

Summary of Q&A at the Small Meeting with Analysts and Institutional Investors

Date/Time: June 4, 2021 (Friday) First meeting: 1:30 p.m. - 3:00 p.m.
Second meeting: 3:30 p.m. - 5:00 p.m.

Form: Video conference

Panelists: Ichiro Tsuge, President & CEO; Tadataka Okubo, Senior Managing Executive Officer

Hisashi Eda, Managing Executive Officer (Regional & Social Infrastructure Group), Yasuhiko Terada, Managing Executive Officer (Telecommunication Group), Eiji Haraguchi, Managing Executive Officer (IT Services Group), Toshiyuki Awai, Managing Executive Officer (Financial Services Group), Takanori Minatohara, Managing Executive Officer (Enterprise Group), Junji Hirooka, Managing Executive Officer (Distribution Group, Global Business Group), Nagaki Fujioka, Executive Officer (Business Innovation & Digital Transformation)

Q: What challenges did you encounter after becoming the President & CEO? What do you want to achieve? What thoughts do you have looking from perspectives even longer-term than that of the medium-term management plan?

A: Currently, I have been thinking about two points. One is that society is growing serious about ESG and the SDGs. The other is that customers have grown more serious about DX than before. Behind these trends are changes in roles that companies are required to play and in workstyles, in addition to the impact of COVID-19. The important issue is how we survive these trends. While we cannot survive unless we are strong as a company, the definition of the word "strength" grows more diverse and complex with the times and is changing rapidly. We cannot survive unless we continue to improve as a company. Previously, the strength of a company referred only to its size and the amount of its profits. Now it also includes ESG, the SDGs, and health and productivity management. What has been especially important is a capability to respond flexibly to change, which is occurring at an accelerated rate. Our management must be agile, instead of traditional top-down management. If it is not, we cannot keep up with the rapid change in society. This leads us to the conclusion that human resources are important. Without diversity, we will be a typical weak company that cannot be strong, cannot accelerate, overlooks issues and cannot find solutions. I would like to manage the company in a way that permits flexible change instead of adhering only to the System Integrator role or the telecommunications field.

Q: How will you as President & CEO work to ensure the people on the front lines share your thinking about improving the company? How deeply will these ideas become entrenched?

A: I think that open, direct communication is the only way to share my ideas with the people on the front lines. As a first step, I have begun to use the internal social media service, e-mail, internal portals, and opportunities such as internal events and information-sharing sessions to communicate openly and directly with the people on the front lines. One year has passed since I began this initiative. While there are no KPIs measuring how much my ideas have spread among the workforce, I believe that they will surely become entrenched if I continue with the initiative.

Q: Could you explain the target for the improvement of the operating profit margin in the new medium-term management plan? Are there any factors delaying the improvement of the operating profit margin, such as upfront investments?

A: The operating profit margin has continued to improve. The improvement is due mainly to three measures: having stopped doing needless things, attempting difficult things, and avoiding less profitable projects as much as possible. I think that numerical results are achieved through the provision of appropriate solutions to clients' issues and needs, instead of aiming to improve the operating profit margin. We will invest up front in human resource development, office integration, new businesses, and other things. Based on this, our goal is to achieve the targeted operating profit margin for FY2021 and FY2023. It is not easy to increase operating profit margin from 9% to 10%. We must do more difficult things and things that have greater added value. While there is a trend of customers shifting to in-house production, they cannot start doing everything on their own at once, and they do not intend to do so. The crucial point is whether we will be deemed unwanted or whether customers will request that we work with them as their partner when many System Integrators, including us, are available. Of course, our goal is to be chosen to be their partner by improving our skills in the combination of technologies at will, which is our strength. Under these circumstances, an operating profit margin of 10% is an extremely realistic target.

Q: What about the improvement of operating profit margin by segment?

