

Questioner 1

Q1

I want to ask you about the large-scale unprofitable project that occurred in the Financial Segment. Could you tell me its effect, cutover date, and nature? In addition to the project in the Public & Social Infrastructure Segment that have reported losses over the past few years, the third quarter saw a large-scale unprofitable project in the Financial Segment. What measures are you going to take against them?

I also want to know if the system failure at Japan Information Processing Service Co., Ltd. that occurred in December 2019 will impact your financial performance.

A1

During the 3 months of the third quarter, the entire Group incurred a loss of 5.9 billion yen from the unprofitable projects, of which 4.9 billion yen originated from the Financial Segment, and most of it came from one project. In this project, we had to carve out and reconstruct the large functions from a legacy system whose operations and programs had become complicated after repeatedly adding functions over a long period of time. It was extremely difficult to develop this system as we had to ensure the carved out and reconstructed portions were consistent with the original complicated system. Although we were aware of the high risk of undertaking this project, the risk was greater than we had assumed. The cutover is scheduled in FY2020, and we have made sure that we have estimated the amount of loss as far as we could reasonably estimate as of present.

Meanwhile, the unprofitable project in the Public & Social Infrastructure Segment has been completed. The projects have common factors: both are for reconstructing the systems that have repeatedly been reworked without a large-scale renovation for a long time, are of highly public nature, and their orders were received through bidding. We expect such projects to increase as legacy systems are renewed and thus will be taking necessary measures.

We extend our apologies for the great deal of inconvenience the system failure at Japan Information Processing Service Co., Ltd. has caused for many local governments and their inhabitants. Because we have not signed a uniform agreement with each of the local governments, we will have to deal with them individually. Thus, we are not in a position to determine the impact of the system failure at present. To recover the system, we mobilized more than 200 employees at the peak time. Although we cannot completely deny its impact on our financial results, we do not regard its impact as significant, considering the size of the business at Japan Information Processing Service Co., Ltd.

Q2

Does the amount of loss in the Financial Segment include man-hours for the next fiscal year?

A2

The cutover will take place in the next fiscal year, and we have estimated the man-hours for the next fiscal year as accurately as possible. We examined the estimates not only on-site but also in the Group-wide committee, which gives us the confidence that our estimate is precise. However, we cannot

deny the possibility of unexpected events occurring in the future.

Q3

In the North America Segment, new orders received used to fall below net sales. Since the fourth quarter of the previous fiscal year, they have recovered over approximately one year. You have explained to us that they would result in an increase in revenues, leading to a profit recovery in the near future. However, you may presently not be in such a situation. When will your revenues increase with the recovery of profits? How will the multiple large-scale projects you received in the third quarter contribute to your financial performance?

A3

Since the fourth quarter of the previous fiscal year, new orders received in the North America Segment has been doing well. Looking back over the past 2 years, we have constantly received new orders for not-so-large scale projects, and have secured large-scale projects. Thus, new orders received has increased. Large-scale projects in the North America Segment have 5- to 7-year contract periods (6 years in average). For example, in the fourth quarter (3 months) of the previous fiscal year, we had new orders received worth 177.9 billion yen, of which about 100 billion yen were from large-scale projects. If you equally divide this amount by 6 (years) and post the result as net sales per quarter, the figure would not be so significant. We want you to understand that accumulated new orders received will be reported as net sales over about 6 years after the transition periods are successively completed. Currently, they do not greatly contribute to net sales, but they gradually will.

Q4

If I remember correctly, the North America Segment used to be more profitable. When will it recover?

A4

The Medium-Term Management Plan aims to achieve an overseas EBITA ratio of 7%. Achieving this goal in the North America Segment is inevitable and we are continuously working toward it. We are confident that we can report profit in excess of the past records by FY2021, the final year of the Medium-Term Management Plan, at the latest.

Q5

For the growth investments and structural transformation costs, you posted 10 billion yen as projected annual increase respectively. I want to know the results of the third quarter and the forecast for the fourth quarter. Could you also give us a concrete image of the effect of these costs?

A5

In the third quarter, growth investments amounted to 6.2 billion yen in total, and the progress rate of the structural transformation costs was approximately 70% of 10 billion yen per annum. We want you to understand that their effect will emerge in FY2021 when the Medium-Term Management Plan will be completed.

Among the structural transformation costs in the EMEA & LATAM Segment, the largest cost is related to “unleashing employees’ potential to increase talent for digital disruption,” in which we reskill employees for digitalization, recruit digital talents, offer early retirement programs for those who have difficulty in acquiring digital skills, and so on. Although we are planning to perform most of these tasks in the current fiscal year, some may be carried over to the next fiscal year. As part of the structural transformation, we are also reviewing projects whose profitability or capital efficiency is low. Depending on the projects, we may decide to withdraw from or downsize the business. Although we have not reached any specific conclusion on this matter, we are determined to complete necessary reforms as we focus on achieving the Medium-Term Management Plan in FY2021.

