ITOCHU Techno-Solutions Corporation

Summary of Q&A at Announcement of Operating Results for FY2017

Date/Time: May 1, 2017 (Tuesday) 16:00-17:00

Place: KDDI Hall, Otemachi

Attendees: President Kikuchi, Executive Vice President Matsushima, Senior Managing Executive Officer Okubo

＜FY2017 Results＞

Q: Although you said that you had great expectations for the Telecommunications and the Distribution & Enterprise business for this quarter, looking at orders received in the fourth quarter of FY2017, the Distribution & Enterprise Group showed significant decline year on year. What were the main reasons for the increase or decrease in each business?

A: In the fourth quarter of the previous year, the Distribution & Enterprise Group received orders for large-scale projects for from the distribution sector as well as orders for several years' worth of software licenses and maintenance. If we exclude the decline due to the absence of these orders, there was no decrease in orders received. The increase in orders received in the Telecommunications segment reflects orders received from a customer which had shown a downward trend in FY2017. In the Finance and Social Infrastructure Group, orders received from megabanks fell slightly, but we think that a fall of ¥400 million is within the margin of error.

Q: You said that the unprofitable project for the telecommunications sector will lead to business in the future. Can you give a little more detail about the challenge involved in this project? And is this project finished? Will any additional costs be incurred in the future?

A: The project is different from the previous network business. We also expect that there will be a next phase in the future. The project is finished, and we do not expect to incur any additional costs.

Q: You notes that the fall in the gross profit margin in the fourth quarter of FY2017 was largely due to an increase in unprofitable projects and an increase in performance-linked bonuses. Is this correct?

A: The main reason for the drop was unprofitable projects because selling, general and administrative expenses improved year on year.

Q: Roughly, what is the gross profit margin of the cloud business? If it is lower than the overall gross profit margin, then surely an increase in the cloud business revenue will cause decline in the overall profit rate, right?

A: In FY2017, the gross profit margin of the cloud business was almost 20%. We think that this will change in the future depending on the growth of CUVICmc2 (because higher CUVICmc2 revenue will lead to a higher gross profit margin). Since the majority of the gross profit of the cloud business translates into operating income, the impact of the cloud business in terms of its contribution to operating income should increase.

＜FY2018 Outlook and Medium-Term Management Plan (FY2018-2020）＞

Q: What is the FY2018 outlook and medium-term outlook for each Business Group under the new Medium-Term Management Plan?

A: The FY2018 revenue outlook is as follows:

・Distribution & Enterprise Group： We expect to absorb the decline caused by the absence of orders recorded the previous fiscal year and to post revenue mostly unchanged year on year.

・Telecommunications Group： We expect that business with individual customers and business in new areas will grow and forecast higher single digit year-on-year growth in the last half of the fiscal year.

・Regional & Social Infrastructure Group：We anticipate that revenue will be mostly unchanged year on year.

・Finance Group：We forecast higher than 10% but lower than 20% year-on-year growth partly due to an increase in the order backlog at the end of the previous fiscal year.

Our medium-term outlook is as follows:

・Distribution & Enterprise Group： The way business grows may change, with advances in business related to AI and the IoT and the agile development of such business.

・Telecommunications Group： 5G-related business may start to emerge around 2019. Network visualization tools are now starting to be used for 4G networks, and business is also emerging. Data traffic also continues to increase.

・Regional & Social Infrastructure Group： We intend to increase revenue, focusing on business for electric power companies and regional banks.

・Finance Group： Projects for data analysis systems, etc. for credit card companies and banks are increasing and such projects are expected to contribute to growth.

The shape of business is set to change over the coming three years, our approach to these changes will be crucial.

Q: In the Medium-Term Management Plan, you explained that you will further develop your strengths. Assuming this means you plan to branch out into new areas in the Telecommunications Business because existing business does not look like it is going to grow significantly, which areas will you target specifically?

A: We are not so much going to change the business of the Telecommunications Business Group as add new business to our existing business. When 5G networks start to be used to support the IoT, carriers will want to further tap into IoT needs and we, therefore, need to step up our activities in this respect. We will be unable to meet these needs with telecommunications and network infrastructure technologies alone. We need to take measures for services beyond those for our service business as our competitors do. We will not be able to keep up with the speed of developments with our current mindset where, for example, we take two years to develop an app. We believe that asking ourselves how we can quickly develop new services that are directly connected to the IoT, etc. and cooperating with customers will lead to new business.

Q: In your FY2018 forecast, you forecast that the gross profit margin will improve 0.4 percentage points, to 24%. What is the thinking behind this?

A: In FY2017, unprofitable projects amounted to ¥2.3 billion, but our plan for FY2018 factors in unprofitable projects of ¥1.5 billion, a decrease of ¥0.8 billion from FY2017. This will be the major factor for the gross profit margin improvement.

Q: SG&A expenses are projected to grow sharply in FY2018. Why?

A: Just over one third of the ¥4 billion year-on-year decrease in SG&A expenses is labor costs. Around half of it is an increase in upfront investment (HR development, global support, M&A-related expenses, office-related expenses). While there will also be an increase in expenses for compliance with the amended Workers Dispatch Act, etc., we plan to offset this to some extent with a reduction in expenses related to mission-critical system renewal.

Q: With respect to the FY2020 target under the Medium-Term Management Plan of "profit attributable to owners of the parent: ¥30 billion," you project profit attributable to owners of the parent of ¥24 billion in FY2018, which means an average growth rate of around 11%-12% over the two years from FY2018 to FY2020. Why? What is the assumed tax rate?

A: Assuming CAGR of around 8%, we forecast organic growth of ¥28 billion. We also aim to generate an additional ¥30 billion through M&A (including the contribution of equity in earnings of affiliates). We assume a uniform tax rate of around 30%.

Q: During the FY2015-FY2017 Medium-Term Management Plan, your customer base appears to have increased and productivity also appears to have improved. Under the Medium-Term Management Plan for the coming three years, it does not look as though large projects and projects for specific customers will grow and you will, therefore, need to raise productivity into order to increase profits. Will your productivity increase in the future? If not, do you plan to increase employees or investment (M&A, etc.)?

A: Rather intentionally, we have narrowed our customer base under the previous Medium-Term Management Plan. Over the coming three years, this trend is expected to become more pronounced. In the future, we expect collaboration and co-creation with priority customers to increase and we will be required to meet even more sophisticated requirements. Consequently, we will focus more than ever before on training to improve engineering skills. Development techniques have also changed quite considerably, and the importance of training has increased. We plan to make upfront investment including this of around ¥2 billion in FY2018. We also plan to maintain a similar level of investment moving forward. In terms of productivity, we imagine that the trend over the coming three years will not be much different from the past three years.

Q: Do you have any plans to increase the number of employees?

A: We will not increase the number of employees all of a sudden. We plan to gradually increase the number of employees alongside training, mainly through the employment of new graduates.

Q: Why didn't you set a market cap target in the new Medium-Term Management Plan?

A: We set a market cap target in the previous Medium-Term Management Plan, but this gave rise to differing opinions and much discussion, partly because market cap is affected by stock market fluctuations. Having made some progress in this regard under the previous Medium-Term Management Plan, we did not set a market cap target this time around.