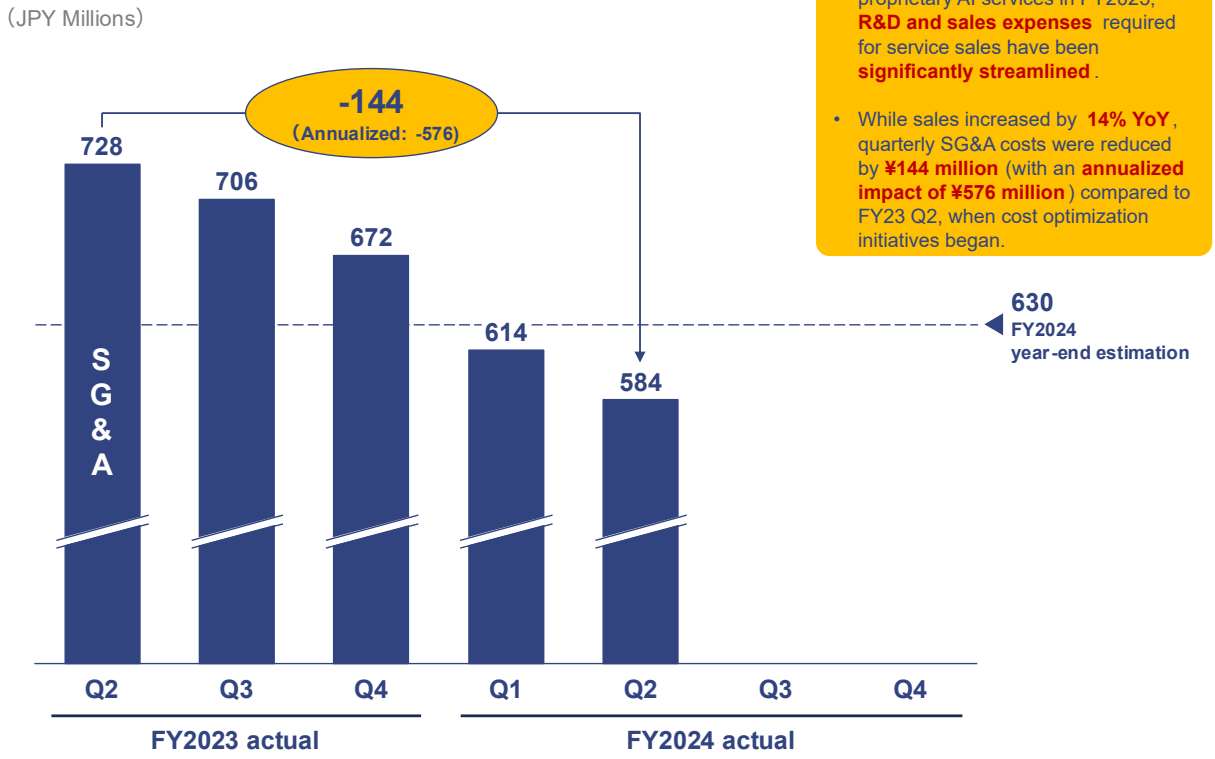
Turning to our financial performance, as mentioned at the beginning, sales this year grew by 14% year-on-year, reaching 880 million yen in the second quarter. While revenue increased by approximately 100 million yen, operating profit rose by 200 million yen. This significant increase in profit is largely attributable to the substantial reduction in selling expenses.

Quarterly revenue



This shows the sales growth curve starting from our second fiscal year. Including our first year, we are now in our seventh year, and have achieved revenue growth for seven consecutive years.