Questioner 2

Q1

Was the Project Review Committee unable to recognize the large-scale unprofitable project in the Financial Segment? Is the large-scale unprofitable project in the Public & Social Infrastructure Segment making steady progress without recording additional losses and so forth?

A1

The project in the Financial Segment was reviewed by the Project Review Committee, which recognized its risk. It was difficult, however, for the Committee to indicate the complexity of the individual operations, so it failed to stop the receipt of the order. From this project, we have learned that large-scale projects in which functions have been repeatedly added over a long period of time are of extremely high risk, especially those in which we have to reconstruct, not the entire system, but a part of it. This experience has led us to review the future way of a project review to prevent such recurrences. We find it necessary to take measures, such as adding reviewed items, because similar projects in which legacy systems are migrated are likely to increase in the future.

The project in the Public & Social Infrastructure Segment is scheduled to complete releases in this fiscal year at the highly difficult sites, and it is making a steady progress. Although we cannot preclude the possible occurrence of unexpected events, we do not expect that additional losses will be posted for this project.

Q2

A number of large-scale projects for updating legacy systems are expected to emerge. From your standpoint, it must be difficult for you to refuse to accept large-scale orders especially from public agencies or financial institutions. Can I trust you not to receive such orders depending on a project?

A2

For example, for public projects, there are cases in which we bid at once for the entire processes, beginning with requirements definition. It will be extremely difficult to receive orders for projects such as this, which is similar to the current unprofitable case in the future. We would like to control risks arising from new orders. If we have a long-term relationship with a client, we will suggest securing an individual process to appropriately determine the requirements, instead of signing a blanket contract for the entire processes all at once. If a client insists on a contract for the entire processes, we must make a decision not to receive such an order.

Q3

Though revenues, excluding the impact of foreign exchange rates, increased in the North America Segment in the third quarter, profits did not grow and the profit rate was down. Why is this? At the briefing on the earnings for the second quarter, you said that profits would gradually recover in the fourth quarter. Does your outlook remain the same?

A3

The gross profit rate in the North America Segment is on an increase trend. We do not consider the profitability of individual projects to be lower. Profits did not grow mainly because selling expenses due to strong new orders received and interim costs, such as investments for further growth have increased. However, we are confident that profits will gradually increase in and after the fourth quarter.

Q4

With the exception of the impact of foreign exchange rates, new orders received in the EMEA & LATAM Segment remained almost unchanged in the second quarter (3 months) and the third quarter (3 months) compared to the previous fiscal year. Could you tell us about the environment for new orders received in Europe?

A4

Concerning the exchange rates, the Yen was appreciated more than we had expected. If we exclude that impact, orders have not slowed down. However, the German automobile and other industries were slightly careful about investment. Thus, if we look at each country, we could not meet our goal in Germany, but on the whole, we are doing well in terms of new orders.

If you look at the orders by quarter, fluctuations cannot be avoided. In the third quarter (3 months), new orders received excluding the impact of foreign exchanges remained almost unchanged compared to that in the previous fiscal year. However, the new orders received from the Spanish energy company, Naturgy, will be reported in the fourth quarter as we explained at the briefing on the earnings for the second quarter. Because this is a large-scale project, new orders received for the full year will be as strong as before. Please understand that new orders received for each quarter will fluctuate and is unlikely to grow indefinitely. The strength, however, is maintained in terms of a general trend. There is no change in the trend in which Spain and Italy are driving the increase of new orders received.

Questioner 3

Q1

The progress rate of operating income against the annual forecast was a total of about 63% in the third quarter for both the previous and the current fiscal year. Therefore, it does not look especially low for the current fiscal year. Nevertheless, you mentioned that it would be difficult to achieve the guideline for the full year. Was this mainly because the growth investments would be large in the fourth quarter?

A1

With regard to the progress rate of operating income, it is necessary to take into account how much losses from unprofitable projects are reported and how measures expenses are spent. Speaking of the measures expenses, we are scheduled to spend structural transformation and growth investment costs also in the fourth quarter. We are working on the measures to use up the projected annual amount of 10 billion yen for each. The progress rate in the current fiscal year seems to be at the same level as that of the previous fiscal year. However, considering that measures expenses will be spent in the fourth quarter of the current fiscal year, we cannot say that the full year guideline for operating income can be achieved naturally without taking special measures; it requires considerable efforts. Our current focus is not on meeting the guideline of operating income in the current fiscal year but on the achievement of the Medium-Term Management Plan. Therefore, we will make management decisions, focusing on the latter.

Q2

Does this mean that you do not suppress investments to achieve the projected financial results in the current fiscal year?

A2

Although we will make individual decisions after discussions going forward, we should manage our business with an emphasis on the achievement of the Medium-Term Management Plan rather than on that of the financial results in a single fiscal year.

Q3

Do you have a profitability threshold for new orders received in the North America Segment?

A3

We make a decision on each individual project, so it depends. However, our management as well as the management of the North America are highly aware of the overseas EBITA ratio of 7%, which we consider when deciding whether we will receive an order.

