



Results for Q3 FY19

Ended December 31, 2019

Net One Systems Co., Ltd.

March 12, 2020 (Stock Code 7518: JP)

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■ Final report by the special investigation committee

- **Improper transactions other than the fraudulent act**
- **Recommendations of the Special Investigation Committee**
- **Recurrence prevention measures**

■ 1. Transfer of cost

- **Summary**

The cost of an actual project had been covered and transferred as a part of cost for the fake transaction with a third party.

- **Impact on financial results**

Cost of revenue of JPY15mn was transferred to costs on uncompleted construction contracts on accounting processing.

■ 2. Unaccounted expenditures of JPY54mn

- **Summary**

The cost of an actual project had been posted to another project in coordination with a company that is supposed to win the bid. The cost had become unaccounted funds as the company couldn't win the bid. Net One Systems employee had used the funds to purchase verification equipment through a third party without proper procedures specified in Net One Systems.

- **Impact on financial results**

The cost of revenue and accrued consumption tax were transferred to an extraordinary loss of JPY58mn because the transaction was recognized as an outflow of funds with no known purpose that does not have a cost nature.

Analysis of origin

■ Issues with management of fraud risk

- Rules were mere formalities
- Issues with risk management approach
- Issues with internal controls

■ Issues with compliance activities

- Compliance activities ineffectual
- Issues in attitude of management and executives
- Measures to prevent recurrence in light of 2013 incident not fully implemented
- Organizational culture

Measures to prevent recurrence

■ Management and executives to have clear understanding of business transactions at actual workplace

- Management and executives to gain proper understanding of business transactions at actual workplace across all divisions and build arrangements for effective reporting, communications, and consultation
- Fundamental reappraisal of commercial transactions in government projects

■ Review of risk management approach

- Rebuild systems responsible for promoting risk management activities around Chief Risk Officer (CRO), who will spearhead aggressive and proactive measures
- Examine and consider the appropriate form of the Management Committee and Risk & Compliance Committee from the ground up
- Clarify responsible divisions and mission regarding risk management overall and management of fraud risk
- Identify and assess significant risks in each division, with such significant risks to be examined and investigated by other division
- Enhance sensitivity of officers and employees to risk and ensure effectiveness of rules and other measures
- Strengthen Internal Audit Office and other monitoring departments

■ Review internal controls

- Investigate and implement measures to prevent collusion between salespeople and suppliers and contractors
- Review drop-ship transaction flows and investigate and implement acceptance confirmation policies
- Redefine role of purchasing department
- Enhance authority to investigate contractors

■ Review compliance activities

- Aggressive and proactive commitment by management and executives in each division regarding undertaking compliance
- Employees to undertake compliance activities they think of themselves
- Examine organizational culture and create better culture

Measures to prevent recurrence in light of recommendations of special investigative committee

■ Basic policy on business transactions

- We will only deal with projects where our Group's added value (our unique services and solutions) is recognized.

■ Strengthening risk management systems

- We plan to establish a sales management office under the direct control of the president on April 1, 2020 to promote company-wide changes in business rules to prevent recurrence.
- At the start of each fiscal year, each division will conduct risk analysis of its own division, and produce a risk survey sheet which it will submit to the risk management office. The risk management office will examine the sheet and make judgments from an objective viewpoint.
- We will undertake a radical review of policies to promote risk management activities and associated systems. It will also reconsider the functions and composition of the Risk & Compliance Committee.
- We will conduct training to increase awareness of compliance among all personnel, including management and executives.

■ Review and enhancement of business controls

- We will review the business role of the sales divisions and clarify their roles and authority. We will remove the authority to place orders and manage acceptances from the sales divisions.
- We will make the purchasing function independent as of April 1, 2020 (currently performed by the group purchasing and logistics department) and enhance its role.
- Competitive quotes will be mandatory when purchasing from a supplier other than one where we have a procurement purchasing contract and regularly conducts procurement transactions. The purchasing department will confirm the appropriateness of the supplier.
- Drop-ship transactions from suppliers shall be prohibited as a rule. If direct shipping is necessary due to circumstances such as deadlines, prior confirmation from the purchasing department that it is not a commercial transaction shall be necessary, and acceptance confirmation from the customer shall be mandatory.
- We shall thoroughly implement personnel rotation and share responsibilities among personnel within divisions (to prevent overreliance on certain individuals).

