Q&A at IR Briefing for Financial Results for the 1Q
for the Fiscal Year Ending March 31, 2023

July 28, 2022
NEC Networks & System Integration Corporation

Questioner A

Q: You said that, in the Environmental & Social Solutions (ESS) Segment, orders for large projects are expected in 2Q and after. In which sectors do you expect orders and what scale of orders do you anticipate? Also, how do you see the profitability of the targeted large projects?

A: ESS are in demand in various markets, especially construction-related markets, including government agencies, and orders can be expected across the board. Whilst I cannot give you a clear idea of the scale of individual projects or the number of orders, the total value of prospective projects in 2Q is several tens of billions of yen higher than in the same period a year ago. Though the projects are large, we intend to accept the orders on the precondition that profitability can be ensured.

Q: It is worrying that orders in the DX Solutions (DXS) Segment decreased by 10%. Since this segment is mostly service-type business, I imagined orders would also be stable. In your view, what was the cause of this decrease?

A: In 1Q of the previous year, there were some large projects in the service business, and this had an impact. The service business is subject to fluctuation in this way depending on the timing of large orders such as contracts spanning several years but, broadly speaking, we believe it is expanding comparatively steadily. However, in areas such as the renewal of existing PBX and such like, due to the business climate, customers seem to be adopting a wait-and-see attitude partly because investment is not urgent and they can afford to wait a little, and SI in existing business has waned. I feel that semiconductor and materals shortages have also affected orders.

Q: Has demand for Zoom plateaued? Also, what is the situation with *regard to DX orders, including multiple cloud services using Symphonict.*

A: Demand for zoom has calmed down after surging temporarily but originally we have been focusing not only on license sales but also on the domain on DX-based work style innovation combining various cloud-based products and services and this domain is about to take off and demand is still strong.

Questioner B

Q: How did negative currency impacts compare with your initial projections? What do you expect the negative currency impacts might be on a full-year basis? Also, what is the situation with regard to passing on higher costs to selling prices as a means of combatting negative currency impacts?

A: In 1Q, we recorded a foreign exchange loss of 400 million yen on a Myanmar project and, in addition to this, each segment reported a foreign exchange loss of around 100 million yen. We made a total year-on-year foreign exchange loss of 700 million yen and around 500 million yen of this was unexpected.

For the Myanmar project, we have increased the provision for loss due to exchange rate fluctuations and from 2Q onwards we will not make any additional losses if the rate stays at the end-of-June level and the negative currency impact may be slightly less if the yen starts to grow stronger. As for the remaining foreign exchange loss of around 300 million yen, we expect there could be a negative impact of between 300 million yen and 400 million yen in 2Q and each quarter thereafter.

As regards passing on cost increases to selling prices, in the case of projects for which contracts have already been concluded, it is difficult to raise selling prices until it is time to renew the contract. However, in the case of new orders, we will conclude contracts based on current foreign exchange rates and so we expect to gradually start passing on higher costs as existing projects come up for renewal in the future.

Q: Regarding the impact of semiconductor and materials shortages, I understand that the shortages had no impact in 1Q a year ago but had a negative impact of 300 million yen on profit in 1Q this year. What *impact will the shortages have in 2Q and after? Could it be the case that there will be positive impacts in the coming quarters?*

A: In 1Q, shortages had negative impacts of 2 billion yen on sales and 300 million yen on profit since newly arising impacts were larger than the positive impact of revenue from projects postponed from the previous fiscal year. However, we are proceeding on the premise that in 2Q positive and newly arising negative impacts will offset each other.

On a full-year basis, the situation remains unclear, and we still hold that new negative impacts arising this fiscal year will be on a similar scale to those last fiscal year.

Q: Regarding your approach to the full-year/first-half forecasts, do you plan to stick to your original forecast, focusing on controlling costs? Are there other factors for improvement from the initial plan that might offset currency impacts?

A: Our intention is to aim for achievement of the forecasts through the accumulation of orders and sales and the implementation of measures such as controlling nonurgent costs. Whilst it is hard to see improvement this 1Q partly due to significant improvement the previous 1Q, the GP margin continues to show a tendency towards improvement when currency impacts are excluded. Improvement in the GP margin as a result of greater efficiency can continue to be expected from 2Q onwards and we expect that there will be a further improvement in profitability once the high added value proposal business based on consulting which we are focusing on under the new Medium-term Management Plan (new MP) successfully gathers momentum.