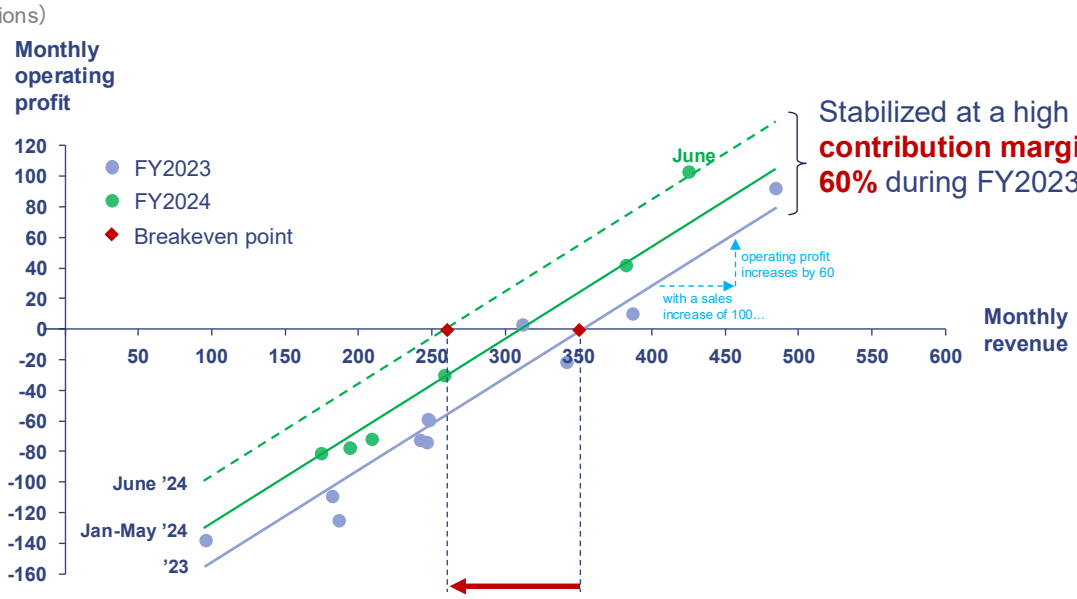
Quarterly SG&A cost



- With the establishment of our proprietary AI services in FY2023, **R&D and sales expenses** required for service sales have been **significantly streamlined**.
- While sales increased by **14% YoY**, quarterly SG&A costs were reduced by **¥144 million** (with an **annualized impact of ¥576 million**) compared to FY23 Q2, when cost optimization initiatives began.

Looking at the trends in selling and administrative expenses, in the past years — particularly last year and the year before — we made significant investments in building our sales organization and advancing research and development. However, those investment phases have now settled down, and as a result, expenses have improved significantly compared to the same quarter last year.

Relationship between revenue and OP (FY2023–FY2024 monthly results)



With the establishment of AI services, sales and development activities became more efficient. As a result, SG&A expenses decreased significantly, leading to a **major improvement in the break-even point**.

This is an analysis of our break-even point. In this chart, the horizontal axis represents monthly sales, while the vertical axis shows monthly operating profit, with each point plotted based on our monthly performance.

