

Presentation

Moderator: Thank you very much for taking time out of your busy schedule today to attend the online presentation of Fiscal Year 2023 4th Quarter Results Presentation of GMO Pepabo, Inc.

I would now like to introduce today's attendees. Kentaro Sato, CEO and President

Sato: My name is Sato. Thank you very much.

Moderator: Yoshito Igashima, Executive Director and CFO.

Igashima: Thank you very much.

Moderator: The two members are present today. Today, CEO Sato will give an overview of the financial results. If you would kindly begin.

Sato: Yes, my name is Sato, the President. Thank you for taking time out of your busy schedule to join us today.

I will now present the fiscal year 2023 4th quarter financial results of GMO Pepabo, Inc.

This is a summary of the financial results.

In the fiscal year ended December 31, 2023, although sales increased as recurring-type business performed well, the Company posted an operating loss due to the impact of bad debt-related expenses recorded through the second quarter.

For the fiscal year ending December 31, 2024, we will first achieve a solid return to profitability and aim to grow our business again.

Here is today's agenda. The second half of the document includes reference materials, so please take a look at them when you have time.

First, an overview of the financial results.

Net sales were JPY10,903 million, 103.5% YoY, and operating profit was minus JPY340 million due to the impact of bad debt-related expenses recorded.

In addition, the profit attributable to owners of parent was minus JPY628 million due to the recording of an extraordinary loss resulting from an impairment loss on some fixed assets.

Fourth-quarter net sales were down YoY due to a curb on the amount of purchases of invoices in the Financial Support business. On the other hand, operating profit increased due to the reversal of allowance for doubtful accounts, which continued from the third quarter.

This is an analysis of changes in operating profit.

The business was significantly impacted by bad debt-related expenses recorded in the second quarter, leading to an operating loss.

The results by segment are as shown.

In the Hosting Business, performance was solid due to the effect of the price revision and an increase in the ratio of subscriptions for high-end plans of Lollipop!.

In the E-commerce Support Business, operating profit improved due to the effect of the price revision of Color Me Shop and a reduction in SUZURI's promotion costs.

In the Handmade Products business, gross merchandise value declined, falling short of the previous year's level.

The Financial Support business posted an operating loss due to the impact of bad debt-related expenses.

Here is an explanation of each segment.

First, the Hosting business.

Net sales were JPY5,758 million, 105.9% YoY, and operating profit was JPY1,921 million, 101.6% YoY.

The rental server service Lollipop! posted sales of JPY2,503 million and operating profit of JPY1,921 million.

Customer unit price has been on an upward trend since the price revision in February 2023. On the other hand, the cumulative number of subscriptions decreased as a result of a YoY decline in the acquisition of new subscriptions under low-unit price plans.

The domain name acquisition agency service MuuMuu domain posted net sales of JPY2,348 million and operating profit of JPY303 million.

Although the unit price per customer increased due to the effect of the introduction of the service maintenance adjustment fee from February 2023, the number of new domain subscriptions was sluggish.

Next is the E-commerce Support business.

Net sales increased 105.4% YoY to JPY2,997 million, and operating profit increased 114.3% YoY to JPY756 million.

The online store creation service Color Me Store posted sales of JPY2,067 million and an operating profit of JPY720 million.

In addition to the effect of the price revision implemented in April 2022, contracts for higher unit price plans increased, resulting in a rise in the unit price per customer.

Although cancellations continued to occur for low-unit-price plans, the number of cancellations is gradually calming down, and the overall number of contracts decreased slightly from the previous fiscal year.

The original goods creation and sales service SUZURI posted sales of JPY918 million and operating profit of JPY85 million.

Although gross merchandise value was sluggish due to changes in consumption trends and curbs on promotions, the absence of TV commercials and other large promotional expenses this year helped the business return to profitability in operating profit.

Next is the Handmade business.

Net sales were JPY1,490 million, 90.3% YoY, and operating profit was JPY63 million, 76.7% YoY.

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Although we worked on real events such as the Handmade Market 2023, sales and profits declined due to decreased gross merchandise value.

The gross merchandise value in 2023 was JPY12.9 billion, 85.6% YoY, as promotional expenses were curbed and sales of low-priced products struggled.

On the other hand, the number of registered creators and brands on minne exceeded 900,000. We will continue to aim to make minne a platform that many creators can use.

Next is the Financial Support business.

Net sales were JPY655 million, 110.4% YoY, and operating profit was minus JPY1,064 million.

Operating profit was affected by bad debt-related expenses recorded in the second quarter of the year, which resulted in an operating loss in the cumulative period, despite the reversal of allowance for doubtful accounts in the third and fourth quarters due to progress in the collection of receivables.

