ITOCHU Techno-Solutions Corporation

Summary of Q&A at Video Conference Call on Operating Results for the 2nd Quarter of the Fiscal Year Ending March 31, 2023

Date/Time: November 1, 2022 (Tue) 14:00-15:15
Presenters: Ichiro Tsuge, President & CEO
Mamoru Seki, Managing Executive Officer, CFO, Director
Hisashi Eda, Senior Managing Executive Officer, CTO

Q: Operating income declined YoY in Q2. What is the probability of delivering the full-year guidance with this result?

A: The operating income was in line with our initial full-year plan.
Generating operating income in 2H to achieve our plan targets is not easy, but a major divergence from our initial plan is unlikely at this point.

Q: Even excluding the one-time expense (50th anniversary payments to employees) in Q1, “other income and expenses” significantly surpassed your estimate of its increase in your plan. What is the factor for this increase?

A: One of the factors is that SG&A expenses increased due to a decrease in transfers to cost of sales caused by lower utilization rates . The others are the accumulation of small differences in expense items of “other income and expenses”.

Q：What is your estimate for personnel and other costs this fiscal year? Are there any plans to implement cost-cutting measures?

A：We expect our business to continue to grow. In order to realize our steady growth, we need to secure human resources. We therefore do not plan to reduce personnel expenses.

Q：As for the low-margin projects in the Telecommunication Group, did the projects result in low-margin due to the weaker yen?

A: No. These were projects that had been acquired strategically at low profitability at the time of their contracts.
Due to the timing issue, sales from several relatively low-margin projects were recorded in Q2.
We are basically passing on the impact of the yen's depreciation to our customers, so there has been no major impact from the weaker yen so far.

Q: What kind of projects were the strategically low-margin projects? Could similar projects give some impact on your performance in 2H?

A: They were strategic projects to acquire new business areas in the Telecommunication Group. At this point, we do not have any new low-margin projects in sight for 2H and beyond, but we may receive orders for such projects if this is necessary for acquiring new business areas.

Q：Were the negative impacts from the vendor rebate decrease and strategic low-margin projects incorporated in your outlook formulated at the time of the Q1 results release?

A: It is difficult to foresee and incorporate all of such impacts in our outlook since the impact materialization depends on the timing of sales booking for each individual project.

Q: Since Q1, GPM has been on a downward trend. How can you improve GPM in 2H?

A: We will grow our sales to absorb the cost increase from the securing human resources at CTC TECHNOLOGY Corporation (CTCT).

Q: GPM, which had remained high since 2H of FY2020, has declined, and it appears difficult to achieve the full-year operating income target. Do you plan to achieve your full-year target in Q4?

A: Achieving the targets for operating income and subsequent income items is a challenge. In any case, we will continue our efforts to achieve our plan.

Q: The increase in GPM from 2H of FY2020 appeared to be driven by its rise in the Telecommunication Group. Did the GPM decline in the Telecommunication Group drag down the GPM level for the entire company in 1H of FY2022?

A: Not necessarily. The Enterprise Group is seeing an increase in DX and Cloud-shifting projects, and its GPM is steadily rising as a result of undertaking more challenging projects. The rises and declines in GPM of the Telecommunication Group are notable because of its large impact on the entire company, but other business groups are seeing steady improvement in their GPM.

Q: How will the yen's depreciation affect GPM? What are the actual impacts so far and your outlook on future impacts?

A: We are hedging the impacts of exchange rate fluctuations by passing them on to customers, using forward exchange contracts and foreign currency deposits in a conventional manner. While there was little impact on the results of 1H FY2022, there is a possibility that 2H could be more affected, but we will continue our efforts to minimize the impact.

Q：What was the impact of the semiconductor shortage in 1H?

A：Revenue of 2 billion yen, projected to be recognized in 1H in our initial plan, was deferred to 2H or beyond.

Q：While the order backlog is at its record high, CTC's revenue forecast remains unchanged. Is this outlook made because of the impact from semiconductor shortage?

A: Correct. In addition to delays in the delivery of products we provide, delays are also occurring in products procured by our customers, affecting our revenue. At present, there is no end in sight to the delivery delays caused by the semiconductor shortage, and we expect the uncertainties to continue for the foreseeable future.

Q：The decline in orders received in the Telecommunication Group appears to have bottomed out. When do you plan to recognize sales of the large-scale 5G/SA project you have received an order for? Do you expect improvements in the environment for a flattening or positive growth in the orders received thanks to SA project increase going forward?

A: Sales for this project will be recognized in FY2023 or beyond. The environment is not bad.

It will take some time for general companies to start doing business powered by 5G technologies. It is just a timing issue. As the 5G environment gets ready, the volume of data communication will increase, which will lead to projects for networking enhancement. MEC is another promising area for us.

A: Telecommunication carriers have been making progress in their 5G/SA networks, and we believe that this will lead to 5G-related construction projects. Preparing for such projects is one of the reasons why we have secured human resources at CTCT.

Q: Will CTC's business grow while the total capex of telecommunication carriers is decreasing?

A: In recent 5G core businesses, some projects use servers, not network equipment. We believe that the business will trend favorably, for example, by selecting manufacturers that do not have delivery schedule concerns.

Q：Orders received were strong in 1H, but your full-year plan remains unchanged. Are you anticipating some kind of risk in 2H or were some of orders acquired earlier than expected in Q2?

A：While we have the delivery delay issue, there are no special factors. We are simply presenting our conservative view.