■ Review of compliance activities

- The officer in charge and relevant executives should state their commitment to compliance activities in the compliance action plan that each division creates at the start of the fiscal year. Depending on their position, the Board of Directors or Management Committee shall review this on a quarterly basis.
- We plans to update its vision book, which contains the Group's goals, mission, and code of conduct. In updating the book, we will select members from across the Company to create and bring about a new corporate culture and redouble efforts to inculcate this throughout the Company.

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■ Financial Results and Forecasts

- **Summary of impact on financial results**
- **Summary of corrections for each consolidated fiscal year**
- **Results for Q3 FY19 (Oct-Dec 3months)**
- **Results for Q1-3 FY19 (Apr-Dec 9months)**
- **Forecasts for FY19**
- **Medium-Term Business Plan Targets**

Summary of impact on financial results

Summary of the cumulative impact on financial result is as follows.

(JPYbn)	Announced on February 13 and February 14		New [announced on March 12]		Total
	The fraudulent acts	Allowances for settlement differences related to the fraudulent acts	Improper transactions other than the fraudulent act	Changes in the treatment of projects from gross to net	
Revenue	△ 27.6	-	-	△ 4.4	△ 32.1
Operating Income	△ 3.6	-	-	-	△ 3.6
Ordinary Income	△ 3.6	-	-	-	△ 3.6
Net income	△ 3.6	△ 5.1	△ 0.5	-	△ 9.3

Summary of corrections for each consolidated fiscal year

Summary of corrections for each consolidated fiscal year are as follows.

	FY2014 Q1-4		FY2015 Q1-4		FY2016 Q1-4		FY2017 Q1		FY2017 Q1-2		FY2017 Q1-3		FY2017 Q1-4	
	Before revision	After revision	Before revision	After revision	Before revision	After revision	Before revision	After revision	Before revision	After revision	Before revision	After revision	Before revision	After revision
Revenue	143,173	141,529	145,180	140,170	157,236	153,124	29,794	28,015	70,696	66,126	107,375	102,791	161,107	153,349
Operating Income	4,205	4,121	2,453	1,927	5,747	5,565	414	(76)	2,311	1,580	3,860	3,123	8,241	7,256
Ordinary Income	4,249	4,115	2,594	2,068	5,701	5,519	400	(90)	2,370	1,639	3,976	3,238	8,418	7,433
Net income	2,457	1,816	1,508	1,015	3,822	3,584	248	(227)	1,569	863	2,640	1,762	5,682	4,401
Net assets	57,113	56,472	55,533	54,398	57,328	55,954	56,377	54,527	57,839	55,760	57,529	55,278	60,363	57,708
Total assets	103,623	103,013	102,613	99,417	103,365	102,038	97,206	95,279	98,205	96,078	96,618	94,392	106,827	102,146

	FY2018 Q1		FY2018 Q1-2		FY2018 Q1-3		FY2018 Q1-4		FY2019 Q1		FY2019 Q1-2	
	Before revision	After revision	Before revision	After revision	Before revision	After revision	Before revision	After revision	Before revision	After revision	Before revision	After revision
Revenue	33,418	30,278	80,598	77,396	122,432	116,102	181,935	174,838	36,038	35,571	88,723	82,164
Operating Income	1,511	1,103	4,935	4,541	7,759	7,142	13,012	12,166	2,107	1,709	7,096	6,078
Ordinary Income	1,533	1,125	5,043	4,649	7,956	7,339	13,258	12,412	2,216	1,817	7,313	6,294
Net income	1,035	(2,203)	3,309	241	5,303	942	8,913	4,323	1,518	2	5,055	2,901
Net assets	60,247	54,353	62,753	57,030	63,128	56,112	66,858	59,614	66,565	57,805	70,358	60,960
Total assets	104,161	98,277	109,828	104,097	107,085	100,222	125,498	118,313	120,406	111,623	124,275	119,432

Results for Q3 FY19 (Oct-Dec 3months)

(JPYmn, % to revenue)	FY18 Q3 Results		FY19 Q3 Results		YoY	
					Amount	%
Bookings	36,762		54,830		+18,068	+49.1%
Revenue	38,705	100.0%	40,681	100.0%	+1,975	+5.1%
Cost of revenue	28,655	74.0%	29,418	72.3%	+762	+2.7%
Gross profit	10,050	26.0%	11,263	27.7%	+1,213	+12.1%
SG&A	7,449	19.3%	7,634	18.8%	+185	+2.5%
Operating Income	2,600	6.7%	3,628	8.9%	+1,028	+39.5%
Ordinary Income	2,690	6.9%	3,642	8.9%	+952	+35.4%
Net Income attributable to owners of the parent company	701	1.8%	2,477	6.1%	+1,776	+253.2%

Bookings, revenue, and profits increased due to the solid performance of security measures and cloud infrastructure business.