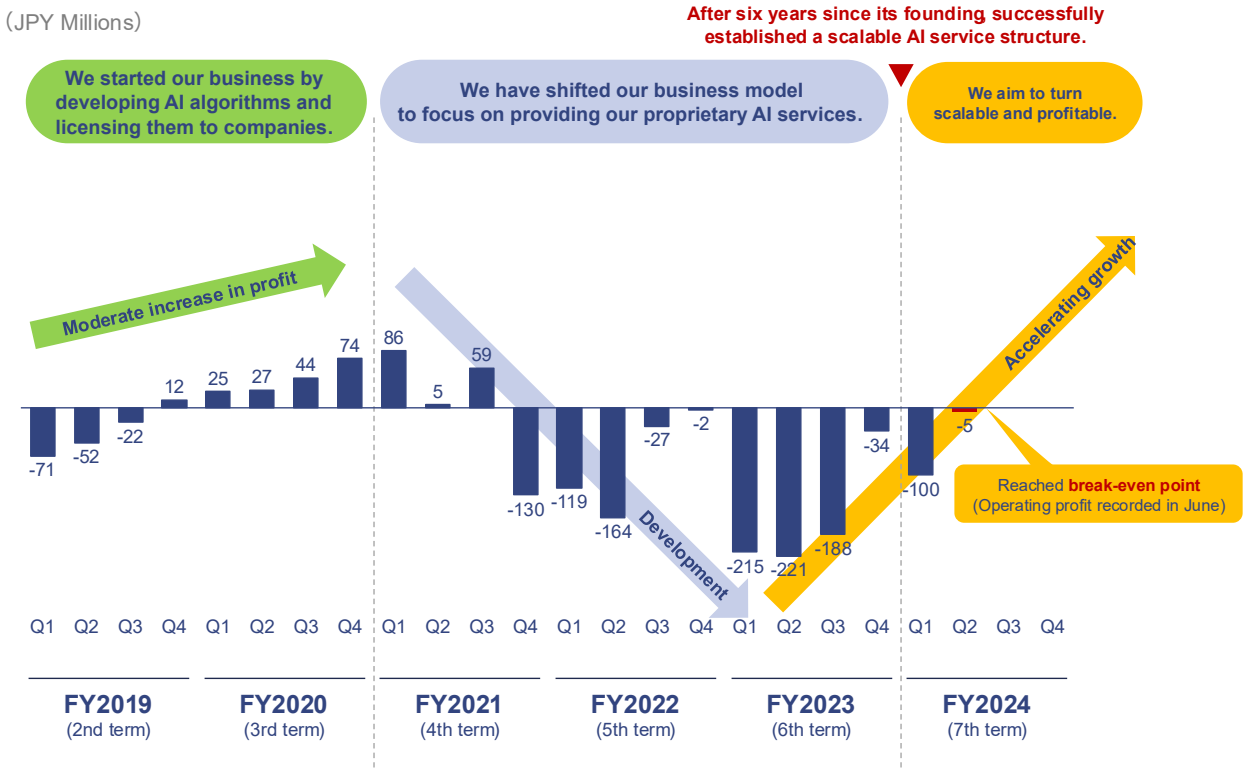
In simple terms, the light blue data points indicate how much profit increases when sales increase by 100 units, which reflects our contribution margin. Currently, the contribution margin stands at around 60%, maintaining a high level similar to last year.

At the same time, the break-even point itself is an important factor. This is represented by where the sloping line intersects with the monthly sales axis. If you look at the rightmost blue line based on FY2023 results, the central green solid line reflecting January to May this year, and the leftmost dotted line that includes June's results, you will see that the break-even point has been gradually lowering while maintaining the same contribution margin.

This indicates that our ability to generate operating profit from the same sales volume — in other words, our earning power — has improved.

We expect further cost optimization in the second half of the year. This mechanism is, in fact, the underlying reason why we are confident about achieving higher operating profit in the latter half.

Evolution of our business models and quarterly operating profit performance.



This shows the transition of operating profit from our second fiscal year onward. At the time of our listing on the Mothers market in 2020, we had just crossed the break-even point and began generating operating profit.

Since then, from 2021 to 2023, we entered a period of business investment. During this phase, as indicated in green at the top left, our focus shifted from basic AI license sales to advancing our edge and smart city AI platforms and transitioning into a company that develops and delivers its own edge and smart city services.

By the end of fiscal year 2023 — our sixth term — we announced that this transition had been successfully achieved. What this signifies is that, going forward, we are now positioned to steadily increase our earnings.

In fact, while we recorded a 100 million yen loss in the first quarter of fiscal year 2024, by the second quarter we had already reached the break-even point. Most notably, in June, we turned operating profit positive.

By continuing this momentum, we believe we will be able to generate strong operating profits in the third and fourth quarters, as reflected in this graph.

Financial results for FY2024 Q2

Reached **break-even point** in Q2
(**Operating profit was achieved in June**,
the final month of the quarter).

