

Earnings Announcement
for the Second Quarter of the Fiscal Year Ending March 2021
held on November 6, 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 FY2020 refers to the fiscal year ending March in 2021.)

[Questioner A]

Q : Net sales in the Focal Area have grown about ¥8.6 billion in the second quarter (the Jul-Sep period). How have GIGA School Program sales impacted Q2 results? Which Focal Area businesses other than the GIGA School Program business expanded?

A : The net sales for GIGA School Program in Q2 was around ¥3.0 billion. Other businesses that saw growth include digital transformation (DX) projects for the retail industry, especially the electronic shelf label solution as briefed on in my presentation material. The Fee-for-Services businesses took a devastating hit from the COVID-19 pandemic, such as inbound tourism services, international transaction of QR code settlement and car-sharing services. However, this was offset by growth in other businesses, resulting in a slight increase. We also saw an extremely large number of inquiries from various customers about small and mid-sized projects related to workstyle reforms and digital transformation. As a result of the buildup of such projects, net sales in the first half grew significantly in the Focal Areas.

Q : How much amount of orders related to the GIGA School Program did you receive in Q2? How much did the orders impact profits?

A : The GIGA School Program orders received in Q2 were about ¥3.0 billion. The business is of a short lead time from receiving orders to recording sales. We hardly have any backlog of the GIGA School Program orders. Orders related to the Program will be received in the second half and will be booked as net sales within the current fiscal year. The business will not have too much of an impact on profits.

Q : May I ask about reasons for an increase in the orders for outsourcing services in Q2? You said that you had received orders for large-sized service projects. Please brief me on the projects.

A : We saw an increase of nearly ¥13.0 billion in the Outsourcing orders as a whole in the second quarter. This included several large long-term projects for financial institutions. On top of that, we saw a large number of orders for small and mid-sized outsourcing projects. The orders received in Q2 from financial institutions are for a long-term renewal project where our existing

customers are helped (through our long-term outsourcing services) to migrate from an existing mission-critical system to a new system capable of facilitating the implementation of digital transformation.

Q : System services orders have recovered to a level on par with the same period of the previous fiscal year. Please brief me on which business sectors you saw a pickup in inquiries about.

A : We haven't seen any impact on system service projects that have been going on since the previous period. However, we experienced a sharp drop in the orders for small and mid-sized project in Q1. The sluggishness carried on somewhat into Q2. Be that as it may, orders in the second half will show recovery signs, as we saw more orders in Q2 than in Q1. We see a very strong pickup in the inquiry quantity about customer interaction solutions from the financial sector and the retail sector. Looking ahead to the second half, we also see a large number of inquiries about ecommerce services. Projects are accumulating in our pipeline. On the other hand, investments are continuously curbed in the transportation and travel-related sectors. We don't think this situation will change in the second half.

Q : You have enabled a continued improvement of gross margin through efforts to improve productivity. Please brief me on your efforts to raise gross margin for support services and system services.

A : We have been working on structural reforms at our regional bases for support services for the past two years. Specifically, we have entrusted local partners with part of our projects in order to reduce fixed costs. The transformational efforts have enabled a structure where we can generate profit amidst the COVID-19 pandemic. We have been working to boost productivity for system services for long. As a result, we have become able to generate steady profit without raising the operating rate of engineers. We achieved this profitability level in the first half period where we suffered from customers reducing investments in small and mid-sized projects that were of high margin for us. We expect productivity to be improved even further in the second half as we see a pickup in small and mid-sized projects.

[Questioner B]

Q : May I ask why you suffered a significant decline in the net sales of system services in Q2?

A : The small and mid-sized project quantity in the first half decreased by about 10% compared with the same period of the previous fiscal year. The decrease is largely attributable to a decline in business sectors where customers were afflicted from the COVID-19 pandemic. Furthermore, customers of other business sectors prioritized investments in the efforts to deal with the pandemic impacts. They postponed small projects that had been already scheduled partly in order to improve system functions, notably in Q1.

Q : System services orders recovered in Q2. Will the order growth enable an increase in the net sales in the third quarter? May I ask for your predictions about Q3 orders?

A : We expect flat sales on the basis of the current pipeline situation. However, we may overshoot or undershoot, depending on the economic impacts from the pandemic in the second half. Small and mid-sized projects are of a short lead time from receiving orders to posting sales. Thus, we think that orders for small and mid-sized projects will move almost completely in correlation with sales. Needless to say, there may be orders for large projects that we will receive in the future. We think that we will see many of those projects in the outsourcing services area where we provide customers with system operation services beyond performing entrusted system development services (system services). We are seeing a stronger trend for customers to outsource to IT service providers such as our company system operation as well as system development. They shy away from operating system by themselves.

