Earnings Announcement
for the Third Quarter of the Fiscal Year Ending March 2020
held on February 4, 2020

Principal Questions and Answers

(with certain details modified in an attempt to provide readers with a deeper understanding.)

(Note) The expression 'FY/Fiscal Year' utilized in this document indicates a fiscal year which finishes at the end of March of the following year.
Example: The expression of FY2019 refers to the fiscal year ending March in 2020.)

[Questioner A]

Q : System Services orders for Q3 (the October-December period) decreased (by ¥1.7 billion) compared with the same period (Q3) of the previous fiscal year (FY2018). May I ask why?

A : In this third quarter, we received plenty of orders for small-scale (worth ¥ three-digit million) System Services projects from businesses in our focal areas and ICT Core area.
Eventually, however, System Services orders were smaller by ¥1.7 billion compared with Q3 of FY2018 partly due to a lack of large-scale projects such as the one worth more than ¥1.0 billion that we posted in Q3 of FY2018. (That project was about performing tests in order to enable BankVision, open core-banking system, to serve its 11th bank.)
We have continued to be in a favorable order environment where we have received many inquiries.

Q : System Services' gross margin significantly grew in Q3 (by 3.2pt compared with Q3 of FY2018). May I ask why?

A : System Services' gross margin exceeded 30% for the past three quarters of the fiscal year under review. These are the result of our fruit-bearing steady efforts to improve productivity that we have been making since the period of the previous mid-term management plan. The efforts were to reuse, standardize and componentize knowledge and expertise.
We have been continuously taking these measures at this point in time. We expect them to help us gradually improve our profitability in the future, as well.

Q : I would like to know current situations of unprofitability. Also, what is your prediction for this fiscal year?

A : We made a ¥0.3 billion provision for unprofitability in Q2 of this fiscal year. We made no provisions anew in Q3. A project subject for the provision posted in Q2 is now in a test phase. We have been managing the project in good shape with the eye towards a production operation in early spring this year. We have incorporated unprofitability project risks worth ¥0.2 billion in the plan for Q4.

Q : In which segments have you received many order inquiries?

A : We have received many System Services orders for comparatively small-scale projects in the digital transformation (DX) area to help customers to reengineer business processes and implement sales reforms. These orders are placed by businesses of all segments including financial institutions, services companies, and distribution companies.

Q : There is a significant increase (of ¥4.1 billion compared with Q3 of FY2018) in net sales of the focal areas in the third quarter. May I ask why?

A : The sales growth was attributable to an accumulation of many small-scale DX-related projects of ¥ three-digit million level. For example, there are projects about call center for manufacturers, re-creating internal systems to enable business process re-engineering and workstyle reforms for life-insurance companies, re-creating life-insurer systems together with agencies, developing sales office systems for comparatively large-scale financial institutions, and energy management. These projects added up to result in the sales increase.

Q : The fee-for-service businesses' net sales in Q3 remained at the same level as the Q3 of the previous fiscal year. You ascribed the situation to a decrease in the Value Card business. I would like to know your forecast about businesses related to cashless economy in Q4 and thereafter.

A : We have seen net sales of Value Card business decreasing by 20 to 30% on a year-on-year basis since around the previous fiscal year.

We expect that the net sales decrease will hit the bottom in Q4 of this fiscal year, and no further decrease in the next fiscal year and thereafter.

With respect to QR Code and barcode payment services, we have seen a steady increase in the number of member shops. We anticipate that a growth of this business will help us to make up for the decrease in the Value Card business net sales in the next fiscal year and thereafter.

Q : Your plan indicates that operating income of Q4 will be unchanged from Q4 of FY2018. May I ask if you anticipate any costs?

A : We are prepared for an increase in R&D costs due to demonstration experiments for this fiscal year (actual costs in FY2018: ¥4.0 billion, planned costs in FY2019: ¥5.0 billion). We expect an increase of approx. ¥0.4 billion in R&D costs in Q4.

We expect a ¥5.8 billion decrease in Products Sales in Q4 compared with the same quarter of the previous fiscal year when we posted one-off sales of hardware products and software products. Thus, we expect a decrease in gross profit of Products Sales. However, we expect a slight increase of ¥0.3 billion in the entire gross profit on a year-over-year basis, attributable to an increase in gross margin of System Services based on an improved productivity of the business.

As a result, operating income is expected to be unchanged from Q4 of FY2018.

[Questioner B]

Q : An increase percentage in orders for hardware products has continued to shrink after its peak in Q4 of FY2018. The orders decreased by 10.4% in the third quarter of this fiscal year.
I only know by hearsay that demands related to Windows 7 renewal still exist among small and medium sized companies. I would like to know your forecast about your hardware products sales in the future.

A : We deal with a broad range of products including mainframe computers and small-sized servers. As a result, an order amount and a sales amount are subject to a product mix or assorted products on sale. The amounts experience vertical fluctuations significantly.
In this Q3, we did not post hardware products orders equivalent to a comparatively large order that we received from a financial institution in Q3 of FY2018. This is part of the reasons why hardware products orders decreased on a year-on-year basis. However, key third-party servers that we deal in as part of our hardware products sales business have small gross margins. Therefore, the hardware sales do not impact the profitability significantly.