Successfully shifted to the profit and **cash generation phase**
after two years of business investment from Q4 FY2021.

On track to **generate profits starting from Q3**
(Supported by a high contribution margin,**a sharp increase in profitability is expected after break -even**)

A favorable impact on future performance is expected, assuming an exchange rate of **160 JPY/USD** for imports and procurement of NVIDIA edge boxes and LED components, with further **positive effects** anticipated if the yen appreciates.

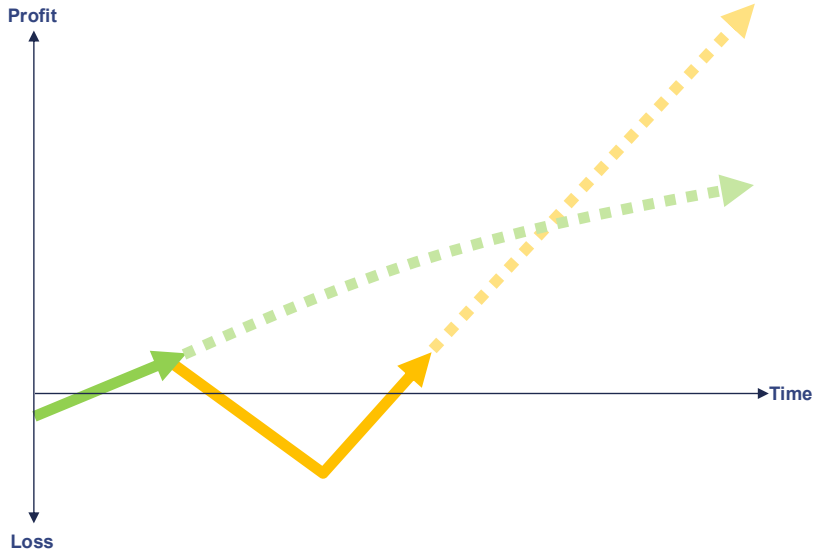
In summary, the second quarter marked an important milestone as we reached our operating break-even point. This signifies our successful transition from an investment phase to a phase focused on generating profit and cash flow — in other words, the investment recovery phase.

Looking ahead, we now have a clear outlook for generating profits from the third quarter onward. At the same time, we expect profitability to increase steadily, supported by our high contribution margin.

As for foreign exchange, which is often viewed as a market risk, we have based our assumptions on an exchange rate of 160 yen to the dollar. At this stage, we do not regard this as a significant risk.

Strategic investments during this period, though resulting in temporary deficits, laid the foundation for future profit expansion and long-term growth.

【 Image of profit expansion for each business model*1 】



*1 This illustration shows a comparative image of scaling based on business model selection. This material does not forecast future profits.

Our business model

【AI Service sale 】

- Building an AI service requires not only the development of AI systems spanning a wide range of front-end and back-end elements, but also the establishment of a sales structure to reach end users.
- **While offering high profit margins and the potential for significant growth through scaling, it requires upfront investments in the short term, which is a disadvantage.**

【AI license sale 】

- The developed AI algorithms themselves become a source of revenue, making **short-term profitability achievable** .
- However, as revenue tends to be directly linked to the number of personnel and licenses sold, **future scaling may face challenges in achieving rapid profit growth** .
- Furthermore, after reaching a certain scale, growth often **slows down or stagnates** .

This is the final slide regarding our financials. Why did we undertake three years of investments? We believe there was significant meaning in doing so.

In the early stages — specifically in our second and third fiscal years — our main business centered on selling AI licenses, as shown in the green box. Selling AI licenses to large corporations was a strong source of short-term revenue and profit because it generated income quickly and easily. However, in terms of scaling the business by a factor of 100, this model presented serious challenges. Growing revenue tenfold would require increasing the workforce by seven to eight times.