(Notes)

1. The financial figures reflect the revised amount.

2. Major differences from revised forecast on February 14: net income decreased by approximately JPY350mn due to the change of accounting policy to not reduce income taxes for extraordinary losses in 1H.

Results for Q1-3 FY19 (Apr-Dec 9months)

(JPYmn, % to revenue)	FY18 Q1-3 Results		FY19 Q1-3 Results		YoY	
					Amount	%
Bookings	130,898		148,978		+18,079	+13.8%
Revenue	116,102	100.0%	122,845	100.0%	+6,743	+5.8%
Cost of revenue	86,264	74.3%	89,853	73.1%	+3,589	+4.2%
Gross profit	29,838	25.7%	32,992	26.9%	+3,154	+10.6%
SG&A	22,695	19.5%	23,285	19.0%	+590	+2.6%
Operating Income	7,142	6.2%	9,706	7.9%	+2,564	+35.9%
Ordinary Income	7,339	6.3%	9,937	8.1%	+2,597	+35.4%
Net Income attributable to owners of the parent company	942	0.8%	5,379	4.4%	+4,436	+470.6%
Backlog	83,716		101,395		+17,678	+21.1%

Bookings, revenue, and profits increased over the same period of the previous year.

(Notes)

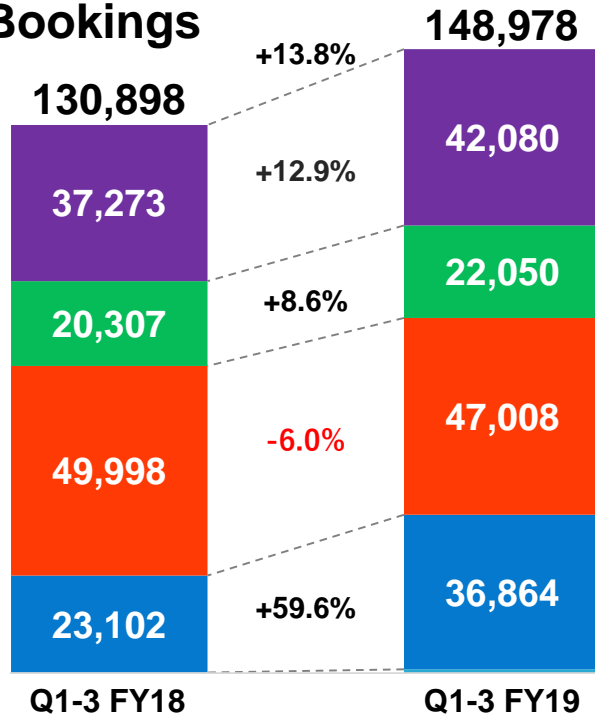
1. The financial figures reflect the revised amount.

2. Major differences from revised forecast on February 14:

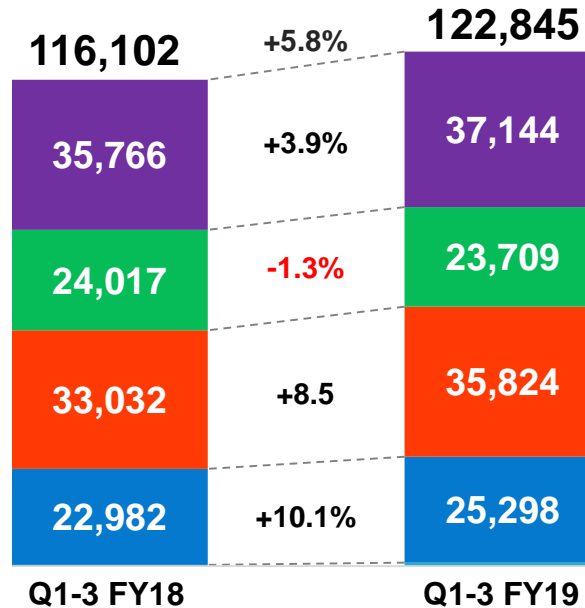
- bookings and revenue decreased by approximately JPY1.4bn due to the change in the treatment of one project in 1H from gross to net
- net income decreased by approximately JPY350mn due to the change of accounting policy to not reduce income taxes for extraordinary losses in 1H

