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, 2021

Date/Time: February 1, 2021 (Monday)　2:00 p.m. - 2:45 p.m.
Attendee: Mamoru Seki, Managing Executive Officer, CFO

Q: Describe the factors in the improvement of gross profit margin for Q3 (October to December). What about their stability?

A: Major factors are the decrease in low-profit projects in the product business from the previous fiscal year, in addition to its improvement in the Regional & Social Infrastructure Group. We will continue with the current initiatives in our efforts to improve gross profit margin.

Q: Why did gross profit margin improve in Q3 (October to December) although revenue decreased? The gross profit margin seems to have been improved because utilization rates were low and personnel expenses were not transferred from SG&A expenses to cost, but when we look at the operating income, it was not improved, was it?

A: The improvement of gross profit margin is attributed mainly to the improved gross profit margin of products from the Regional & Social Infrastructure Group. We respond to customers' expectations, which has led to a high evaluation of CTC's technological capability and has allowed us to receive orders for projects at appropriate profit rates. Therefore, it was not because personnel expenses were not transferred from SG&A expenses to cost that gross profit margin was improved. Utilization rates were improved in Q3 (October to December). We see them returning to the normal level.

Q: Slide 9 of the IR Presentation, Breakdown of “Other income and expenses” in the Announcement of 3rd Quarter Operating Results for the Fiscal Year Ending March 31, 2021, shows that "Others" under SG&A expenses have decreased. Why? Will a reactionary increase happen next fiscal year?

A: In "Others," one example of a decreasing expense is overseas travel expenses. Whether they will decrease further next year depends on what will happen in the COVID-19 pandemic. However, we understand the need for overseas business trips from the viewpoints of management of operating companies and sales activities. Expenses will not remain on the lower level. However, they will not return to the same level as before, because workstyle reform, including utilization of video conferencing, is progressing.

Q: What is your outlook on personnel expenses for the next fiscal year?

A: Personnel expenses will increase overall due in part to an increase in personnel. We cannot comment on what will happen in the next fiscal year. However, the expenses will not decrease in the long run. We will compensate for it by raising the top line.

Q: There was no change to the full-year plan. To achieve this, you must increase operating income by more than 20% year on year in Q4. How confident are you in its achievement?

A: The overall results have been almost as planned as of Q3, although they are uneven among business groups because there were some unprofitable projects. Regarding operating income, its progress has been around 51% in the current fiscal year, which is on the same level as past years, excluding the previous fiscal year, when the progress had remained high until Q3. We will do what we can to achieve the plan.

Q: Is there any special challenging factor and will you achieve the plan if things go normally?

A: Gradual recovery has begun to be seen in orders received by the Enterprise Group, the Distribution Group, and others, in addition to the Telecommunication Group and the Regional & Social Infrastructure Group that have been strong, although the timing differed among them due to the COVID-19 pandemic. We can continue trying hard toward Q4.

Q: Operating results for Q3 (October to December) show that while revenue did not increase, orders received increased and backlogs have also been accumulated. We would like to check if revenue and profit for Q4 have any business execution risks. Will you achieve the revenue as planned while the state of emergency has been declared again?

A: In Q3 (October to December), operation recovered gradually. We would like to facilitate communication with customers towards acceptance inspections in Q4. Under the state of emergency, 10% to 15% of our employees, including those who work full time in customers' offices, commute to offices. The rest are teleworking. We consider that it has been functioning well as a workstyle.

Q: Profit by segment shows that the margin of only the Distribution Segment has yet to recover. Why? What is your outlook for Q4?

A: The Distribution Segment is struggling. It may be difficult to recover the previous fiscal year's level in Q4. It was greatly affected by the unprofitable projects that were generated in Q2. In addition, while revenue in the current fiscal year is mainly from project orders that were received in fiscal 2019, the performance had leveled off partly because large-scale projects peaked at that time. Because figures for orders received are currently positive, we look forward to future development.

