ITOCHU Techno-Solutions Corporation

Q1 of FY2017 Results Briefing - Summary of Questions and Answers

Date and time: August 3, 2017 4:00 PM to 4:30 PM

Attendee: Matsushima, CFO

1. Results of Q1 of FY2017

Q: Do you think the results are better than estimated?

A: I am under the impression that they are slightly better than estimated.

Q: I feel that the gross margin improved dramatically and I heard that it improved for all business models. What factors caused the improvement?

A: The gross margin, excluding unprofitable projects, improved by 1.2 pts, from 22.3% (Q1 of FY2016) to 23.5% (Q1 of FY2017). Converted to an amount, it improved by about ¥1 billion year-on-year. It improved for all business models. For “Services,” the SE utilization rate of some subsidiary companies improved. For “Development,” profits of individual development projects in the Distribution and Enterprise businesses group improved. For “Products,” improvements were observed in the Distribution and Enterprise business group, mainly caused by the impact of the difference between the lease accounting standards in Japan and IFRS.

Q: What is the breakdown of unprofitable projects?

A: In FY2016, there were seven unprofitable projects, which resulted in a total loss of ¥300 million. In FY2017, there were five unprofitable projects, which resulted in a total loss of ¥700 million.

For the full-year plan, a loss of ¥1,800 million is anticipated, which is still within the scope of our assumption so far.

Looking at the results by segment, some of the unprofitable projects occurred in Telecommunications but are not critical.

Q: Did you see the Q1 decrease of ¥700 million at the time of initial forecast?

A: We did not forecast the occurrence of unprofitable projects that would cause a loss of ¥700 million. We forecasted that some unprofitable projects would occur as a risk.

Q: Is my understanding correct that the sale of all unprofitable projects that occurred in Q1 will improve within the current fiscal year?

A: We are striving to produce sales from all of those projects within the current fiscal year.

Q: Could you summarize the factors for the year-on-year increase in operating income of ¥700 million?
A: Although the increase of ¥300 million caused by the lack of impact of foreign exchange (loss) is a temporary factor, we also increased the income in our main business line by absorbing the impact of unprofitable projects and increasing SG&A. We will strive to continue this trend. We see the accumulated order backlog as a bullish factor for Q2 and subsequent terms. Of the backlog at the end of June, we forecast that one third will be booked in Q2 and another third in H2. We anticipate a relatively strong revenue momentum.

Q: What are the main breakdowns in finance income?
A: Appraisal profits are accruing from the fund operated by our affiliate company, ITOCHU Technology Ventures, Inc., and partly capitalized by us.

Q: SG&A was assumed to increase to ¥3 billion yen in the current fiscal year and ¥-1 billion of the amount would be an increase in the depreciation cost. However, there was little increase in Q1. Has the assumption changed?
A: The assumption has not changed. We forecast that it will occur in the future. The SG&A results in Q1 are almost in line with the assumption.

Q: I understand that the non-consolidated financial results are based on Japanese accounting standards. However, I feel that the cost and subsequent accounting items are different from the consolidated financial results. What is the difference?
A: The difference between the non-consolidated and consolidated operating incomes is ¥1.7 billion (non-consolidated: ¥-1 billion, consolidated: ¥+0.7 billion). Factors for the difference include:
1. Improvement in the profitability of some domestic subsidiary companies and the impact of merging CTC Life Science Corporation into CTC, which caused an increase of ¥0.6 to 0.7 billion.
2. The impact of the difference between the Japanese lease accounting standards and IFRS, which resulted in increase of ¥0.3 to 0.4 billion (revenues are recorded together and profits are deferred under Japanese lease accounting standards. However, in IFRS, profits are also recorded together).
3. The impact of reclassification of IFRS display. This impact was caused by reclassifying the account item “Non-operating profit and loss” in Japan lease accounting standards to “Other incomes and costs” in IFRS, which is valued at ¥+0.3 billion. The breakdowns are a decrease in foreign exchange loss by ¥+0.24 billion and a decrease of impairment loss by ¥+0.06 billion.

Q: The orders received in the “Others” category decreased. What was the impact of the inclusion of CTC Life Science Corporation in the non-consolidated financial results?
A: CTC Life Science Corporation caused a loss of approximately ¥1 billion. In addition, the decrease in businesses for financial institutions offered by overseas and domestic subsidiary companies also had an impact.

Q: In the credit card industry, has the demand for compliance with the revised Installment Sales Act come out?
A: Orders related to C-ARCS have been increasing gradually.

2. Outlook for Q2 of FY2017
Q: What is the trend for orders received in Q2 in Telecommunications?
A: The orders received increased in Q1. Considering the fact that the Products business was favorable in FY2016, it may decrease slightly in Q2. However, we will continue to strive to maintain previous year’s records in H1.

Q: I think the improvement of the gross profit margin in Development and Products depends on the continuity of individual projects in Distribution and Enterprise businesses group. Will the improvement of the gross profit margin in Services continue with high possibilities?
A: At the moment, it is uncertain whether this improvement trend will continue. However, we will continue to strive to maintain the current momentum.

Q: The Q1 results were favorable because of the improved profitability of operating companies, etc. Will this momentum continue in the future?
A: The weight of Q1 is small, so it is difficult to judge based on its results. However, we will continue to strive to maintain the current momentum.

End.