Performance by market sector

Bookings

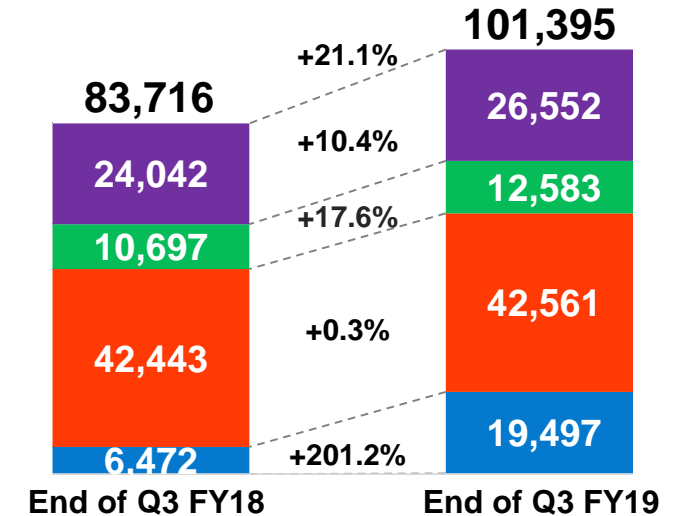


Revenue



Backlog

(JPYmn)



Enterprise

Business of security, cloud infrastructure, and work style innovation continued to grow steadily. Smart factory business, which is a focus market in the medium-term business plan also remained robust.

Telecom Carrier

Service infrastructure business performed well.

Public

Security and cloud infrastructure business including healthcare and education, the focus markets were strong.

Partner

Business with key partners continued to remain solid. In 3Q, we received 5G business via partners.

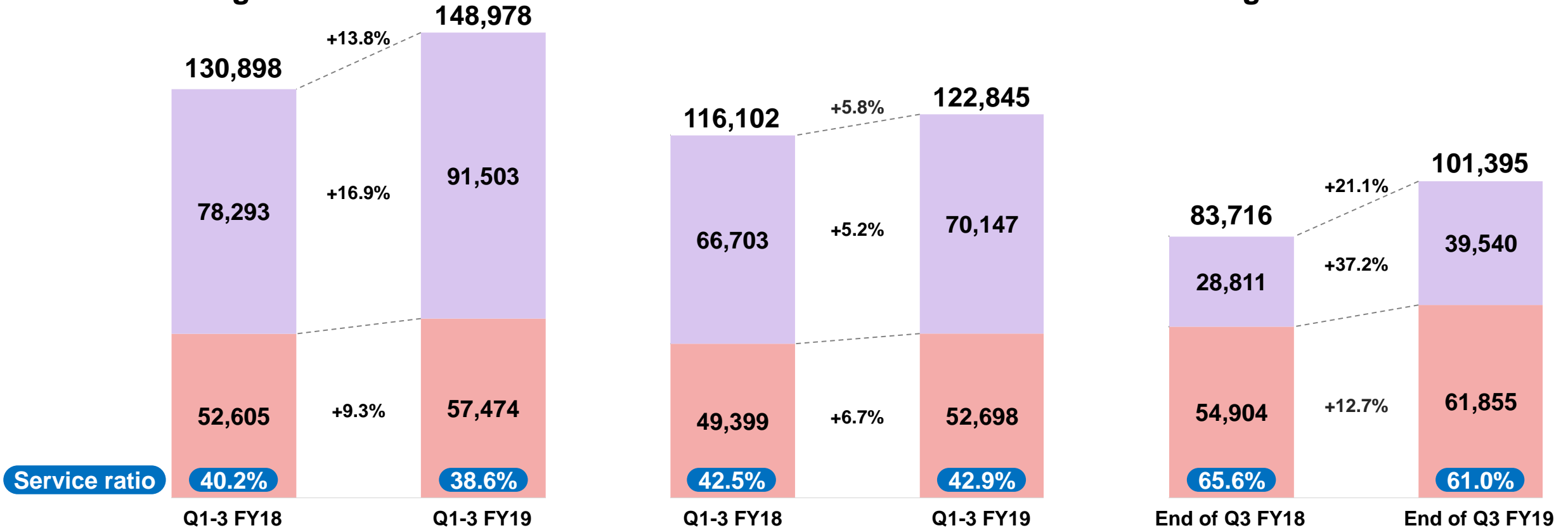
(Notes) The financial figures reflect the revised amount at the Public sector.