A: The sales of the Telecommunication Group are a fairly large proportion of the overall sales of the company. While the group's profit rate is relatively low, this segment is important in terms of sales volume. I think that the operating profit margin will increase if we are able to newly approach the RAN/wireless domain. The IT Services Group is creating a mechanism for maintaining a stable income, instead of a sales-oriented mechanism, in its recurring businesses such as the cloud and data center businesses. I believe that the provision of highly reliable services will be a reliable source of income and contribute to profit because security is a matter of concern at present.

Q: One of your targets is an ROE of 13%. How will you achieve this?

A: First, it is based on the indicators of operating profit and operating profit margin, which measure the results of the businesses. We believe that ROE will rise to 13% at a minimum, based on growth of profits. I don't think it is high, but it is not necessarily true that the higher it is, the better. Of course, the dividend policy also needs to be taken into consideration. Our stock is said to be a 5G stock, and we have been asked when the 5G business will begin to weaken. However, the business is not yet in full swing. DX is also a theme. Further, new businesses, such as businesses connecting AI to other AI, could be created. There are business opportunities in many fields, and we could aim to achieve even higher quantitative targets. We are also engaged in a variety of SDG and ESG initiatives. We will improve our PR activities to share information with you. Please keep an eye out for it.

Q: What are the ideas you have behind the quantitative targets set in the medium-term management plan?

A: We wanted to set simple KPIs. We would like to achieve the bottom-line 40.0 billion yen net profit target, paying attention to qualitative aspects as well, instead of showing complicated numerical values.

Q: In the medium-term management plan materials, you say, "Expand the scope of value." We need KPIs that allow us to understand CTC's initiatives. Did you discuss KPIs such as the ratio of business from services and that of DX, which have been announced by other companies?

A: I think that content of our businesses will change in the next three years. Examples include the shift from 4G to 5G and the sophistication of systems. The target operating profit of 40.0 billion yen reflects our desire to express the speed, aiming to reach that level in three years. KPIs are difficult to set, and one KPI represents just one aspect of many. We need to keep a multidimensional perspective when managing the company. Therefore, we do not want to set KPIs that are incomplete. Of course, we will keep monitoring them. We have internal indicators by model. However, even if the development and System Integrator models increase significantly, it means nothing if their quality is low, which makes the matter difficult.

Q: I think that the number of engineers and the number of qualified people, among others, are visualized in documents other than the P/L statement. I request that you widely disclose information about things that are perceived as an expansion of the scope of value.

A: The relevant matter in that sense is operating profit margin. We will surely explain special factors, such as the relocation in the current fiscal year. We will also give specific explanations about the progress in the nine priority scenarios of the medium-term management plan.

Q: In your review of the previous medium-term management plan, you evaluated Go Upwards! as "○" instead of "◎". Does it mean that there was not as much progress in the digital business targeting key customers as was hoped while you proceeded with agile development and low-code development?

A: We evaluated it as ○ relative to others because it is far from finished and we have yet to do all that we can do. It is neither "△" nor "×". We intended to indicate that we can have higher hopes for it.

Q: What prospects do you have for the expansion of the wireless domain in your businesses targeting telecom carriers?

A: I think that O-RAN will be the mainstream in the RAN domain. We have received orders for projects on the common platform using virtualization technologies, server technologies, and network technologies, which are our strengths. It will remain one of our core businesses.

We would also like to attempt new things in the wireless domain. As a company, we must acquire national qualifications to handle wireless equipment. We are taking initiatives to increase the number of qualified personnel. We would like to create a system which will enable us to support wireless equipment design, sales, maintenance, and operation in the wireless domain. This is something we already do in the System Integrator domain. We hope to establish a track record in these businesses with the cooperation of the other business groups.

Q: What do you sell in the RAN domain?

A: Common platforms include servers and virtualization software, which are our strengths. The majority of the equipment introduced by telecom carriers in Japan in the wireless domain is mainly from Europe. For medium- to small-scale networks, such as local 5G, we have begun to see multiple emerging products. We conduct PoC for multiple types of equipment to cater to customer needs.

Q: Could you give us a general idea about the upcoming schedule and scale of the project applying virtualization in O-RAN, from a quantitative perspective?

