

Summary of Q&A at Announcement of Operating Results for FY2018

Date/Time: April 26, 2019 (Friday) 14:00-14:50

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

Q: I would like to confirm the outlook for the Telecommunications segment. I think that, in general, carriers will not increase their network investment during the current fiscal year. How does CTC plan to expand business with carriers after the strong performance in FY2018 and in what areas?

A: At present, we are not hearing much talk about investment restraint from the sales frontline. For example, in FY2018, there was investment in networks to cope with disaster. This year, not just one carrier but other carriers may also make this kind of investment. CTC has a proven track record and technology in this area and can be expected to do well. In light of these factors, we think that the overall outlook for the telecommunications market including group companies and other carriers is not bad. In addition, because order backlogs at the end of FY2018 increased, we will steadily generate revenue from them.

Q: What was the approximate value of orders received for 5G-related projects in FY2018? What is the outlook for FY2019?

A: Orders received for 5G-related projects fell just short of ten billion yen and were concentrated on the third quarter. I cannot clearly state the outlook for FY2019 because there are still many uncertainties.

Q: You mentioned local 5G in your briefing. Does this mean you will aim for infrastructure projects?

A: There are various different approaches. Local 5G is 5G in a confined area and CTC has no intention of providing 5G wide-area networks. We will work with customers in confined areas, for example, at a specific plant.

Q: Do you plan to go beyond infrastructure development and become involved as a 5G market player? How are you likely to generate profit?

A: One possible way of generating profit is a profit-sharing arrangement for 5G apps. We will now start exploring possible profit-sharing arrangements for 5G apps used at customer plants. We would like to go beyond simply developing infrastructure and therefore intend to also examine participation as a market player.

Q: What are CTC's views on the current status of virtualization in communications networks and future developments?

A: Orders received by CTC for virtualization projects are currently increasing. A trend which is related

to 5G is that in areas where CTC previously received orders for carrier grade switches and routers, CTC is now receiving orders for servers. In other words, so far, hardware containing embedded software is being replaced with software. As a result, CTC's revenues are basically made up of revenues from servers and software. Similarly looking at market trends, the other day, Linux Foundation launched a new NFV architecture for AT&T's 5G service. As a result, it is now the norm for all networks, even carrier-grade networks, to be software-based. I am sometimes asked about the extent of our involvement in product and infrastructure development for 5G projects but, for these projects, we often receive orders for network environment consulting, development and construction and so hardware is now little more than one resource among these. Since there are not many vendors that can meet these market needs, I believe that CTC can continue to demonstrate its strengths.

Q: What was the gross margin of the Telecommunications segment? What will it be in FY2019?

A: It is difficult to give the gross margin for the Telecommunications sector alone. However, in FY2017, the gross margin was definitely lower because we made a provision for unprofitable projects. We now have almost no unprofitable projects in the Telecommunications segment and so the gross margin has recovered. However, the reason the gross margin for FY2018 appears to be not so high is that revenue from the unprofitable projects provided for in FY2017 were generated in FY2018 and this revenue of several billions of yen yielded virtually no profit. Provided these projects cease to have a negative impact, the gross margin may be slightly higher in FY2019.

Q: Do you think that the gross margin of the Telecommunications segment will start to improve gradually from now on?

A: Provided conditions remain as they are now, we can be optimistic, but it depends on our customers. The Telecommunications segment has ups and downs, and sometimes products sell well and sometimes they don't. The gross margin on product sales is not very high and so when revenues from product sales increase, the gross margin falls. The reason the gross margin fell in the fourth quarter of FY2018 was that sales of products increased.

Q: I believe that p29 of the presentation materials shows actual revenues in FY2018 after restructuring in FY2019. What is the revenue outlook for each business group in FY2019 based on the new organization?

A: We expect the Distribution segment to see almost double-digit growth, the Regional & Social Infrastructure segment to post mid-single-digit growth, and the Enterprise and Telecommunications segments to register low single-digit growth. The Finance segment will remain mostly flat. The main point of the restructuring was to transfer a part of the Finance segment to the Distribution segment. The distribution and retail industries cover a range of businesses and, since the resources that were previously available were insufficient, CTC strengthened the framework for supporting digital business in the distribution and retail industries by transferring engineers with operational expertise from the Finance segment to the Distribution segment.