Performance by product category

Bookings

Revenue

Backlog



Products

Service business

Due to the expansion of “Integrated Services Business”, service business increased for bookings, revenue, and backlog. On the other hand, the service ratio of bookings and backlog were lower due to 5G business mainly composed of hardware products.

(Notes) The financial figures reflect the revised amount.

Revenue and P/L by reportable segment

(JPYmn)		Reportable segment					Other	Total	Adjustment	Amount recorded in consolidated income statements
		Enterprise	Telecom Carrier	Public	Partner	Sub-total				
Q1-3 FY19	Revenue	37,150	23,712	35,829	25,300	121,993	879	122,872	(27)	122,845
	Segment income	3,739	2,031	2,104	2,483	10,359	0	10,358	(652)	9,706
	Segment income margin	10.1%	8.6%	5.9%	9.8%					7.9%
Q1-3 FY18	Revenue	35,766	24,017	33,032	22,982	115,797	416	116,214	(112)	116,102
	Segment income	1,781	2,509	1,467	1,724	7,482	132	7,615	(473)	7,142
	Segment income margin	5.0%	10.4%	4.4%	7.5%					6.2%

(Notes)

1. The financial figures reflect the revised amount at the Public sector.
2. The “Other” segment is not included as a reportable segment. It contains the global business in FY19 and the server service business in FY18.
3. The adjustment in segment income included corporate expenses not attributable to any reportable segment.
Corporate expenses are mainly related to general administrative expenses not attributable to reportable segment.

Consolidated balance sheets

(JPYmn)	Mar 31, 2019	Sep 30, 2019	Change	
	Results	Results	Amount	%
Total assets	118,313	119,579	1,265	+ 1.1%
Current assets	106,225	109,456	3,230	+ 3.0%
Cash and deposits + CD・CP	25,305	26,469	1,163	+ 4.6%
Notes and accounts receivable-trade	42,928	34,748	(8,180)	- 19.1%
Inventory assets	14,290	25,256	10,965	+ 76.7%
Other	23,700	22,982	(718)	- 3.0%
Noncurrent assets	12,087	10,123	(1,964)	- 16.3%
Property, plant and equipment	5,240	4,728	(511)	- 9.8%
Intangible assets	1,434	1,599	164	+ 11.5%
Investment etc.	5,412	3,795	(1,617)	- 29.9%
Total liabilities	58,699	57,732	(967)	- 1.6%
Current liabilities	49,906	48,617	(1,289)	- 2.6%
Non-current liabilities	8,793	9,115	321	+ 3.7%
Total net assets	59,614	61,847	2,233	+ 3.7%
Shareholders' equity	59,387	61,346	1,958	+ 3.3%
Accumulated other comprehensive income	62	205	142	+ 226.9%
Subscription rights to shares	163	180	16	+ 10.1%
Non-controlling interests	-	115	115	-
Total liabilities and net assets	118,313	119,579	1,265	+ 1.1%

(Notes) The financial figures reflect the revised amount.

Exchange rate, EPS, Employees

	FY18 Q1-3	FY19 Q1-3	YoY	
			Amount	%
Exchange rate (\$JPY)	109.70	109.00	(0.70)	-0.6%
Earnings per share (JPY)	11.14	63.51	+52.37	470.1%

	End of FY18 Q3	End of FY19 Q3	YoY	
			Amount	%
Employees	2,316	2,449	+133	+5.7%

- (Notes)
1. The financial figures reflect the revised amount.
 2. Excluding the effect of new consolidated companies (Net One Next Co., Ltd., eXtreak, Inc., and Net One Asia Pte. Ltd.) and transfers to unconsolidated subsidiaries, the number of employees at the end of Q3 was 2293.

Forecast for FY19 (Revised on February 14)

(JPYmn, % to revenue)	FY19 Original forecast		FY19 Revised forecast [Announced on February 14]		Compare to original forecast	
					Amount	%
Bookings	189,000		195,000		+6,000	+3.2%
Revenue	187,500	100.0%	188,000	100.0%	+500	+0.3%
Cost of revenue	139,800	74.6%	140,300	74.6%	+500	+0.4%
Gross profit	47,700	25.4%	47,700	25.4%	± 0	± 0%
SG&A	32,700	17.4%	32,700	17.4%	± 0	± 0%
Operating Income	15,000	8.0%	15,000	8.0%	± 0	± 0%
Ordinary Income	15,000	8.0%	15,000	8.0%	± 0	± 0%
Net Income attributable to owners of the parent company	10,200	5.4%	9,400	5.0%	(800)	- 7.8%

Bookings, revenue, operating income are expected to achieve original forecast.
Due to the extraordinary loss related to the fraudulent acts, net income attributable to owners of the parent company is expected to decrease.