A: Business in the RAN domain has just begun. We will try hard to increase the scale of the business so that it will have a certain level of presence internally.

Q: We believe that progress in the virtualization of telecom carriers' core networks has resulted in a wide range of benefits for CTC, which handles compatible products. However, the hardware market is shrinking. On the whole, this is expected to make growth difficult for CTC. What is the impact of the core network virtualization?

A: To keep growing, we need to take two measures. One is to secure sales by increasing the quantity of sales in existing domains. The other is to explore new domains. We would like to do both. Demand will remain for dedicated equipment, so we will continue working in existing domains while attempting to enter new ones.

Q: Do you mean that you will continue to grow in total by entering new domains, such as wireless and O-RAN, because CTC's existing domains will be affected by decreased unit prices in the future?

A: That is correct.

Q: You said that the Telecommunication Group will attempt new things in the wireless domain. Do you mean specifically that you will develop products in the RAN domain or that you will prepare human resources who can handle the technologies?

A: The latter is correct. We are not a manufacturer. Therefore, we do not create or produce goods but develop human resources.

Q: Will you improve the level of knowledge that your human resources have by training them on RAN related technologies because you cannot talk with customers without knowledge of the wireless domain when collaborating with a telecommunications construction company?

A: To start with, companies that do not have national qualifications are not permitted to work in the wireless domain. We have continued to develop human resources to reach that level and be permitted to engage in sales, construction, operation, and maintenance.

Q: Do you mean that some of your organizations are working to ensure their staff acquire qualifications at the cost of the rate of operations?

A: CTC System Management Corporation has staff members with wireless qualifications. In addition to transferring qualified staff members and recruiting qualified people from outside the company, we ask our staff who want to take on the challenge of qualification to study hard to become qualified.

Q: What are CTC's initiatives and products addressing local 5G, edge computing, and MEC?

A: Regarding local 5G, we are working mainly on proof of concept (PoC) or some products. By partnering with the Regional & Social Infrastructure Group we operate a business targeting local governments, and we work together with the Enterprise Group on a business targeting manufacturers and major enterprises. We handle local 5G, and also private 5G, which telecom carriers will begin to work on in the future. Wireless

technologies are essential for advancing these businesses, so we are proactively engaged in initiatives to acquire these technologies.

While the number of projects that we can disclose is limited due to reasons related to customers, an example that we disclosed recently is the implementation of a corporate version of the hometown tax donation program involving the dispatch of temporary workers. We implemented this program for the prefectural government of Niigata. Our employees participate as advisors in projects solving local issues using ICT. This is the first example of a program with a Japanese prefecture involving the dispatch of temporary workers. If similar projects begin with other prefectures, we would like to work together with the Regional & Social Infrastructure Group to expand the initiative.

A: Last fiscal year, the Enterprise Group began to receive business inquiries about local 5G verification tasks for manufacturing plants. The Enterprise Group provides support for plants in their building of local 5G environments, and sells, designs, and builds equipment, among other services. Some telecom carriers have begun providing private 5G services. Unlike local 5G, which requires that the customers acquire a wireless license, a license is not needed for private 5G.

In response, we have begun to propose solutions including private 5G to customers through collaborations with carriers. In addition to local 5G, we would like to include DX in our businesses.

A: The Regional & Social Infrastructure Group provides PoC for local 5G and various products, targeting cable TV companies and electric power-related subsidiaries. In addition, CTC System Management Corporation, a Group company, has staff members with wireless licenses, which enables us to help customers when they apply for wireless licenses. Because 5G environments are limited to urban areas at present, we assume that the generation of demand for 5G will be slightly delayed in rural areas.

A: Regarding 5G-related equipment, the Telecommunication Group has a local 5G team, which selects equipment from the equipment of five or six companies to conduct PoC in accordance with customer requirements. Local 5G networks range from those built in a part of a building to those that entirely cover a specific area. Therefore, equipment needs to be selected in accordance with the characteristics of each network. We fulfill customer requirements by selecting equipment and clarifying the characteristics.