[Questioner C]

Q : You said that you expect an order for a large-scale Outsourcing Services project in Q4.
May I ask you to brief us on that project?
I remember a regional bank that agreed on transforming the core-banking systems through the use of cloud computing ('BankVision on Azure'). Did you refer to the bank?

A : We anticipate an order for an Outsourcing Services project from a financial institution which is not a regional bank in Q4. The order will exceed ¥10.0 billion based on a 10-year project agreement.
We are now developing systems to enable cloud-computing platform operations for a regional bank with the eye towards a production operation in 2021 as we described in a news release the other day.

Q : Please tell us your Products Sales forecast for the next fiscal year.

A : We have seen market needs become extremely variable and grow as indicated in the needs for 5G accompanying devices and edge devices. Furthermore, we are aware of demands for AI-related servers such as those that we posted in Q4 of the previous fiscal year. Therefore, we hope that we can post a decent level of sales from Products Sales in the future as long as we make proactive efforts to receive orders without fail.

[Questioner D]

Q : It seems that other companies in your industry look to hire employees and experience a tight labor market. May I ask if you have secured the human resources needed partly by employing new graduates and retaining subcontractors?

A : We saw a very large number of new graduate applicants. We have been able to employ 204 new graduates as we planned for this fiscal year. We plan to employ 240 approx. for the next fiscal year. Furthermore, we have been able to steadily employ mid-career candidates well versed professionally and experienced in business development with the eye towards business model reforms. Thus, we do not have issues with employee employment in general.

We have developed systems through close-knit relations with subcontractors. At the same time we have been reviewing partner strategies in light of changes of the times and we have been establishing relations of stronger collaboration. Therefore, even though we are short of engineers who possess skills required in some projects, we are not in a situation where we see our businesses negatively impacted from scarce human resources.

Q : I have seen an increase % of operating income beating that of net sales for the past few years. May I ask how long you assume you can continuously depend on effects of productivity enhancement enabled partly through ‘packaging’? If you achieve a year ahead of schedule your target level indicated in the mid-term management plan (which is an 8% or more operating margin for the fiscal year ending March 2021), do you plan to redo your mid-term management plan?

A : We plan to go ahead with business restructuring in the future with the eye towards further emphasizing service-type business and platform-type business. In fact, we have only begun to consider the next mid-term management plan. Therefore, at this point in time, we would like to refrain from explicit replies about a future profit level. We will take the opportunity of announcing the full-year performance results in May in order to brief you on our performance forecast for the next fiscal year, the final fiscal year of the current mid-term management plan.

[Questioner E]

Q : I see the number of your employees continuously decrease in the past few years.
May I have your forecast of a future employee number?

A : We planned a transition of approx. 7,700 employees for the period of the current mid-term management plan (from FY2018 to FY2020) at the point in time when we announced the plan. (This number excludes the number of employees working for a system development subsidiary in Vietnam.) We see now the employee number approaching the planned level.

The number of employees was just over 7,500 people at the end of March 2019. It will be approx. 7,600 at the end of March 2020. We have intensified mid-career employment in order to hire employees who have strength in the fields of technology and system development. As a result, we foresee a level of approx. 7,700 at the end of 2021, the final fiscal year of the current mid-term management plan.

Q : You have continuously improved the productivity per employee. May I ask if you see any more room left for improvement?

A : We have significantly taken on what should be done. Therefore, we expect that the speed and intensity of our future efforts will be moderate compared with the past three years. Having said that, we have room for improvement in the areas of system development and outsourcing. We can improve partly through re-using and standardizing knowledge and expertise as well as streamlining operations.

We think that we can expect a dramatic improvement of profitability in some projects once we exceed a marginal profit ratio in an environment where we make advance with servitizing businesses and developing them into a platform. We have been making efforts to strengthen such businesses. We have set operating income amount per employee as one of our KPIs for the entire company. We have been making efforts to improve profitability through these efforts.

Q : I see a transition of your SG&A expenses within the range of approx. ¥52.0 billion to ¥52.5 billion per annum for the past few years. In this fiscal year, however, the expenses seem to begin to gradually increase mainly due to an increase in R&D costs. Do you foresee that SG&A expenses will stay on the increase in the next fiscal year and thereafter?

A : We have been making efforts to reform our business models, and many of those efforts are proofs of concept to increase new businesses. Thus, we expect an increase in R&D costs. We plan an increase of ¥1.0 billion in R&D costs for this fiscal year and the absolute value of ¥5.0 billion per annum. We do not think that our entire performance will be impacted by an increase in R&D costs. We expect an increase in personnel costs by a certain percentage due to a performance-linked bonus system that we have adopted. However, despite an increase in bonus paid in conjunction with performance, we have seen personnel costs remain unchanged for the past few years due to a decrease in overtime pay as a result of shorter overtime duration partly attributable to workstyle reforms. We now have the overtime duration reduced to a certain level. Therefore, we anticipate an increase in personnel costs for an increase in bonus to be paid in connection with an improvement of performance in the future.