This dependency on human resources is a major growth constraint, not only for us but across the AI industry. Businesses directly tied to headcount tend to hit growth ceilings easily, and achieving rapid, exponential growth becomes difficult. Furthermore, as more engineers and salespeople are hired, it becomes harder to secure top talent, which is another factor inhibiting industry growth.

If we had continued with this AI licensing business model, the growth trajectory would likely have followed the green dotted line, with incremental but limited profit growth.

Instead, we chose a different path, as represented by the yellow box. As shown by the yellow solid and dotted lines, we deliberately took on investment that created a 'V-shaped' dip in profitability. This was necessary to build our AI service business.

Constructing this business required significant front-end and back-end investments, which went far beyond developing AI algorithms. As explained in earlier slides, without foundational technologies — such as

security systems, visualization and management systems for edge devices, automatic remote updating systems, and platforms capable of rapid deployment — AI services cannot be delivered to end customers.

Developing these supporting systems was neither simple nor inexpensive. As a result, while investing heavily in this infrastructure, our short-term sales were still limited, which led to temporary losses. This was the unavoidable short-term downside.

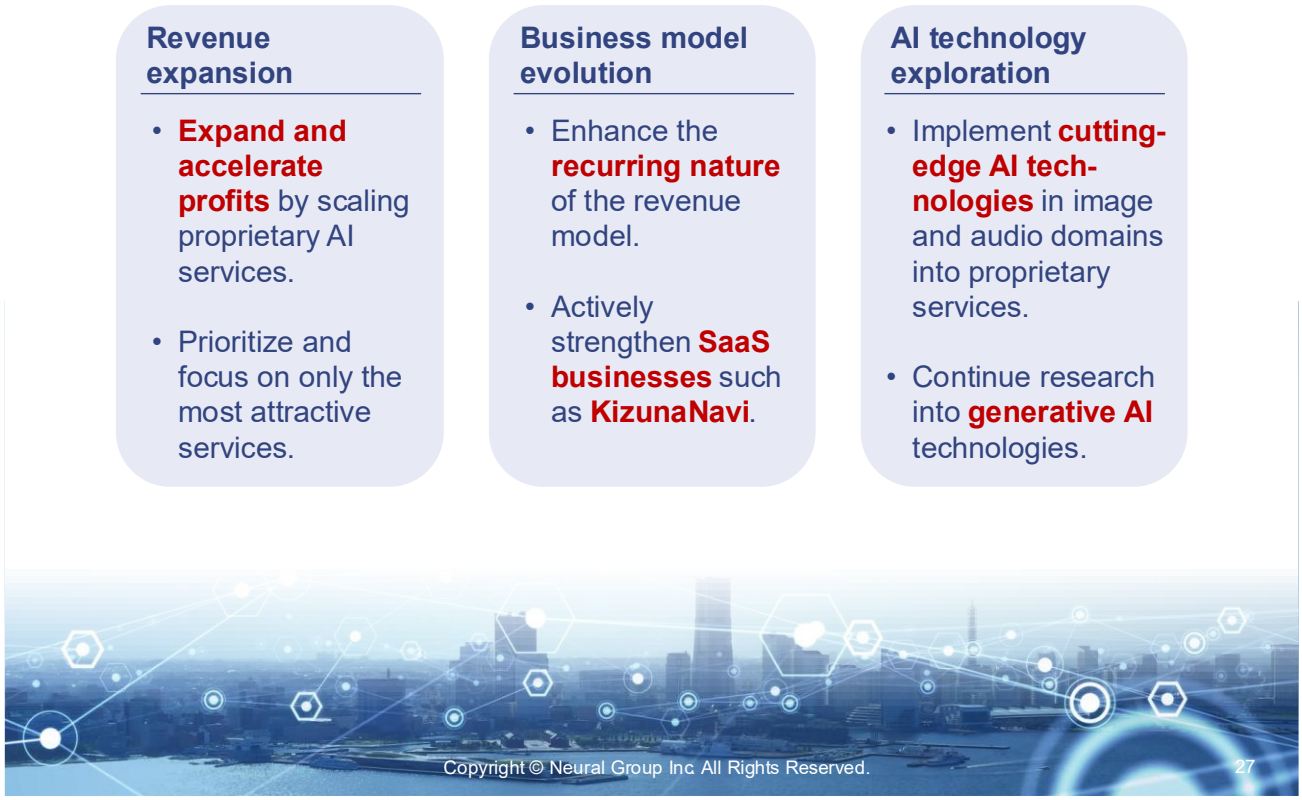
However, why did we choose this path? It is because once we cross the break-even point, the contribution margin becomes overwhelmingly high. Scaling the business by tenfold no longer requires ten times the staff. Business can now grow with a limited workforce, and we can offer the same service to many customers without having to create new solutions each time.

