ITOCHU Techno-Solutions Corporation

Summary of Q&A at Conference Call on Operating Results for Q1 of FY2019

Date/Time: August 1, 2019 (Thursday) 14:00-14:40

Attendee: Toru Matsushima, Executive Vice President, CFO, Director

Q: How much higher than projected were orders received, revenue and income in Q1?

A: We do not announce specific projections for each quarter, but our results were higher than projected partly because we performed strongly and because we were slightly conservative in our projections, projecting that results would be mostly unchanged year on year.

Q: How were gross margins by business model in Q1? Assuming there will be no major increase in profitability on a full year basis, could you tell me if there are any factors that will push down profit in Q2 and onward, given that profitability improved in Q1?

A: In Q1, the gross margin of the SI Development business model improved. At present, no major unprofitable projects or low-profit projects are forecast in Q2 and onward. If we can keep up this pace, a gross margin of 24% on a full year basis is possible. I am not sure because I only have Q1 results to go on, but I think we have made a good start.

Q : The gross margin improved in Q1, but if we take into consideration the fact that projects for telecommunications carriers in new fields generated revenue but zero profit in the same period a year ago, it looks as though profitability has not improved much. There is also no major change in the sales ratio of products. Why was there little improvement in the gross margin?

A : The level of unprofitable development projects was unchanged year on year. The gross margin excluding unprofitable projects improved 0.6 pts but if we exclude special factors in the previous fiscal year and this fiscal year respectively, we estimate that the gross margin excluding unprofitable projects was effectively unchanged year on year. Some of us within the company took the view that the gross margin excluding unprofitable projects could potentially fall, but we appear to have maintained the year-ago level.

Q : Regarding your forecast for orders received in the Telecommunications business in Q2 and beyond, I believe you estimated that orders received would not increase significantly this fiscal year because they increased considerably in the previous fiscal year. Is there any change in this forecast? And after Q1, have any elements emerged that will grow more than initially anticipated?

A : In Q1, both orders received and revenue decreased year on year in the absence of large projects. However, they were both slightly better than anticipated. This was partly due to follow-on orders received for 5G projects for which we received orders the previous year. Projects on the horizon in Q2 and beyond have increased but conditions are not significantly different from our initial assumptions.

Q: I believe you originally said that orders received by the Telecommunications Business Group in Q1 were likely to be down year on year but could you tell me the factors behind the decline in orders received in Q1, including declines in the absence of orders received a year ago, and when revenue will start to grow?

A: Orders received fell in the absence of large projects for fixed telecommunications carriers and disaster recovery network projects in Q1 of the previous fiscal year. On the other hand, positive factors included some customers for which projects, including 5G, increased. Taking decline in the absence of orders received a year ago into account, we had expected orders received to decrease further in Q1, but the results appears to have been better than anticipated. As for revenue in Q2 and beyond, 5G-related projects for which we received orders in Q3 of the previous fiscal year will generate revenue mainly in the second half and this will, therefore, contribute to revenue growth. At the moment, our outlook for the full year is much the same as initially anticipated.

Q：Is Q2 still a transitional period as far as the revenue of the Telecommunications Business Group is concerned?

A：It looks like that at the moment.

Q: Have any new investment projects emerged for telecommunications carriers? And how profitable are they?

A: Whilst there is a shift towards 5G among large telecommunications carriers, there are also other investment projects such as the capital investment projects for disaster recovery that have been ongoing since the previous year. Strategy and investment timing vary from carrier to carrier but there is no major change in the overall investment trend. We expect that follow-on 5G projects will also start to emerge a little more from now. Since, if anything, most investment projects will probably be follow-on projects rather than new projects, we are not too worried about profitability. Also, given that the 5G (SA) specifications are due to be finalized by the end of the year, we suspect that a different trend will emerge again after that.

Q: Looking at revenue and profit before tax, why did the Telecommunications segment post decreased revenue and increased profit?

A: In the same period a year ago, we recorded revenue for projects in new fields (revenue of around 4 billion and profit of almost zero) and the results reflect the absence of these projects. Meanwhile, the effective utilization rate has increased company wide, rising to around 60-65% for employees and 80-85% for outside contractors. We believe profitability has improved due to these factors.

Q: What are the factors behind the improvement in the effective utilization rate?

A: The improvement is due to strong orders received. Idling time is shorter.

Q：What are the factors behind the increase in orders received by the Enterprise Business Group and the Regional & Social Infrastructure Business Group? I believe that, in the case of the Enterprise Group, the increase was due to a build-up of numerous projects rather than large projects. Could you tell me whether these projects were for existing customers or new customers?

A: In the case of the Enterprise Group, projects for existing customers increased across the board including increased projects for automotive groups. In the case of the Regional & Social Infrastructure Business Group, tender projects for government ministries and agencies contributed to the increase.

Q: Give details of the timing of recognition of revenue and the profitability for these projects of the Regional & Social Infrastructure Business Group.

A: We plan to record revenue in Q4 of FY2019 and we believe that revenue will be of a level that ensures we make a profit.

Q: CTC records most of its revenue in Q4. Do you have enough resources?

A: There are no major problems at present.

Q：Why is non-consolidated operating income weak compared to consolidated operating income?

A：Operating income was down 0.2 billion yen year on year on a non-consolidated basis and up 1.7 billion yen year on year on a consolidated basis. The difference is 1.9 billion yen, of which around 1.3 billion yen is the impact of transfer of maintenance business to a subsidiary, around 0.3 billion yen is the increased income of domestic subsidiaries and around 0.2 billion yen in the increased income of overseas subsidiaries. The improvement in net income on a non-consolidated basis is attributable to dividends received from subsidiaries.