Regarding edge computing-related business, we do not deal in edge devices. We would like to operate a business targeting enterprises in particular by combining technologies including micro data centers.* We can fulfill customer requirements by effectively combining local 5G equipment with the mechanism of micro data center. This is our feature.

*Micro data centers are small data centers that can be built in a factory, shop, or similar facility, unlike conventional data centers that feature centralized processing. It processes data close to the end users to reduce latency.

A: The Telecommunication Group, which is in charge of 5G construction, is attracting attention at present. Moving forward, the issue will be how to solve the problems that will be faced by customers as they use 5G. We are building a new business based on telecommunication technologies by forming an alliance with companies whose strength lies not only in telecommunication infrastructure but also in design orientation. We are also engaged in diverse initiatives addressing ESG and the SDGs as well. We request that you see these aspects of us, as well.

Q: You say that you will consider operating a business targeting carriers in Asia via the Telecommunication Group. What is your perspective on your price competitiveness? Can you bring in customers?

A: The Ministry of Internal Affairs and Communications says that prices set by Japanese carriers are too high. But currently they are the second lowest following the prices set by carriers in London. However, I remember experiencing connection failures even in the city when I visited London before. However, in Japan, devices can connect even on Mt. Fuji. There is a reason for the low price. Recently, living standards have risen in Asia, and people in the region care about quality. In the ASEAN region, there is a market of carriers seeking Japanese quality regardless of price.

Q: How much lower will the prices be for business with carriers in Asia compared to the prices offered in Japan?

A: We do not simply do construction work in each country using the same equipment as in Japan. Different equipment is used outside Japan. In Japan, we have begun PoC to see if the current level of quality can be maintained using software-defined equipment.

Q: The strategy of the Distribution Group includes the keyword, "expansion." Does this mean major new projects or something similar?

A: The customers of the Distribution Group include wholesalers, beverage manufacturers, and credit card companies in addition to businesses in the distribution industry. During period of the medium-term management plan, there are multiple projects modernizing mission-critical systems. At present, there is a project that has proceeded to the preliminary examination phase. We will steadily work on each of the projects to achieve our target.

Q: Do you expect the Distribution Group to grow at a high rate during the period of the medium-term management plan?

A: Yes, we do. The company is also expecting that. We will appropriately construct systems by steadily responding to customer requirements while securing profit.

Q: Will new projects increase in the ITOCHU Group in the future? What relationships do you have?

A: At present, sales from the Group are less than 10% of our consolidated revenue. We would like to increase this percentage.

However, regarding relationships, we are engaged in many cross-sectoral initiatives, such as the introduction of alliance partners to promote DX, investments in overseas companies in collaboration with ITOCHU Corporation, and of course businesses directly with the Group.

A: ITOCHU Corporation is also utilizing data to promote DX. In this context, we support systems for data analysis and collection, for example. We would like to accelerate these initiatives to expand our business.

Q: You said that the Distribution Group has several projects modernizing mission-critical systems. Considering the recent major unprofitable project, new technologies will increase the risk of unprofitability, won't they?

A: In the current fiscal year, we restructured the system engineers' organizations within the business group and

created a cross-sectoral resource pool for organizations. We will increase the mobility of system engineers to enable them to cross-sectorally share their expertise and experience. We will also consider measures to cooperate with an external consulting company.

A: We established a Project Management Office (PMO) under the direct control of CTO. While its main duty had previously been monitoring, we have reformed it so that it is capable of immediately discovering an issue after a problem occurs and creating a path to a solution, in addition to reporting issues.

Q: Am I right in assuming that because PMO's new initiative began in the current fiscal year, it will begin to produce effects from the next fiscal year?

A: We began the initiative a little while ago. We think, however, that it will take one year before the system is established. We have no unprofitable projects continued from last fiscal year, so we would like to steadily follow through on the initiative.

Q: What is the current status of the public-interest group initiatives and how will they develop in the future?

A: We were given the opportunity to propose DX solutions not from the customer's information system division but from their sales planning division.

Because the customer also has a team in charge of promoting DX, we would like to have our Business Innovation & Digital Transformation, which we established in the current fiscal year, propose solutions together with the customer's team.