This ability to scale without proportional increases in costs is precisely what leads to a high contribution margin.

While, on a short-term view during these past two to three years, this decision made our profitability look weak and placed us in the red, the dotted line showing future projections indicates a much steeper and faster upward trajectory. This is the key strength of our business model.

With this background, we made the strategic shift to AI service sales and have been steadily driving this transition forward.

Our growth strategy



Finally, I would like to discuss the direction of our growth strategy.

Our medium-term strategy consists of three main pillars.

The first is revenue expansion. As we explained in our full-year results, the reason we transformed our business was to enable scalability and achieve a leap in profitability. With that in mind, we intend to steadily execute on this plan from the second half of this year into next year.

At the same time, we recognize that our current range of services may be somewhat too broad. In fact, during this year's annual shareholders' meeting, some shareholders pointed out that we may have too many services, and I share that view. At present, many of our small and mid-sized services are steadily growing, but going forward, we believe it is necessary to consolidate and focus. We aim to scale some of these services to a significantly larger size — perhaps by an order of magnitude — while at the same time streamlining and integrating our service lineup.

The second pillar is strengthening our revenue model. This means enhancing the recurring nature of our business. Until now, some of our revenue has come from equipment sales, which are typically one-time transactions. While maintaining steady sales of these products is important, our goal is to strengthen recurring revenue streams so that our business can achieve more exponential growth. To that end, we will continue to actively expand our SaaS business, particularly through *KizunaNavi*, and increase the share of recurring revenue.

Lastly, as I mentioned earlier, we will continue our research into AI technologies, which form the foundation of our business.

That concludes my remarks.

Question & Answer

Moderator [M]: We will now move on to the Q&A session. Our CEO, Mr. Shigematsu, and CFO, Mr. Kisaka, will be answering your questions.

If you have a question, please click the 'Raise Hand' button on Zoom, and we will call on you in order.

Now, Mr. Iwamoto, please go ahead.

Iwamoto [Q]: This is Iwamoto from TIW. I have two questions, so I'd like to ask them consecutively. First, regarding selling and administrative expenses, I believe the SG&A ratio for the second quarter is 66.4%. Should this be considered a stable level going forward, or is it rather a temporary figure in the investment cycle? In other words, how should we view your SG&A ratio in a normalized state? That's my first question.

The second question is about the benefits of yen appreciation in relation to imports and procurement. While you explained that yen appreciation would be positive, could you provide some quantitative insight? For example, with the current assumption of 160 yen to the dollar, what kind of benefits would result from a fluctuation of 1 yen or 10 yen? Any rough idea would be helpful. Those are my two questions.

Shigematsu [A]: Thank you very much. Starting with your first question regarding the 66.4% SG&A ratio — I assume your point is that this still seems quite high. At the moment, yes, this level is considered stable. That said, I do agree it is still high.

Iwamoto [Q]: Right, I can see from your graph that the ratio is trending down quarter over quarter. But given the need for further investment in SaaS and personnel, should we expect this bar graph to continue decreasing? Or should we view it as fluctuating as part of the investment cycle?