Q : The outsourcing sales have remained unchanged since around the fourth quarter of the previous fiscal year. May I ask why?

A : The orders for and net sales of conventional outsourcing services have been posted, roughly as planned. In fact, we would like to grow the Fee-for-Services businesses and Service type businesses. However, businesses related to inbound tourism and sharing economy took a devastating hit under the COVID-19 pandemic. Thus, the net sales from Fee-for-Services business only saw a modest growth.

Q : You said that you posted orders for long-term outsourcing projects in the second quarter. The projects will not have much of a short-term positive impact on net sales. You plan a ¥13.6 billion increase in H2 net sales compared with the same period of the previous fiscal year. Did you make the plan based on your expecting an increase in net sales of small and mid-sized outsourcing projects?

A : Outsourcing orders in the second quarter significantly increased. These are orders from financial institutions for long-term projects. As you indicated, a short-term impact on net sales from the orders will be small. We will see a buildup of small and mid-sized outsourcing projects in the second half. However, a key driver for an increase in H2 net sales will be sales of products such as electronic shelf label (ESL) and AI ordering solutions. We expect an increase in the amount of ESL sales in the second half.

[Questioner A]

Q : I recall that you posted several high-margin mainframe projects in the second quarter of the previous fiscal year. You assumed that this would negatively affect the gross margin in the same quarter of this fiscal year due to the dropout of those projects. May I ask whether you saw this impact? Also, you plan a significant increase in software net sales in the second half. May I ask what types of software products you expect to receive?

A : We posted high-margin in-house open-source software sales in the second quarter of this fiscal year. This is why gross profit did not fall much. We expect sales mainly of security software products such as those related to the GIGA School Program in the second half.

However, these are not of high margin due to the fact that these products are not developed by us.

[Questioner B]

Q : May I ask for your predictions about entrustment businesses from a long-term viewpoint? In a case where electronic application has become the norm for the government, entrusted system development may be drastically overhauled. There may be possibilities that such entrustment businesses will not grow in the future. Do you have no concerns that your entrustment system development businesses will continue to be flat or less in the next fiscal year?

A : We had not expected entrustment businesses to grow. Therefore, we baked in our current mid-term management plan our assumption of a flat growth for the businesses and an enhancement of the Focal Area businesses. We have not done much business in the governmental sector. Thus, we do not think that we would benefit from the Digital Agency. On the flip side, that means that we will not be impacted negatively by public sector demands. Having said that, customers are prepared to boost their business speed and shift to cloud services where they can combine existing services. They will shy away from entrusting us with system development. We had already anticipated this movement. We expect that sales will remain flat for the next fiscal year, although we are not sure if we can recover the sales to the level of the previous fiscal year. Specifically, we will see a large number of inquiries about entrustment businesses related to DX. Basically speaking, we will continuously see flat sales from the conventional type of entrustment businesses in the next period, although we keep in mind some volatility of the sales which depend on when customers in the business sectors of transportation and travel will resume ICT investments.

[Questioner C]

Q : I would like to ask about projects related to electronic shelf labels in your presentation material. Please give me slightly more details about circumstances in the second half where you expect a sales growth, customer quantity, business sectors of customers, profitability and others. May I ask if you have already received orders for services related to robot use and AI-driven automated ordering as well as your electronic shelf label solution?

A : We implemented our solution based on electronic shelf label (ESL) for a major retailer at their chain stores. We already recorded a certain amount of sales from the implementation in the first half. We plan to expand the implementation for the customer and also for major chain stores. ESL hardware sales do not generate large profits. However, we aim to secure a certain level of profitability through implementation services and accompanying services as well as the AI-driven automated ordering service that we developed. Our strength is that we can deliver a full-package DX solution for the entire store. Electronic shelf labels are installed for retailers that have large stores. Our main targets will be mass retailers and supermarkets.

Retailers operating shops include apparel retailers that are not keen on investing in ESL service under the pandemic. We provide them with our solutions to enable a shift to e-commerce. We will support their business through close cooperation.

(Note)

Forecasts in this document rely on judgments and assumptions based on information available at present. Actual results may differ from the forecasts due to changes in risks, uncertainties, economy and other factors. Thus, the certainty of these forecast is not guaranteed by our Group. Also, the information is subject to change without prior notice in future. Information in this document is intended to provide further understanding of Nihon Unisys, Ltd. and is not intended to solicit investment. This Company shall not be held responsible for any damages whatsoever incurred as a result of utilizing the information provided in this document.