ITOCHU Techno-Solutions Corporation

Summary of Q&A at Conference Call on Operating Results for the Third Quarter of the Fiscal Year ending March 31, 2020

Date/Time: February 4, 2020 (Tuesday) 2:00 p.m. - 2:35 p.m.

Attendee: Toru Matsushima, Executive Vice President

Q: I think that you have made good progress compared with the full-year forecast up to Q3. Why have you not changed the full-year forecast? What do you have in mind as the fluctuating factors for the full-year forecast?

A: As a premise, the weight of Q4 is high at CTC, and this makes it very difficult to have an outlook. In addition, we have some concerns about the delivery times of vendors in the Telecommunications Business Group, as I mentioned earlier. This means that it is difficult to forecast how much revenue we can post in the current fiscal year. Besides, the utilization rate of SEs has risen as well, and this will also become a fluctuating factor in terms of whether or not it will continue in the months ahead. In addition, there are unprofitable projects of 600 million yen up to Q3. Because it appears unlikely that unprofitable projects will reach 1.5 billion yen as we expected for the full year, another factor is what the difference will be.

Q: Are you saying that you are not worried about the demand side, although there are concerns about the supply side from venders?

A: We do not have any serious concerns, but if I were to tell you one thing, there is a possibility that the time for SA projects to come to the surface will be delayed because the decision on the international standards for 5G－SA is delayed. We need to continue to pay close attention.

Q: What are the factors for the improvement of gross profit in Q3 (October-December)? And what is your outlook for Q4?

A: The gross margin rose 0.8 percentage point in Q3 (October-December), and the major reason for this is that the gross margin by business model improved 1.0 percentage point. In particular, the gross margin rose 3.0 percentage points in Application Development and Infrastructure SI, rose slightly in Products, and remained flat in Services. Also looking at the composition ratio of revenue by business model, the gross margin fell 0.1 percentage point due to the occurrence of unprofitable business of 200 million yen, rose 0.1 percentage point due to a rise in the percentage of profitable services, and fell 0.3 percentage point due to an increase of 1.4 billion yen in revenue that is posted by the cost recovery method which is not accompanied by profit recording. As a result, the gross margin rose 0.8 percentage point in total. While there are also some other factors such as the revenue composition ratio for which a forecast is difficult, we will work to achieve the target gross margin of 24% that we set in the full-year plan in Q4. The utilization rate is rising, and taking this into account, we believe that the gross margin is probably increasing.

Q: What is the content of orders received by the Telecommunications Business Group in Q3 (October-December)? And what is your outlook for Q4? I believe that there was on a year-on-year basis of about 15 billion yen as a reactionary fall, but given that the actual decrease was 11.8 billion, I think that there is a factor that increased orders. What are the projects for which orders increased? You said at the time of the announcement of operating results for the first half that you wanted to acquire orders of around 10 billion yen for 5G-related projects in the second half of the current fiscal year. What is likely to happen to these projects?

A: Speaking of the decline in orders received by the Telecommunications Business Group in Q3 (October-December), there was a reactionary fall of 15 to 16 billion yen on a year-on-year basis including medium-sized projects, but we recovered about 4 billion yen in this environment. Regarding 5G-related projects, we had said that there had been orders of about 8 billion yen in the first half, and we received orders of about 6 billion yen in Q3. Because the orders for 5G-related projects that we received in Q3 (October-December) of the previous fiscal year were about 9 billion yen, the reactionary fall was only about 3.5 billion yen. On the other hand, with respect to the disaster recovery networks that we had similarly mentioned as a factor for the reactionary fall, there was a reactionary fall of about 3 billion yen in Q3. There was also a reactionary fall in some mobile core projects and data center projects, but 5G-related projects and 4G expansion projects made up for the fall. Regarding 5G projects, we think that total orders could reach 10 billion yen in the second half, but there is one cause for concern: the impact of the trade friction between the United States and China. Because we are no longer able to use HUAWEI products, the placement of orders is concentrated on some vendors. For this reason, a problem may occur with their delivery. That said, we will continue to focus on 5G projects because we have received inquiries.

Q: Orders received by the Distribution Business Group decreased year on year in Q3 (October-December). What is the reason for this? Also, what is your outlook for their orders by major customer?

A: The main reason for the decrease is a timing difference in posting in some projects in the current fiscal year, in addition to a reactionary fall on a year-on-year basis in development projects for convenience stores and credit card companies. This could have an impact on orders in Q4 as well. However, there are numerous inquiries about projects for convenience stores and credit card companies overall, and we will proceed with these projects while checking their profitability with an awareness of their profit margin. We will focus on settlement systems, among others, given that the business for the distribution industry and the business for the credit card industry have been integrated through the organizational restructure in the current fiscal year.

Q: Please provide a breakdown of the increase in orders and revenue in Others in Q3 (October-December).

A: Orders increased 300 million yen. While orders decreased about 3.5 billion yen as a backlash to a project for a leading ISP at ITOCHU Techno-Solutions America, orders increased about 3 billion yen due to the strong performance of CTC Global Sdn. Bhd. and about 1.7 billion yen as a result of the new consolidation of two Indonesian companies that we acquired. Revenue increased 5.5 billion yen. Revenue rose about 3 billion yen at TC Global Sdn. Bhd. and about 2.5 billion yen as a result of the new consolidation of two Indonesian companies.

Q: What impact did the Indonesian companies that you acquired have on your operating income?
A: Just under 300 million yen in Q3 (October-December) as a result of their consolidation.

Q: Did you make any adjustment for management accounting purposes in Q3 (October-December)?
A: No, we didn't.

Q: Regarding your new initiatives such as OMNIedge and Volterra that you mentioned in the Consolidated Financial Results, what is your outlook for their future development? When will they contribute to revenue? And how competitive are they?
A: We expect that OMNIedge and Volterra will make a contribution in the areas of IoT and edge computing and edge cloud in 5G, respectively. We don't think that they will have an impact on the numbers for the current fiscal year. We are currently closely examining how to develop them in the next fiscal year and hope that we will be able to comment on this when we announce the plan for the next fiscal year.