Questioner C

Q: I understand that this fiscal year the plan was to increase growth investment from the previous fiscal year for achievement of the new MP targets but you also mentioned controlling costs in 1Q presentation. Which is the priority and what is your approach to expenses?

A: There is no change in our policy of making necessary investment, but we are considering delaying the timing of investments if pushing back a little would have no impact. We also intend to make efforts such as cutting back in areas such as staffing and other ordinary expenses where greater efficiency is possible.

Questioner D

Q: You explained your first half order forecast for the DXS Business by saying that there will be large projects in 2Q and after, but it is also conceivable that this will be a phase where business confidence deteriorates further. Is the decrease in orders in 1Q really a fleeting decrease attributable to the timing of large contracts or is the worsening business climate already starting to have an impact? What is your outlook for DXS orders, including your impression about the second half and beyond?

A: The outlook for the business climate is extremely difficult, but I get the impression that customers are delaying their orders because of the uncertain business climate. On the other hand, the DX/workstyle innovation domain is a domain that will also help improve business results, as customers seek to improve efficiency through investment. Investments that can be put off a little such as the renewal of PBX, for example, may also wane but we intend to expand orders by properly responding to domains in which customers will invest even if the business climate worsens.

Questioner E

Q: Regarding foreign currency impacts, the yen must have already weakened to some extent as of the April results announcement but the impact on business results probably could not be envisaged, right?

A: When we announced the full-year forecasts in April, we thought we would be able to offset currency impacts in the period between the formulation of the budget and the results announcement through the implementation of various measures throughout the year but this time currency impacts emerged in an even shorter period from then due to the sharp depreciation of the yen.

Questioner F

Q: Looking at DXS orders during 1Q over the past three years, orders have not grown even taking the impact of GIGA school into consideration. I expect that the DX/workstyle innovation domain is an area in which demand can be expected above and beyond the business climate and imagine it is a domain that will grow even with fluctuation in large-scale projects but this is not the case. Are the current order difficulties attributable to the external environment (business climate) or to issues with your strategies? What is your view?

A: When you make a comparison based on 1Q alone, growth is probably difficult to see but, on a full-year basis, the DXS segment has grown and, in our view, it is difficult to get a sense of the trend over the period of a quarter due to the timing of large projects.
However, I believe that the current situation is attributable to both the external environment and issues at the Company. My impression regarding the business climate is that customers are waiting and seeing to some extent and that nonurgent investment (renewal of existing systems) is being reined in. In our view, we must further expand the DX/workstyle innovation domain so that we can overcome any investment restraint in the existing system renewal business and we must put even more effort into strategic sales.

Q: Demand for NW Solutions (NWS) for telecommunications carriers decreased in 1Q, partly due to the impact of a large project in the previous fiscal year. I recognize that demand from telecommunications carriers is waning at all communication construction companies but what are your views on capturing demand from telecommunications carriers in the future?

A: We recognize that base station investment will be reduced but, looking at NWS as a whole, unlike communication construction companies, we have a small volume of base station business and we expect that investment restraint among telecommunications carriers will impact us less than other companies. Since we intend to expand the proposal-type business field that will help improve the internal efficiency of telecommunications carriers through the use of DX in addition to the SI of core networks, we believe that, with telecommunications carriers thinking about reducing costs, this is an area where, if anything, demand for such efficiency improvement can be expected.

Questioner G

Q: The bar set for 2Q orders seems high compared to the previous year. In your view, what is the probability of achieving it?

A: We believe it is an achievable level given projects postponed to 2Q from 1Q amounting to several billion yen and the current outlook, though some projects depend on tender results.

Questioner H

Q: Please give details of growth of DX orders in 1Q and the scale of local 5G orders and sales, if known.

A: In the multi-connectivity field overall, which includes local 5G, orders, which amounted to several hundred millions of yen last fiscal year, came to around 3 billion yen this 1Q and drove growth in DX orders. In addition, solutions involving DX also increased for government agencies in anticipation of digital towns.

End