In the Financial Support business, the amount of purchases of invoices has decreased significantly since the second quarter of 2023 due to tighter controls. The purchase amount for the fourth quarter was JPY1.4 billion.

Next, I will explain our forecast for the fiscal year ending December 31, 2024.

For the year ending December 31, 2024, we are projecting sales of JPY10,963 million, or 100.5% YoY, and operating and ordinary profits of JPY700 million. Profit attributable to owners of parent are as shown.

There is no change in our dividend policy of a payout ratio of 50% or more, and we plan to pay a dividend of JPY40 per share in 2024.

I will explain the forecast by segment.

The Hosting and E-commerce Support businesses are expected to exceed the previous year's results as unit prices per customer continue to rise, and immediate profits are expected to accumulate.

Sales in the Handmade Business are expected to be flat YoY, but operating profit is expected to fall below the previous year's level due to promotional expenses to expand the gross merchandise.

In the Financial Support business, sales are expected to decrease due to the recent curbing of invoice purchases, but operating loss is expected to improve significantly from the previous year due to eliminating the impact of bad debt-related expenses.

The following is a description of the main measures in each segment.

In the Hosting Business, we began offering MuuMuu Server, which allows centralized management of everything from domain name acquisition to server contracts, in November and is focusing on increasing server use. Until now, after acquiring a domain name on the MuuMuu domain, customers have had to choose the server they would like to contract with from various services, including ours, resulting in a lost opportunity for us. Therefore, we aim to reduce opportunity loss by contracting both domain and server simultaneously. It will also be more convenient for users, as they can make payments and manage their accounts simultaneously. By 2024, MuuMuu Server is expected to acquire approximately 5,000 new subscriptions.

In addition, the Hosting business is currently preparing to offer a new server.

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For example, we are offering new plans to meet the diversifying needs of servers for games that can be played with simultaneous connections and multiplayer, such as Pal World, which sold 19 million units in roughly two weeks after its release on the 23rd of last month, and Minecraft, which has more than 160 million monthly active users, as well as diversified social networking services such as Mastodon and Misskey. We plan to start offering this service by the second quarter of 2024.

In the E-commerce Support business, Color Me Shop is strengthening the acquisition of higher-end plans.

For medium-scale stores, we will increase the number of contracts for stores with gross merchandise scale potential by increasing the number of agency partnerships.

In 2023, we also implemented free WordPress and Amazon Pay.

The convenience of building and operating EC sites is improving daily, so in 2024, we will focus on sales and marketing to acquire new contracts by leveraging these strengths.

SUZURI has experienced an increase in purchases through smartphone apps, and in 2023, the gross merchandise value circulated via apps exceeded JPY600 million. In 2024, we will focus on smartphone apps, which are experiencing growth in gross merchandise value, and expect to acquire a distribution value of JPY1 billion.

We also aim to expand the number of users by continuing to utilize digital content and IP.

In the Handmade business, low-priced items continue to struggle, and gross merchandise value is declining.

Regarding promotions, profit margins are also on a downward trend, as discount campaigns are the primary means of promotion. To address these issues, we intend to mainly target customers who purchase creations in the medium and higher price ranges with higher unit purchase prices.

We will make improvements in the future by expanding the use of minne advertisements and devising promotional measures.

In addition, minne plans to offer new products for creators by the end of 2024.

We will continue to focus on measures to build a community of creators to facilitate their activities.

Next, let me explain our future business growth.

Consolidated net sales have been steadily increasing annually. Although we recorded an operating loss in 2023 due to bad debt-related expenses, we will return to the levels of the past few years in 2024.

Even if profits in 2024 will not be as high as they were in 2020 and 2021, when demand for stay-at-home was high, we will certainly return to profitability and achieve business growth again in 2024.

Excluding the Recurring-type business Hosting Business and the one-time revenue from Color Me Store, sales from the Recurring-type business in the fourth quarter of 2023 totaled JPY1,760 million and are growing steadily.

The gross merchandise value of E-commerce-related services, including the three services of Color Me Store, SUZURI, and minne, totaled approximately JPY56.0 billion in the fourth quarter.

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Despite a continued decline in gross merchandise value at existing Color Me Shop stores, favorable sales of food products and gourmet gifts during the year-end and New Year holidays increased gross merchandise value QoQ.

Cancellations after the price revision have also settled down, and we aim to increase gross merchandise value by acquiring upper-tier stores.

Regarding initiatives other than services, in human capital, the ratio of creators, including engineers, designers, and directors, increased from 57% to 60%.

We will work to strengthen our development capabilities by raising the ratio of creators over the medium to long term.