Q4

A Nikkei's article mentioned that the Japan Fair Trade Commission would investigate you in connection with financial APIs. Did the Commission actually investigate you?

A4

The Commission widely distributed questionnaires not only to us but also to financial institutions and

vendors. We answered the questionnaire, but apart from that, there is no such fact that we were investigated at the moment.

Questioner 4

Q1

To what extent did total operating income in the third quarter fail to achieve an internal plan?

A1

Because we do not create a quarterly profit plan, we cannot give you a specific figure. The profit in the third quarter was lower than expected because of the unexpected occurrence of the unprofitable project in the Financial Segment. In the current fiscal year, we intended to curb huge losses from unprofitable projects incurred in the previous fiscal year so that we could use the surplus as funds for growth investments and structural transformation. However, the second and the third quarters saw unprofitable projects arising on a larger scale than initially assumed. We will make efforts to control unprofitable projects and take steady measures for achieving the Medium-Term Management Plan.

Q2

You mentioned that you are considering withdrawing from projects of low profitability as part of your structural transformation in the EMEA & LATAM Segment. How large are the target projects? And when will you make the decision to withdraw?

A2

With regard to reviewing projects of low profitability, we intend to make the decisions as early as possible. Although we do not know if we can examine all the projects in another 2 months, we wish to cover most of them in this fiscal year.

Q3

If you decide to withdraw from the businesses during the current fiscal year, I believe that you will incur certain costs. Is it highly likely that you will post them in the next fiscal year?

A3

It depends, but if we can expect losses from withdrawal, we may report the costs during the current fiscal year.

Q4

As I look at your net sales by product and service, I find a noticeable increase in revenues from consulting in this fiscal year. By what factor did this occur?

A4

The consulting domain, including digital projects, expanded both in Japan and overseas. In addition, as the North America Segment currently lacks capability in the consulting domain, it raised its level by focusing on M&A's of firms that are strong in consulting. The new M&A's we conducted in North America contributed to the revenue growth.

Questioner 5

Q1

For the large-scale unprofitable project that occurred in the Financial Segment, is it more challenging to estimate the additionally posted losses than for the large-scale unprofitable project in the Public & Social Infrastructure Segment?

A1

The estimation of the current project in the Financial Segment is less challenging compared to that in the Public& Social Infrastructure Segment. In the latter, we had difficulty in determining if the systems would be accepted before the clients ran the acceptance tests. It was also highly difficult to estimate how many man-hours were required to gain acceptance. Such factors were extremely small in this case, so we regard it as less challenging.

Q2

You are planning to spend 10 billion yen for the structural transformation in this fiscal year. If you fail to complete the optimization of the human resources portfolio during this fiscal year, will you post some of the costs in the next fiscal year? Your overall progress rate is about 70% as of the present, but what about the progress rate by item of the measures?

A2

We decline from commenting on our progress on the individual items. We are determined to complete the optimization of the human resources portfolio as much as possible during this fiscal year, such that only the unavoidable costs will remain in the next fiscal year.

Q3

You are spending 10 billion yen for the structural transformation in this fiscal year. Will this decrease in the next fiscal year and become a factor for the increase in profit?

A3

We have not yet discussed a business plan for the next fiscal year. We will have a variety of discussions. For example, we may reduce spending in some areas while actively investing in new areas. It is difficult, therefore, to answer your question at this point. However, we would like you to know that we will have less structural transformation costs in the next fiscal year than in the current.

Q4

How will you respond to SAP's 2025 Deadline?

A4

This is closely related to each client's IT strategy. Generally speaking, domestic leading SAP users characteristically customize SAP more than their overseas counterparts. This makes it more difficult for them to migrate from conventional on-premise systems to S/4HANA. Even if they use general-purpose tools for the migration, they will face some limitations. Also, the fact that Japan has only few SAP

specialists might become a problem. We need to make adjustments with the clients, who will have to adopt an approach of using a package to replace the conventionally customized functions.

Questioner 6

Q1

You answered the questionnaire from the Japan Fair Trade Commission. How influential or binding will the report that will come out in March be? You have made long-term investment in the Zengin Data Telecommunication System, CAFIS, and ANSER, while having some difficulties since their launches. These projects are now profitable. How will you justify your business to the Commission?

A1

Various news reports have suggested that we are interfering with the spread of Fintech, which is not true in reality. We are one of the Japanese companies that has made most efforts to diffuse Fintech. Our use of APIs spare Fintech companies from discussing or negotiating individual specifications with financial institutions. Therefore, they are beneficial to both the Fintech companies and financial institutions. We are actively working with Fintech, like holding innovation contests or establishing a Fintech lab. Furthermore, we do not monopolize this market, and naturally, there is a competition with other companies. If we charge higher fees, some companies surely will not use our system. Therefore, our pricing is not unfair.

We do not know how influential the report will be at the moment. We will pay attention to the announcement by the Japan Fair Trade Commission in March.