ITOCHU Techno-Solutions Corporation

Summary of Q&A at Announcement of Operating Results for FY2016

Date/Time: May 1, 2017 (Monday) 16:30-17:30

Attendees: President Kikuchi, CFO Matsushima, CTO Okubo

1. FY2016 Results/FY2017 Forecasts

Q: Looking at revenue and profit before tax by segments on page 2, fourth-quarter results show increased revenue and decreased profit for Distribution & Enterprise and decreased revenue and increased profit for Telecommunications. What are the reasons for this?

A: The decrease in profit for Distribution & Enterprise is mainly attributable to an increase in SG&A expenses, including performance-linked bonuses.

The Distribution & Enterprise segment was formed through the integration of the former Distribution business segment and the former Enterprise business segment in reorganization which took place at the beginning of FY2016. This reorganization has enabled the further development of customers through the combined strength of the former Distribution business segment and the former Enterprise business segment.

In Telecommunications, business with certain carriers grew sharply in the fourth quarter of FY2015.

In the fourth quarter of FY2016, revenue fell in the absence of such growth. However, profit increased thanks to improvement in the profitability of the Products business.

The improvement in profitability of Products can be attributed to a number of factors. However, fluctuation in exchange rates also appears to have had a positive impact.

Q: What are the FY2017 forecasts for each business group?

A: We forecast increased revenue for all four main business groups.

The pace of revenue growth will be high in the Distribution & Enterprise, Public & Regional, and Finance & Social groups, while Telecommunications is expected to grow at a slightly lower rate than the other three business groups.

Q: The gross profit margin for the fourth quarter of FY2016 improved significantly year on year. What are the reasons for this?

Will the gross profit margin continue to improve in FY2017?

A: Excluding the impact of unprofitable projects and reclassification of SG&A to COGS in overseas subsidiaries, the gross profit margin improved 1.8 pts year on year in the fourth quarter. Improvement in the sales mix had a positive impact of 0.3pts. The remaining improvement is largely attributable to improvement in the profitability of Products.

The improvement in the profitability of Products is largely due to growth in high value-added projects through multivendor arrangements and sales efforts (including control of the risk of exchange rate fluctuations).

In FY2017, the gross profit margin is expected to improve slightly from FY2016, reaching 23.8%. In view of the opinions of frontline staff, etc., we see this as an appropriate level.

Q: In the fourth quarter of FY2016, "Other income and expenses" increased significantly. Why was this?

A: The increase mainly reflects an increase in performance-linked bonuses, size-based business tax and business commission fees associated with the development of internal systems.

Q: What percentage of the order backlog at the end of FY2016 of 238.0 billion yen will be converted into revenue in FY2017?

A: We expect that around 70% of the order backlog will be converted into revenue in FY2017.
Conversion into revenue will probably be quick because a high proportion of the order backlog is hardware.
On a business group basis, we expect the Enterprise & Distribution and Telecommunications business groups to make large contributions to revenue.

Q: The corporate income tax rate was just under 30% in FY2016 and the level of the FY2017 forecast is also low compared with past years. Why is this?

A: In FY2016, although corporate income taxes increased due to higher revenues, the corporate income tax rate came to around 30%, reflecting the recording of tax credits to promote increase of salaries and deferred tax assets and reduction of the reversal of deferred tax assets in FY2015 in addition to the impact of a lower statutory corporate income tax rate.
In FY2017, we expect the corporate income tax rate to be mostly unchanged from FY2016, despite the uncertainties.

2. Capital policy/Shareholder returns

Q: Is there any change in your dividend policy approach?

A: Our policy of aiming for a dividend payout ratio of 40% remains the same.

Q: What is the purpose of the "reduction of the capital reserve" announced at the same time as the operating results announcement?

A: Capital reserve has less flexibility for the usage as its nature. We decided to submit a proposal to the general meeting of shareholders to transfer 20 billion yen to other capital surplus to implement a flexible capital policy.

3. Others

Q: Approximately how much is revenue from SDN/NFV-related business? What is the outlook for this business?

A: In FY2016, revenue from SDN/NFV-related business amounted to around 4 billion yen. The majority of this was SDN projects.
We expect that demand for network virtualization using SDN/NFV technologies will grow in the future, especially in the telecommunications sector. There is also increasing demand for virtualization in the load balancing and security fields.
We would also like to expand business in these areas.

SDN: Software Defined Network

NFV: Network Function Virtualization

Q：Please give details of M&A activities overseas.

A：We would consider M&A transactions not only overseas but also in Japan. However, we have no concrete plans in the pipeline at the present time.

Q：What is the status of the operating companies in Malaysia and Singapore acquired in FY2013?

A：On a local currency basis, the operating company in Malaysia posted increased revenue and increased profit in FY2016. The operating company in Singapore posted increased revenue and decreased profit.

In Malaysia, we focused on the profitability of business operations after a challenging year in FY2015. In Singapore, upfront investment to change the business model increased.

In FY2017, we will focus on profit growth in Singapore.

The combined profit of the two companies declined slightly in FY2016 due to the impact of a stronger yen. At any rate, both companies are, in our view, progressing as we anticipated at the time we acquired them.