In addition, Pepabo R&D Institute, which conducts technological R&D, promoted the use of AI, such as a function to detect fraudulent use by users and a large-scale language model to support medium- to long-term business growth, and also developed a function that recommends similar products using image AI.

These are the new initiatives, including AI.

The Business Development Department, newly established in October 2023, will provide new services utilizing AI for toC and toB in the future. We hope to commercialize new services that create a future with AI in 2024, in line with an era in which the use of AI will become the norm.

For the toB market, we will develop the AI Transformation business.

We will develop services that contribute to improving corporate productivity by leveraging our technological capabilities and customer service knowledge.

For the toC market, we will develop the AI eXperience business, which will support the output of creators by providing new methods of expression using AI in the field of digital distribution, etc.

This concludes the explanation of the financial results. Thank you all very much.

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Question & Answer

Moderator [M]: This concludes the presentation of the summary of financial results for this fiscal year. Thank you very much.

We will now move on to the question and answer session. First of all, I would like to explain how to submit questions.

If you have a question, please press the “raise your hand” button at the bottom of your Zoom screen. I will call you by the name you have registered with Zoom, so please press the unmute button when you are called. At that time, please state your company name and your name, and then ask your question.

Now, if you have a question, please press “raise your hand”.

Yes, we have received a question. All right, first, Mr. Tokunaga, please state your question.

Tokunaga [M]: Hello, can you hear me?

Moderator [M]: Yes, we can hear you.

Tokunaga [Q]: Excuse me, my name is Tokunaga of Daiwa Securities.

I would like to make two points regarding the company plan and one point regarding the new business.

First, the company plan. I believe that the fourth quarter will be better than the third quarter, and the plan for the current fiscal year is for the deficit in the Financial Support to shrink significantly, which is the outlook for collecting such receivables.

The trends in the collection of receivables and the reserve ratio for the Financial Support business are the assumptions for this projection. How do you plan to achieve this guidance for the Financial Support business this fiscal year? Could you tell us about the first point related to reserves?

Moderator [M]: Yes, thank you. Then, if you would please

Igashima [A]: Well, I, Igashima, will answer your question.

First of all, regarding the allowance for doubtful accounts, we set up an allowance for doubtful accounts of approximately JPY1.5 billion in the second quarter of last year, and in terms of the recovery of the large outstanding balance, this was done last year. For the current fiscal year, rather than making significant progress in collection, we are now considering the possibility of steadily recovering a certain amount of money each month. Therefore, we do not expect to incur any additional large debts in the future, and with regard to the reversal of debts, we do not expect to be able to recover hundreds of millions or tens of millions in a single month, which is one of the reasons we are considering the current allowance for doubtful accounts.

Regarding this fiscal year, in terms of how we will operate our business, basically, the banner of the GMO Pepabo consolidated group is to support creators, and in line with this, we intend to promote the purchase of receivables, mainly from engineers and creators.

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Currently, we are focusing on this, along with other SES companies, and we are considering achieving our performance targets for the current fiscal year by promoting the purchase of safer loans through alliances with these companies and other means. That is all.

Tokunaga [Q]: I'm sorry, just a follow-up. Looking at the balance sheet alone, it looks like there are still quite a few accounts receivable. Is it your understanding that you have recovered most of the seemingly risky receivables that existed in the past in this fiscal year? Please tell us about the contents.

Igashima [A]: Yes, unfortunately, in terms of collection, we have made some progress. Therefore, at the end of 2023, the amount of accounts receivable is JPY1.6 billion, while the amount of loans receivable is currently JPY1.1 billion, so basically, the amount of expected receivables is the difference.

On the other hand, regarding this receivable, if the counterparty were to go bankrupt, for example, we would treat it differently, but as the company is still in existence, we follow the guidance of the auditing firm and treat it as it is now.

Tokunaga [Q]: I'm sorry, that was not the right way to ask. So, am I correct in thinking that it is generally reserved? Is that too optimistic?

Igashima [A]: In that case, since we have already allocated for the most part, we do not currently expect to add any large amount to the allowance.

Tokunaga [Q]: I understand very well. Thank you very much.

Second, I would like to ask about the corporate plan for this fiscal year other than the Financial Support business.

In your company plan for this fiscal year, you expect an increase in profit in the E-commerce Support business and also an increase in sales in the Handmade business. In the midst of a slightly difficult EC market, I think it is necessary to make certain corporate initiatives.

On the other hand, the EC market is undergoing major changes, such as the move by Mercari and the price increase by BASE. Under these circumstances, how do you plan to manage minne, SUZURI, and Color Me Shop and achieve the plan for this fiscal year? Please explain.