Q: You said in response to a previous question about the revenue outlook for each business group that, in FY2019, both the Enterprise and Telecommunications segments will post low-single-digit growth. Explain the assumptions on which this forecast is based, including special factors the previous fiscal year, as, in my view, the order environment of these business groups is not bad.

A: Since the Telecommunications segment grew substantially in FY2018, a further double-digit growth over the coming year would be difficult. We expect the Enterprise business to show continued growth, driven by orders for the manufacturing sector. In the results for FY2018, the rate of revenue growth of the Distribution & Enterprise segment may appear low but this reflects the absence of large projects for the distribution sector recorded the previous year.

Q: Why did the Regional & Social Infrastructure segment post declines in revenues and profits in FY2018?

A: Both revenues and profits generated through business with the public sector decreased but since we have succeeded in receiving orders for new projects, we expect segment results to recover in the coming fiscal year.

Q: Similarly, why did the IT Services segment record gains in revenues and profits in FY2018? Will this trend continue in the future?

A: This segment also includes operating companies such as CTC Technology and CTC System Management. The higher profits are largely attributable to the growth of these operating companies. The operating companies are expected to continue growing in the future.

Q: You said that, overseas, projects for the financial sector and internet service providers increased. Is this a temporary factor or are these projects likely to continue?

A: We are involved in projects for the financial sector in Malaysia and Singapore and we have expertise in this field. On this occasion, it was business in Malaysia that grew. We believe that projects will continue to emerge in the future but it is difficult to tell how much business there will be each year. It was in North America that projects for internet service providers grew. We have received a continuous stream of work these past few years and we see this as a promising area for the future.

Q: I think that the global business does not make a significant contribution to profit at the moment. Will you continue to focus on it in the future? Does this not mean that your resources end up being scattered?

A: Indeed, profits did not grow as much as we initially planned but we still recorded a certain level of profitability. Many of CTC's customers are major global players in areas such as the banking or manufacturing industries and if we did not have a network in Asia, this would affect our business in Japan. Since we will be able to cover four ASEAN nations once our Indonesian operations become

more efficient, we expect to see the benefits of this. We are also considering structural changes during the period of Medium-term Management Plan, which will make a difference.

Q: Am I correct in understanding that the fall in the gross margin excluding unprofitable projects reflects a change in the business model mix due to growth in sales of hardware to the Telecommunications sector explained previously?

A: Yes, that is basically correct. Gross margins by business model indicate growth in Services, but slight decline for Products. In addition, the ratio of products with comparatively low profit margins increased.

Q: Give details of unprofitable projects.

A: I cannot give details of individual projects. However, I believe unprofitable projects will not affect performance this fiscal year because we made appropriate provision in FY2018.

Q: What is the outlook for unprofitable projects in FY2019?

A: 1.5 billion yen

Q: Give details of CUVICmc2 results (number of projects/revenues) for FY2018.

A: We launched the CUVICmc2 service in FY2016 and the number of projects is increasing, with 12 projects in FY2016, 13 projects in FY2017 and 20 projects in FY2018, making a total of 45 projects. Under our initial plan, we expected the service to turn profitable on a fiscal year basis in FY2018 but did not quite achieve this. However, the service turned profitable in the second half of FY2018. It will also take slightly longer than planned to eliminate the accumulated deficit and we plan to do this in FY2021. Revenues from this service amounted to just under 1 billion yen in FY2018. The service would have been profitable on a fiscal year basis if revenues had reached 1 billion yen.

Q: The number of contracts appears to have increased. Will this upward trend continue in the future?

A: In many cases, businesses introduce the CUVICmc2 service at the time of SAP system renewal. Consequently, we do not really receive a surge of orders at a specific time and contracts tend to increase little by little. At present, many of our customers are SMEs but since we also want customers who are large enterprises to introduce the CUVICmc2 service in order to increase the business volume, we are taking a trial and error approach to achieve this.

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