Summary of Q&A at Conference Call on Operating Results for Q1 of FY2018

Date/Time: August 1 (Wednesday) 15:00-15:30
Attendee: Executive Vice President Matsushima

Q: How are the Q1 results compared to the estimate? Are they in line with the estimate or better than it?

A: They are better than estimated because we made a conservative estimate internally. Because the Q1 results are favorable, we have great expectations for Q2 as well. However, we would like to examine the estimate fully because some projects were brought forward in Telecommunications.

Q: Regarding the Telecommunications Business Group, orders received have increased, although IT investments by telecommunications carriers have been decreasing. Could you tell me the specific factors for the increase in orders received? Could you also tell me the prospects for Q2 and onward?

A: Major factors for the increase in orders received in Q1 are an increase in infrastructure projects for fixed telecommunications carriers, which constitute slightly more than half of the increase, and the presence of large-scale infrastructure projects for internet service provider, while orders received from mobile phone carriers did not change greatly.

With regard to the prospects for Q2 and onward, we hope that this momentum will continue. We expected orders received to grow at a relatively low rate, but they increased, due in part to the presence of some projects that were brought forward from Q2. We will strive to maintain the rate of year-on-year growth that was achieved in Q1.

Q: I think that there was a reactionary fall in orders received from the orders for large-scale projects for public bodies that were received in the previous fiscal year. Orders received increased by 5% by offsetting this reactionary fall, so I believe that the actual results are stronger. Is my understanding correct that the orders received are also better than estimated?

A: Yes, it is correct. We expected orders received to decline due to the absence of orders for large-scale projects that we received in the previous fiscal year. This was offset by orders received in Telecommunications and other businesses.

Q: With regard to orders received in Q2, I think there will be a reactionary fall from the large-scale projects for financial services in the previous fiscal year. Do you think this can be offset? Will it be as difficult as expected?

A: We want to maintain the momentum experienced in Q1, but we don’t know whether the reactionary fall can be offset because those projects in the previous fiscal year were very large in scale. We would like to achieve a recovery by making efforts for two more months.

Q: You said that the year-on-year decline in orders received for “Services” is attributed to a decrease in projects for public bodies. Could you tell me a bit more about it? Can I assume that “Services” will continue positive year-on-year growth from Q2 onward?

A: We suffered a significant reactionary fall from the large-scale projects for public bodies in Q1 of FY2017, mainly those on operation. However, about half of the decline was able to be offset by the increase in orders for other projects. From Q2 onward, we would like to continue focusing our efforts on the expansion of the Services business.

Q: I would like to ask you about the factors for the fluctuation of the gross margin. Loss from unprofitable projects decreased from 700 million yen to 100 million yen, and gross margin excluding unprofitable projects declined by 0.3 percentage points. Revenue by model shows that the ratio of products has increased. Is the worsening of the revenue composition ratios by model the factor for the fluctuation? Or is it due to the increase in revenue from projects for telecommunications carriers, which were unprofitable projects in the previous fiscal year, in new fields?

A: We watch for fluctuations in the gross margin, regarding it as an important point. The decline in gross margin excluding unprofitable projects is attributed to the two factors that you mentioned in the question just now. This time, revenue calculated in accordance with the cost recovery method (revenue from development and system integration with no profit), which always has an impact on our gross margin, declined and had a positive impact on gross margin. Excluding the three special factors of unprofitable projects, projects for telecommunications carriers in new fields, for which we allocated a provision in the previous fiscal year, and revenue calculated in accordance with the cost recovery method, the gross margin for Q1 of FY2017 is 24.4% and that for Q1 of FY2018 is 24.8%, which means it has improved by 0.4 percentage points. It is not a significant improvement, but we recognize the trend as favorable.

Q: What is the current phase of projects in the Telecommunications business that were unprofitable in the previous fiscal year?

A: Those that became unprofitable in the previous fiscal year and whose sales improved in Q1 are in Phase 1. They are expected to move to Phase 2 and Phase 3 hereafter.

Q: Can you expect normal or higher-than-normal profitability in the next phase?

A: We are working on it by reflecting on past fiscal years. We would like to improve profitability from the next phase onward.

Q: Concerning the trend of profit before tax by segment, what were the factors for the modest increase in profit in the Telecommunications business, which occurred despite the decrease in unprofitable projects in the business, and for the increase in profit in the IT Services business, respectively?

A: The profit margin of the Telecommunications business appears to be low because revenue with little profit, which is related to unprofitable projects in past fiscal years, was booked. Apart from this, we think that profitability is not so bad. Profit from the IT Services business increased because of an increase in revenue from the cloud business and the existence of revenue from a maintenance project, part of whose cost was booked in advance in the previous fiscal year.

Q: You said that the impact of the change in the accounting policies on the consolidated results is minor. What is the level of impact on each business group? Is my understanding correct that the impact will remain in Q2 and thereafter?

A: Due to the change in the accounting policies, revenue calculated in accordance with the cost recovery method, which had been booked in "Others" until the previous fiscal year, began to be booked in "Each business group" in the current fiscal year. Accordingly, the impact on the consolidated results is minor in the year-on-year comparison. In the year-on-year comparison of each business group, however, revenue appears to have increased in the current fiscal year. In monetary terms, the impact is +1,600 million yen in Distribution & Enterprise Group, +1,300 million yen in Telecommunications Business Group, +700 million yen in Regional & Social Infrastructure Group, and +700 million yen in Finance Group.

You may assume that this impact will remain until the end of the current fiscal year.

Q: Do you mean that in the year-on-year comparison, the gross margin of each business group for the current fiscal year appears to be lower than that for the previous fiscal year, even if it remains unchanged from the previous fiscal year's level, because revenue calculated in accordance with the cost recovery method will continue to be booked in each business group in Q2 and thereafter?

A: Exactly.

Q: I would like to confirm one thing about the impact of the change in the accounting policies. The impact in monetary terms on business groups, which you told us about earlier, amounts to 4,300 million yen. Is my understanding correct that the same impact is not reflected in the results for Q1 of FY2017? If yes, do you mean that while orders received increased 4,400 million yen year on year, 4,300 million yen of it is attributed to the impact of the change in the accounting policies, and the actual value has remained unchanged?

A: The change in the accounting policies does not have an impact on the orders received. The values I told you earlier are the impact on revenue in monetary terms.

Q: Do you mean that while revenue increased 4,900 million yen year on year, it actually increased only 600 million yen?

A: The change in the accounting policies has a positive impact on each business group. However, this is offset by the negative adjustment in “Others,” which is equal in amount to the positive impact. As a result, the change does not have an impact on the consolidated values. Accordingly, the value for revenue is an actual value, and it increased by 4,900 million yen.