Sato [A]: I will answer this one.

First of all, in terms of our EC-related services, the number of individuals selling on their own has been affected by the "stay at home" period and has grown rapidly, but as people began to take action in the real world, the use of these services has declined, and this has had a noticeable impact on the current situation.

On the other hand, there is an increasing number of similar EC products in the EC market, and although we have always been in the toC field, we are now gradually shifting to the toB field.

For C customers, churn is gradually increasing, and for B customers, of course, the top line is growing, and those whose GMV is growing are continuing to do so. Conversely, cancellations are increasing for those whose GMV is not growing, as in the case of C. Although there is profit from this unspecialized [Inaudible], we assumed that the case numbers are not growing.

In the current fiscal year, given this situation, we assume that we expect sales growth in areas other than GMV rather than a large increase in sales.

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For example, in the case of minne, we will provide fee-based services for creators or advertising on the minne platform.

Regarding SUZURI, digital content, IP sales, and other areas beyond those created by existing creators are also being considered to expand GMV.

Regarding Color Me Shop, as explained earlier, we are now thinking of providing more services to stores that sell at the top end of the market rather than to long-tail players, and we expect growth in ARPU rather than in the number of sales. That is all for my answer.

Tokunaga [Q]: I'm sorry. I would like to ask for a follow-up on two points.

Firstly, even though the EC market is rather weak, do you plan to somehow increase sales? In other words, is it correct to say that you plan to achieve the plan by conservatively building up the market and increasing sales other than GMV?

Sato [A]: Yes, we are making a very conservative plan. It was a little difficult to read whether or not GMV itself would be able to grow through our efforts. There are some plans to increase sales to a certain extent by increasing promotion, but basically, the plan is based on the premise of natural growth, so we are not making the plan too aggressively.

Tokunaga [Q]: Thank you very much. I'm afraid the other follow-up is a bit short-term thinking, but it is quarterly. Of course, SUZURI and minne have busy seasons, but if you are talking about measures that will be effective, of course, the measures being implemented now will contribute to the 4Q and the second half of the year, so should we expect some kind of growth rate recovery in the second half? Or, in fact, can we expect to see the contribution of measures already in such areas now?

Sato [A]: Well, in that respect, there are quarterly trends, so it is easiest to understand by looking at the QoQ comparison. For SUZURI and minne, we had done a slightly stronger promotional campaign in the 1Q of last year, so I think it would be easier to understand the progress if you compare it with the 2Q to 3Q of the previous year.

Tokunaga [Q]: I understand very well.

Lastly, I would like to ask about the business using AI. This time, you have announced a number of new services that will create the future with AI, and you are aiming to commercialize them this fiscal year. How much of this is included in your guidance, and how do you plan to grow it from the next fiscal year onward, even if you are just planting seeds this fiscal year? It would be very helpful if you could give us an idea of this. That is all.

Sato [A]: With regard to AI, we have included expenses, but we have not included sales estimates. We are still in the initial stage of the project, so I don't think it will hit the top line this fiscal year. We are considering the next fiscal year and beyond.

What we can do this term is to set up an AI business and encourage clients and creators to use it in advance. For example, we can offer it free of charge for a certain period of time. Rather than adding that much to our performance this fiscal year, we think the situation will not have much of an impact since costs have already been factored in.

Tokunaga [Q]: Thank you very much. Should we consider these sales as an increase in the unit price of existing services?

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Sato [A]: Consideration [Inaudible], although we are thinking of it as several projects. For example, we will provide solutions for corporate clients, which we have not yet done, and we would like to have a certain amount of stock in this area. In terms of the amount of money, the corporate part of the business is the part that could be offered for a few hundred thousand JPY or a few million JPY rather than what we have been offering. As for the “toC” aspect, as we have done in the past, through methods such as receiving money directly from creators or providing media, we expect that many people will use the service and that various types of transactions and [Inaudible] planning will be carried out. It is assumed that the business will be in the form of a few tens of JPY or a few hundred JPY.

Tokunaga [M]: I understand very well. That is all from me. Thank you very much.

Sato [M]: Thank you very much.

Moderator [M]: Thank you very much, Mr. Tokunaga. Are there any other questions? If you have any questions, please press the “raise your hand” button. Are there any other questions?

So, we still have some time left, but since there are no other questions, we will end the question-and-answer session.

This concludes the GMO Pepabo, Inc. online Fiscal Year 2023 4th Quarter Results Presentation.

After the Zoom, a questionnaire will appear, and we would appreciate your responses.

Thank you very much for your participation today.

Sato [M]: Thank you very much.

Igashima [M]: Thank you very much.

[END]

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