Earnings results for FY18 (fiscal year ended March 31, 2019)

Q1. What factors account for the slowdown in profitability growth in the enterprise market in FY18? Please give your rationale for operating margin targets set for each segment for FY19 and for those laid out in the medium-term business plan.

A1. Operating margin in the enterprise market was affected by less-than-expected investments in data center integration in the information industry. On the other hand, our business in the manufacturing and non-manufacturing industries was strong, leading to an increase in the share of sales coming from services, which contributed to higher operating margin.

In the medium-term business plan starting FY19, we aim to grow profit in the enterprise market so the segment operating margin will be on a par with that of the public market and the partner sector. We expect the operating margin in the public market to increase gradually on a rise in recurring businesses. We have set conservative targets for the partner sector, while targets for the telecom carrier market were made under the assumption that performance will remain unchanged.

Q2. The balance sheet shows lease assets and lease obligations have expanded; is there a risk of irrecoverable debts? How long does it take for the lease assets to be recognized as revenue since the time of their booking?

A2. The increase in lease assets and lease obligations is due to robust performance of the NetOne “all in” Platform, which combines hardware leasing and services under a monthly subscription model. The risks of irrecoverable debts related to the service is borne by a leasing company. Contract period varies, with shorter contracts running for 12 months and longer ones spanning a period of up to five years.

Outlook for FY19 (fiscal year ending March 31, 2020)

Q3. Will you be able to achieve FY19 targets with improved profitability in the enterprise market, overall revenue growth, and reduced SG&A expenses?

A3. We expect revenue growth to be in line with the medium-term plan. Although bonuses and incentives for earnings surpassing targets booked under SG&A expenses in FY18 will be absent in FY19, we do not expect to see a substantial reduction in SG&A expenses as we plan to hire some 100 employees to drive future growth for a total headcount of about 2,500. We expect operating margin to improve on an increase in the share of solutions business to total revenue, which has a higher margin than sales of hardware.
Q4. The projected revenue decline in the public market is noticeable in FY19 earnings forecast.
Could you explain this drop in comparison to FY18 results?

A4. While we expect a revenue decline of roughly JPY12.0bn due to the fallout of large projects, the revenue forecast also takes into account additional factors such as steady growth in the number of projects for local governments and the gradual expansion of new businesses in the healthcare- and education-related fields.

New medium-term business plan (FY19 to FY21)

Q5. How did you set revenue and profit targets for the three-year period covered by the medium-term business plan?

A5. We expect to meet revenue targets by making progress in new focus markets, which will add to revenue results up to FY18. Overall, the medium-term plan prioritizes profit growth over revenue growth. We aim to increase operating margin through focus markets and new models and by expanding service business, and target JPY17.0bn in operating income in the second year of the plan. In the final year of the medium-term plan, we expect the launch of new business models such as refurbishment (product recycling) to further contribute to profit growth.

Q6. Please give a breakdown of the JPY38.0bn increase in revenue over the next three years.

A6. Of the JPY38.0bn increase in revenue, we expect JPY25.0bn to come from three focus markets and two new models, each contributing JPY5.0bn. In regards to the remaining JPY13.0bn, we expect contributions from revenue growth in the existing Cloud System with Security business.

Q7. In which segment do you expect to see the most improvement in profitability after three years?

A7. We are not sure how the boundaries between the enterprise and public markets will have changed after three years. The two markets are becoming increasingly similar in terms of business content and scale, and if they become similar enough so that same solutions can be offered, it will be difficult to predict by how much each market will grow. The public market is leading the enterprise market in terms of initiatives toward adopting security measures and optimizing data center operations. We expect to see growth in these areas in the enterprise market going forward.

Q8. How much do you expect the new model, Managed Service Provider (MSP) Support, to grow in the next three years?

A8. We plan to make an additional JPY5.0bn investment in MSP Support. The MSP Support is a service business that has a high profit margin and we expect it to turn a profit by increasing the number of projects.
Q9. In the MSP Support business, will Net One Systems be providing service menus while MSPs sell those services as partnering companies?

A9. To launch services planned by partnering companies, MSP Support adopts a business model in which Net One Systems designs and provides solutions together with hardware to be installed at the client’s site.

Q10. How do you think 5G will affect infrastructure integration for telecom carriers?

A10. We believe some business operators have already begun building 5G infrastructure, but we are not involved in it at the moment. We will focus on profitability in all our projects, including ones relating to the 5G infrastructure building.