(Notes) The financial figures reflect the revised amount.

Medium-Term Business Plan Targets

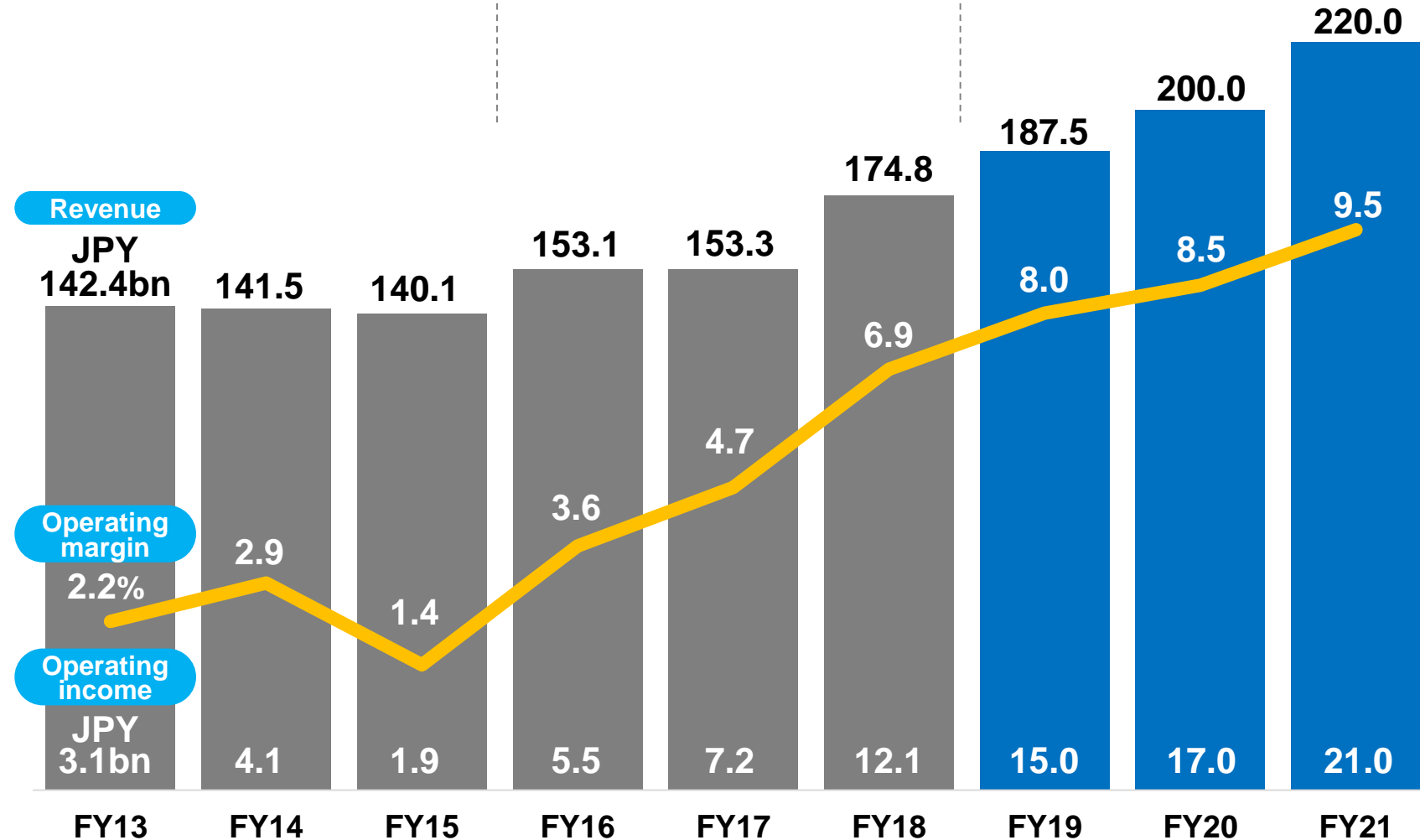
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	FY18 result	FY21 target
Operating margin	6.9%	9.5%
Services business ratio	42.6%	50%
ROE	7.4%	16.8%

Business model transformation

Continuous growth
(Cloud / Security)

Transformation
for the next generation
(Service business)



(Notes) The financial figures reflect the revised amount.

charge ∠ channel ∠ change



net one