Shigematsu [A]: Thank you for clarifying. To be honest, I think there is still room to reduce SG&A expenses. While new services like *KizunaNavi* may involve some increases, we expect any rise to be minimal or at the same level.

Let me break this down into two parts. For existing sales activities, I believe we can achieve further efficiency. Sales productivity has been improving considerably, with lower staffing and outsourcing costs while increasing revenue. This means that higher revenue does not necessarily require higher costs. I believe we can continue to grow revenue without significantly increasing SG&A.

Of course, I don't mean we will cut SG&A in half or anything drastic. But gradual and continuous improvement is very much achievable.

Now, regarding your point about whether new services like *KizunaNavi* will create cost fluctuations — I don't believe so. We are in partnership with Sony and plan to work with external partners on sales as well, so we do not need to build a large in-house sales force.

Furthermore, we are not aiming to rapidly scale *KizunaNavi* by adding many small customers. Instead, the focus is on increasing user seats within existing enterprise customers. This means we do not need to proportionally increase headcount to expand sales.

If additional personnel are needed, we intend to rely on external partners. While some may worry that relying on partners could create risks — and indeed this is a common issue in the AI industry — we are addressing this by diversifying our partner base to avoid overdependence on any single distributor. This is the approach we are taking for SG&A expenses.

Iwamoto [M]: Thank you. That's very clear.

Shigematsu [A]: Regarding your second question on foreign exchange impact — when we started our LED business a few years ago, the exchange rate was around 110 yen. When it rose to 150-160 yen, it reduced our profits by roughly 100 to 200 million yen. This was a major negative impact as we acquired LED capabilities through M&A.

However, despite that, we are now achieving revenue and profit growth based on a 160 yen assumption. So any yen appreciation going forward will strongly support our business performance.

Iwamoto [M]: Understood. Thank you very much.

Moderator [M]: Thank you. Are there any other questions?

Iwamoto [Q]: I'd like to ask one more follow-up question. I'm particularly interested in the future scope of your SaaS business. *KizunaNavi* does not seem to fit directly into your smart city solutions. Why did you decide to offer this service? Also, will your SaaS business remain tied to smart city-related digital solutions, or are you planning to expand into other industries, such as apparel or logistics?

Shigematsu [A]: Thank you. Yes, you are right — *KizunaNavi* may not fit perfectly into the smart city category. However, from our perspective, while there is a difference between office work and activities in city spaces, we see this as part of the larger societal issue of work style reform, which makes it an important company initiative.

That said, I do agree that our business scope is quite broad. We intend to narrow our focus somewhat, prioritizing areas with large market potential (TAM). We plan to select industries more carefully going forward and will likely present a clearer direction at a future IR opportunity.

Service selection is also guided by technology. *KizunaNavi* integrates many of our AI technologies — visual AI, language AI, generative AI — and is therefore of great technical interest to us. From the customer's perspective, they may not care about the technology itself, but for us, this comprehensive use of AI is meaningful.

Additionally, people-related markets are currently very large. The recruitment sector, for example, has seen unicorn companies emerge by digitizing hiring processes. More recently, new ways of working and utilizing time have become hot investment themes.

What we are focusing on is employee retention — helping people work better rather than replacing them when they leave. This area of human capital investment is growing, and we believe *KizunaNavi* has significant potential here.

So, regarding your question about whether we will expand SaaS beyond smart city solutions — yes, we do plan to expand into other areas if they are backed by solid market needs and align with our technology. We are and will continue to be an edge AI company, so we intend to develop services that leverage our technological strengths while addressing key social needs.

Iwamoto [M]: Thank you. That was very helpful.

Moderator [M]: Thank you very much. Are there any further questions?

As there are no additional questions, this concludes the Q&A session. Thank you again for attending Neural Group Corporation's FY2024 Interim Financial Results Briefing. This concludes today's event.

[END]

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