

Questions & Answers at the Financial Results Briefing
for the Third Quarter of the FY Ending March 31, 2023

January 30, 2023
NEC Networks & System Integration Corporation

Questioner 1

Q: Regarding the revised forecast for the Network Solutions (NWS) segment, the size of the revision to forecast operating income (from 11 billion yen to 8.5 billion yen) seems large. What are the specifics behind the revision?

A: We had been aware that telecommunications carriers were curbing capital investment mainly in the area of base stations, but in the second half of the year we also started to see an impact in the area of core networks, which is a key business area for us. We understand that core networks are an area where carriers will need to make future investments as traffic increases, so we see this business as being postponed instead of disappearing.

In addition, regarding proposals in the area of high added value supporting the strengthening and streamlining operations at telecommunications carriers, which is an area we are focusing on, it appears that customers have a strong interest, but are playing things a little cautiously due to these being new services, and based on market conditions. This area is on an expansionary trend, but it is not currently making significant contributions to orders or sales. However, since we see operational streamlining as a theme that corresponds to customer issues, we believe those needs will expand from the next fiscal period and beyond, and we want to be in a position to firmly capture that demand.

As for why the profit revision is so large, in addition to the businesses that factor into these revisions being highly profitable, we have taken into account that the impact on a marginal profit basis is larger due to the size of the revision.

Q: Regarding the Environmental & Social Solutions (ESS) segment, there was a reversal of allowances for the Myanmar Project and forecast operating income was revised upward, but on an actual performance basis excluding this reversal of 2 billion yen, do you see profitability improvements as still only partially implemented?

A: As you pointed out, we recognize that we are still part-way through this process. This fiscal year, the sales mix has deteriorated due to the kitting business, which has a high equipment ratio. In the future, we hope to expand orders and sales in more profitable areas, such as those related to the environment and community development.

Questioner 2

Q: Regarding the decline in profit for the third quarter in the DX Solutions (DXS) segment, it

seems that the profit margin has peaked. What is the reason for this? Additionally, what is the demand environment for orders?

A: This period the equipment ratio has been high for DXS SI and construction projects, and the deteriorating sales mix has negatively impacted margins.

We see demand trends as solid. Business for financial institutions has been expanding, and in the areas of DX and workstyle reforms business was flat compared with the previous year in the first half, but has expanded in the third quarter. As we have seen a firm increase in the number of potential project we are trying to win orders for, our perception is that the demand is there.

Questioner 3

Q: Why hasn't the increasing order backlog translated into sales? From the fourth quarter and into the next fiscal year, will this situation be resolved? Please share your thoughts on the next fiscal year as well.

A: A major factor is that there is a prolonged lead time from the receipt of an order to its recording as a sale due to shortages of semiconductors and various materials. To give you a rough idea, it is 1-2 months longer than usual. Generally speaking, shortages in the supply of semiconductors and materials are on track to be eliminated, so we believe this will be gradually reflected in sales from the fourth quarter and into the next fiscal year, but since there are still difficulties procuring certain goods such as components that use analog semiconductors, rather than these issues disappearing overnight, we expect them to ease off gradually.

Q: You explained that orders in the DXS segment ran over into the next period. What were the reasons? You mentioned earlier that demand was solid, but again, is there any decline in demand?

A: In terms of business running over from the third quarter to the fourth quarter, overall there is no change to our perception that demand is strong. The factors behind delays that run into subsequent periods vary depending on the project, but in all cases these are timing issues and we do not see them as being due to some specific factor.

Q: In as much detail as possible, what is your approach to operating income heading into the next fiscal year?

A: Details about the next fiscal year are still under consideration so we cannot give a clear answer at this point, but we recognize the need to consider this carefully in light of various factors and market conditions. We will incorporate the more limited foreign exchange impacts and the elimination of special factors such as overseas factors into our approach and will aim for increased sales and profits.

Q: Regarding sales and improved gross profit (GP) margin, has your perspective for the next fiscal year been lowered compared to when the medium-term management plan was announced?

A: When we announced the medium-term management plan, we said we would aim to improve the GP margin by a little less than 1% per year, but based on the progress we have made this fiscal year, we may not be on pace to achieve that GP margin in the next fiscal year. However, the fact that the order backlog has still not translated into sales is one of the causes of this, so we intend to make every effort to make hockey stick curve improvements as we head towards the final year of the medium-term management plan. In the areas we will be focused on through the measures set in the plan, we believe we can speed up once our new services are accepted from customers, so we also want to aim to achieve the targets laid out in the medium-term management plan.

Questioner 4

Q: In the areas of DX and work style innovation, I get the impression that you haven't achieve as much growth as expected, including at other companies. What are the factors getting in the way of significant expansion in these areas? How do you see the situation, such as looking at investment in light of profitability or the economic environment?

A: There are many factors at play, but many of our customers take a hard look at the economic environment. And there are many customers considering what the benefits are to them and how added value will increase by implementing DX. We believe that understanding will advance quickly once this point can be clearly seen, so we hope to accelerate the development of proposals that make the potential benefits easy to see, including specific projects and examples of DX introduction.

Q: Regarding NWS, looking at market trends I get the impression that the local 5G market will not be particularly active in the next year as well. What are your thoughts on this? Also, there are concepts out there for non-ground based networks utilizing manmade satellites, unmanned aerial vehicles and so on. It seems there may be business opportunities for you in these areas. What are your thoughts on this?

A: Regarding local 5G, we get the impression that process is lagging about two years behind what we initially expected, but we don't think that the demand will dry up. We believe local 5G will expand mainly among customers looking to steadily implement security, and we see it as an area where demand will gradually increase. Regarding networks that utilize satellites, non-ground-based equipment, both the wireless and space businesses are operating areas for us, and we are fully capable of targeting this field. We are now at the stage of exploring which fields to enter.

Questioner 5

Q: I get the impression that IT investment by local governments is heating up. Do you feel the same? Also, heading into the next fiscal year, what areas do you think hold the most promise?

A: Regarding the areas of work style innovation and DX on the part of local governments, we have displays of various solutions aimed at local governments at our Nihonbashi office and we deal with a great many inquiries and tours there, so we recognize there is a high level of demand. Customers that are government entities need to develop budgets, so it may take some time before we see a significant expansion, but we believe there is strong demand there, and that NESIC will be able to fully reap the benefits of that demand.

Questioner 6

Q: Regarding active cost increases, in what areas are you spending on?

A: We are mainly increasing costs to develop DX-related solutions and to hire more personnel and sales staff in connection with that. In addition, we are also spending to relocate to a new head office that will be a place to demonstrate our solutions, and incurring costs on things like the development of our new mission-critical systems.

Q: I think the active increase in costs corresponds to your plan to make growth investments each fiscal year as outlined in the medium-term management plan. In the current fiscal year, I believe you had to curb growth spending due to downside factors such as exchange rates, but looking to the next fiscal year, do you believe these costs will increase, or will you take a somewhat restrained approach?

A: For the next fiscal year, costs associated with the relocation of head office are no longer incurred, but costs for the development of our new mission-critical systems will still increase, so we don't expect that expenses will fall significantly overall.

Questioner 7

Q: What was the background to the reversal of allowances for the Myanmar Project?

A: In the network development project in Myanmar, last year we recorded losses due to a review of the construction schedule and other matters due to the political changes that occurred, and we were making arrangements with related parties about whether we could make changes to the details of the project, considering those factors. In the course of those negotiations, in the third quarter we reached an agreement on revising the contract, and since this lowered our loss risks, we implemented a reversal of the

allowances corresponding to that lower risk.

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