Net One Systems Co., Ltd.
Q1 FY03/20 results briefing Q&A (summary)
15:30 on Thursday, July 25, 2019

Participants: 86
Duration: 40 minutes (briefing: 10 minutes; Q&A: 30 minutes)
Questions: 13 questions from 6 people

[Questioner A]
Q1. Order bookings in the telecom carrier market are increasing. On the other hand, they are decreasing in the partner sector. Please explain the conditions behind these changes in detail.

A1. The rise of order bookings in the telecom carrier market is due to an increase in orders for projects involving the replacement of old hardware. These projects are boosting hardware sales. On the other hand, order bookings for cloud service projects have slid to Q2 or later, and the product mix between hardware and services has changed as a result. Consequently, Q1 figures were impacted slightly but we expect that full-year results will be in line with plans. In the partner sector, hardware sales for managed services conducted through telecom carriers are trending downward, but performance has been strong otherwise. Segment income fell slightly below forecast, but we estimate that it will catch up during 1H.

Q2. The number of consolidated subsidiaries with poor income margins has increased. Despite this change, your gross profit margin has improved. What is the reason for this?

A2. Our two newly consolidated subsidiaries did not have a large impact during Q1. Please understand that, as before, Q1 figures were mostly determined by performance at Net One Systems and Net One Partners. Furthermore, eXtreak, a newly consolidated subsidiary, is a facility engineering company, and it is recording gross profit margins at about the same level as ours. Net One Systems believes that the largest reason for the improvement in gross profit margin is growth in service ratios, particularly in the public and enterprise markets. We champion all of our businesses as integrated services and believe that we are gradually seeing the results of our efforts to increase service ratios.

[Questioner B]
Q3. Regarding order bookings in the public market, were the large projects worth JPY12.0bn that were recorded in FY18 all central government projects?

A3. Yes, they were.

Q4. Please inform us of any updates to initiatives related to focus markets and new models promoted in the medium-term business plan.
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A4. In terms of focus markets, performance in the healthcare market has been extremely favorable. The education market has also been strong. The pipeline in the smart factory market has also been increasing, but order bookings are at the same level as FY18, so we would like to further focus on this market moving forward. Several new mechanisms have just been established in support of the new managed service provider (MSP) model. We will develop these mechanisms properly going forward. Expansion of the refurbishment (product recycling) model is proceeding according to plan, but we believe there is a lot more in store.

[Questioner C]
Q5. Were scheduled orders in the public market moved forward? Please explain the year-on-year increases in certain orders.
A5. No scheduled orders in the public market were moved forward. We saw large growth in orders from some local governments in FY18, and we projected some drop-off in FY19. However, Q1 results were higher than expected, which was the main reason for order increases in question. Furthermore, growth in the healthcare market also exceeded expectations.

Q6. What is the reason for the high operating margin in the enterprise market? Will it remain at a high level in the future?
A6. Revenue in the enterprise market have risen above the break-even point. We believe that this rise is the main reason for the high operating margin. Additionally, we consider the gradually rising service ratio to be another contributing factor. We will work to expand services to ensure that this trend continues.

[Questioner D]
Q7. Will order bookings for local government projects continue to pick up speed in the future?
A7. During a typical year, we accept most orders for local government projects in 1H. Therefore, we expect some gradual slowdown starting in 2H. However, we believe that orders for local government projects have the potential to exceed full-year projections.

Q8. Has your total number of employees increased with addition of new consolidated subsidiaries, the hiring of new graduates, and efforts to strengthen mid-career recruits?
A8. Yes, our total number of employees has risen due to the hiring of new graduates and the consolidation of subsidiaries. The number of employees leaving the company and the number of mid-career recruits were the same. Furthermore, the total number of groupwide employees, which includes those from non-consolidated subsidiaries, has not changed significantly from end-FY18.
Q9. Are current individual employee capacities abundant enough to accomplish company objectives?
A9. We believe that our engineers are currently being stretched thin. For this reason, we plan to make adjustments to work styles moving forward. Although we are cooperating with partner companies, we have been able to secure income.

Q10. Your income margin has continued to improve as services increase. Can you continue to secure income margin growth moving forward?
A10. The income margin of our system integration services is not particularly high when measured against the rest of our services. We are also providing consulting services, but they are not producing high levels of income. Income in maintenance services generally seems to be trending downward moderately but we have been able to secure growth in revenue, so overall performance has been level with FY18. On the other hand, income from operating services is increasing. We have been promoting their automation to the fullest extent possible to ensure that we can secure income. Mechanisms linking operating services with consulting services have also been created, leading to an overall increase in income margin. Consequently, we believe that we can continue to improve our income margin in the future by increasing service ratios.

[Questioner E]
Q11. How much higher than company projections were Q1 order booking results? Please explain in terms of overall order results and results in the public market. Furthermore, is this trend of outpacing projections sustainable?
A11. In Q1, we anticipated that order bookings for the entire company would decline by JPY12.0bn year on year and then grow somewhat. However, actual results exceeded these expectations.

In the public market, order bookings outpaced projections by about JPY5.0bn. That said, we believe that completely making up for the JPY12.0bn decline due to the dropout of large projects recorded in Q1 FY18 during 1H FY19 will be difficult. In other segments, orders in the enterprise market were in line with our prediction while orders in the telecom carrier market exceeded our target by JPY1.0bn. In the partner sector, orders were JPY800mn below our projection, but we believe they will meet our target for 1H. In our full-year forecast for FY19, we announced that order bookings would increase year on year, and we will work to meet this goal moving forward.
Q12. How is the demand environment in the manufacturing industry?
A12. Some of our customers’ plans have been delayed due to trade friction between China and the United States. On the other hand, customers that have not been affected are showing a strong willingness to invest. There has been some deviation from initial projections, but it is our understanding that performance was ultimately in line with plans.

[Questioner F]
Q13. In Q1, the gross profit margin was high at 27.4%. Can you maintain this level in Q2 and achieve a 1H gross profit margin of 25.7%?
A13. We now believe that we can potentially reach our target 1H gross profit margin of 25.7%. Additionally, we will promote initiatives aimed at achieving our full-year gross profit margin target of 25.4%, and will continue to work to meet our full-year operating income goal of JPY15.0bn.