Q: The COVID-19 situation has worsened again in ASEAN countries. Does this impact the business plan for the current fiscal year or change your approach to overseas business in the medium-term management plan?

A: Malaysia is locked down again. In addition, the Indonesian government has budgeted for measures to address COVID-19. There are these and other negative moves. On the other hand, Singapore is seeing a rapid recovery, with financial institutions shifting their IT investments from Hong Kong. The United States is also on a trend toward recovery. While the speed of recovery differs from country to country, we do not see a slowdown in IT investment. Regarding the period of the medium-term management plan, we expect that all countries will begin to grow as planned if the situation returns to normal.

Q: Are there any growth themes under which the operating profit of the whole company will increase significantly?

A: If we had found a theme for growth of the entire company at the size that it is, we would have already begun working on it. We believe it is most important to solve immediate issues. Then we will create the things we want to be able to and the things we want to have. All we have to do is to repeat this process steadily. ESG and the SDGs are reservoirs of challenges. IT will play a leading role when considering what issues we can solve and to what extent we can address the individual challenges. Addressing challenges and developing solutions will create good opportunities from the perspective of revenue, as well. While there could be domains where major growth will be achieved with something new, profit will not increase significantly in the short term in those domains. We will therefore continue with our down-to-earth management.

Q: What compliance initiatives are you engaged in, such as the prevention of fraudulent transactions?

What is your policy on the development of engineers?

A: We provide thorough compliance training to our employees. In addition, our organizational structure does not allow a single person to control an entire process from order acceptance to order placement and the recording of sales. This makes fraudulent transactions difficult to accomplish.

Regarding our policies for the development of engineers, we would like to work again to ensure our corporate culture is entrenched and further develop our long-held challenge-oriented mindset to develop human resources who are able to respond to change and act autonomously on their own initiative, instead of only providing training.

Q: What are your thoughts on engineer development?

A: The IT industry has something like an apprentice system, under which new technologies are learned through specialized training in many cases. At present, there are a broad range of technologies. It is therefore difficult to develop generalists who know everything about IT. Accordingly, we work to fulfill customer requirements through a combination of highly professional human resources, but it is difficult to meet all requirements.

According to the chaos map included in one report, there are as many as 2,500 modules, and some believe that you cannot meet every requirement unless you can handle every one of those modules. Actually, the extent to which the team's productivity can be improved by members with expertise making low-key efforts to broaden their range is important. Only having knowledge of business is not enough to provide consulting services. We expect a change, after which we will always do community work with people having multiple technologies, with the central role played by human resources familiar with IT, who are a kind of business partner.

We request that people who want to become managers gain knowledge of a wide range of technologies to manage projects. We would like people good at programming to aim to be creators creating new value. And we would like to create human resources who are able to help customers with DX and with their pursuit of new business models. At present, we are studying a mesh-type personnel system for engineers.

Q: In the technology domain, added value is being achieved in semiconductors and edge computing at present. We think that AI chips will also be used in the communications section of the hardware layer.

Will you change your previous business model?

What innovation dilemmas does CTC face?

A: In our research activities, we began to contact AI chip vendors in Israel, the United States, Europe, and other regions five years ago. Our strength is that we are able to talk with top people at the vendors on a strategic basis about how the chip's architecture will change and other topics. We have already introduced some of them to our customers and begun to try new ways to use computers, as well. In the era of Sun's Unix and Microsoft's operating systems and in the era of virtualization, we worked as a part of core infrastructure. Just creating the things that customers tell us to create through contracted development is not what we have been doing. We are positioned as a system integrator, who has demonstrated its capabilities at

various technological turning points.

A: For example, we were told previously that we would lose jobs as cloud computing emerges. However, we didn't lose jobs. We are in an era when software is on a chip, like Software on Chip. However, this does not mean that all customers directly operate semiconductors. Of course, there are applications on them and networks linking them. While technologies continue to evolve, we continue to learn new technologies and remain always ready to provide them to customers.

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