Q: Is there concern over additional allowances to be made about the unprofitable project, for which an allowance was made in Q2?

A: Due to the difficulty of this project, a cautious stance needs to remain. However, no major problem has occurred to this point.

Q: Did you expect the level of orders received by the Telecommunication Group in Q3 (October to December)? What is your projection for Q4?

A: The level was higher than expected. Orders received by the Telecommunication Group in Q3 were JPY 55.6 billion. This includes about JPY 22.0 billion for 5G-related projects. It is impossible to make an accurate projection for Q4 because there are diverse factors, such as the rush demand at the end of the fiscal year, changes in the status of product supply by vendors, and revisions to overall budgets to be made by some customers. However, we strongly sense the appetite to invest in 5G.

Q: Regarding the future business trends for telecom carriers, you explained that you would achieve a gradual increase overall while compensating for the decrease in 4G projects by increasing your market shares and venturing into new domains, in addition to acquiring 5G projects in existing domains. Looking back on the past couple of years, however, the increase in 5G investments is greater than the decrease in 4G investments. Does it mean that your previous projection was conservative and the progress exceeded the projection? Does it mean that investments in 4G will decrease more than projected from the next fiscal year onward?

A: We do not know what will happen in several years. However, we do not have the impression that there will be a sharp fall in 5G investments in the period into the next fiscal year. Investments in 5G still have room for growth because there are many categories to invest in. We also expect that we can respond to the expansion of local 5G in the tide of DX, although it will happen in the future.

Q: How much of JPY 22.0 billion as orders received for 5G-related projects in Q3 (October to December) was in the RAN domain?

A: Looking at the cumulative total for the first nine months (April to December), SA projects constitute approx. 25% of JPY 42.0 billion as orders received for 5G-related projects. RAN projects are included in SA projects, but the amount is not large yet, being around JPY 1.0 billion. To describe their contents, the projects are aimed for commercialization.

Q: What is the situation in Q3 and your outlook for Q4 of orders received by the Enterprise Group and the Regional & Social Infrastructure Group?

A: Regarding orders received by the Enterprise Group, orders for projects for some customers were sluggish, which has been behind the plan in Q3. However, we focused our efforts on other customers, and the initiatives began to take effect in Q3.

Orders received by the Regional & Social Infrastructure Group were strong, with contributions from railroad-related projects, construction-related projects, GIGA School, and others. Toward Q4, we forecast moves in the public sector, where we are focusing our efforts. However, many things are still unclear. From the next fiscal year onwards, we would like to acquire projects on networks of the central government and local governments, among others.

Q: Slide 11 (Recognition of the current situation) of the IR Presentation states that the impact of the COVID-19 pandemic will be prolonged in some industries, while certain industries will return to normal. Explain this part.

A: For example, the Enterprise Group has some customers who are under tough conditions. On the other hand, some sections of the Enterprise Group, which serves a large number of customers, experience demand related to remote work and DX. They are carrying out intensive sales activities targeting customers with this demand. Target customers include ones from the manufacturing and the transport industries who are working on IoT, factory visualization, and similar themes, in addition to ones from the pharmaceutical, the game, and the education industries.

Q: Describe the figures for the cloud business and performance of the business in overseas countries.

A: We only aggregate H1 and full-year figures for the cloud business. We are having difficulty in Indonesia due to the impact of the COVID-19 pandemic. The business seems to be struggling in Malaysia due to a reactionary fall attributed to special demand in the previous year. However, activities are carried out steadily, and preparations are being made toward future expansion. In Singapore, we have laid out the framework and are working on the business steadily.

Q: Describe your possible performance for the next fiscal year.

A: We are discussing in-house the next medium-term management plan, which will start next fiscal year. It is therefore difficult to give quantitative comments at this stage. However, factors such as DX and 5G have created favorable conditions for us, so our mission is to respond to our stakeholders' expectations by benefiting from these conditions.