Questions & Answers at the Financial Results Briefing for 1H of the FY Ending March 2023

October 28, 2022

NEC Networks & System Integration Corporation

Questioner A

Q: The second-half forecast for operating profit margin in the DX Solutions (DXS) segment is below the previous fiscal year and is on par with the first half of the year (which should be lower than the second half due to seasonal factors), despite an improving trend up to now. Why is this?

A: For DXS, sales of conventional business have declined in the period between seasons as we re-tool it into businesses that utilize DX, and that decline in profitability has been incorporated in the forecast. Additionally, in the first half of the year we received many orders for financial institutions with a high ratio of products, and we expected a temporary decline in profitability in the second half. However, since profitability is high and steadily growing in the DX areas on which we are focused, once we escape this off season of re-tooling our conventional business, we believe the situation will gradually turn around.

Q: In the first half of the year, an overseas subsidiary recorded a loss (communications infrastructure project in Thailand), and I believe you recorded losses in Myanmar in the previous fiscal year. What other major construction projects do you have under way overseas? Also, how much risk is there of incurring losses going in the future?

A: In terms of major overseas projects apart from Thailand and Myanmar, we are continuing with projects in Saudi Arabia worth 4-5 billion yen. As we have instituted a strict project review structure and the project involves ongoing business with a single customer in Saudi Arabia, there is no major risk.

Regarding the project in Thailand in which we incurred losses, in part in the interests of our customers we cannot go into details, and as it became highly likely that orders placed with us would shrink due to a project revision conducted by the customer, we recorded a loss reflecting the deterioration in profitability in connection with that development, and we will not incur further losses from this.

Questioner B

Q: Regarding the impact of foreign exchange rates in the second half of the year, the yen has depreciated more than initially forecast. What assumptions have you incorporated into your revised forecast?

A: In the second half of the year, we expect the exchange rate to hover around 145 - 150 yen. In some cases the passing on of prices has not kept up with the rapid depreciation of the yen, but we believe the effects will be seen as we continue to steadily renew contracts. In the case of NESIC, equipment and SI development is offered as a set, and with many projects there is a long time between order receipt and the recording of a sale. There are aspects which make it difficult to negotiate over the passing through of prices after an order contract has been entered into, but we are steadily passing on prices.

Q: Regarding the Network Solutions (NWS) segment, orders in the first half of the year were strong, but how is the outlook in the second half for local 5G and marine-related projects, which were a factor in the first-half performance?

A: Looking at conditions in the marine business, projects are in full swing and we understand these favorable conditions will continue in the future. With regard to local 5G, we have made progress in reducing costs on the equipment side, but cost reductions on the terminal side will be needed for a full-scale expansion, and we believe that will be one or two years later when carrier 5G achieves widespread adoption. As for the size of business, orders received in the first half of the year for multi-connectivity overall, which includes local 5G, amounted to around 5 billion yen, and we feel that performance in the second half of the year will be around the same level.

Note that with the NWS business for carriers, we do not expect major growth as 4G investment has ended with the shift to 5G, and the initial large-scale investments by a new carrier having already run their course.

Questioner C

Q: Sales in the first half of the year did not reach forecast levels in any of the three segments, but there are plans to get back on track in the DXS and NWS segments in the second half. While the order backlog has accumulated, how will you materialize those orders as recorded sales going forward?

A: Recently the service businesses in the DXS segment are on an upswing, but since it is necessary to revise construction schedules and processes due to semiconductor and material shortages in the SI and construction areas of each segment, the lead time from order receipt to the recording of a sale has lengthened. Although the semiconductor and material shortages have yet to improve, we have gained insight into response measures including the handling of substitute goods, and we are looking to speed at which the order backlog turns into sales.

Q: How should we look at the direction operating income will take in the next period?
A: We believe extraordinary factors such as the exchange rates impact and overseas losses can be improved. Additionally, we believe that declines in conventional business in DXS segment peaked this period, and we think the situation will improve as these businesses are replaced with new spiral-type growth models in the future.

Q: Regarding the DXS and Environmental & Social Solutions (ESS) segments, you have mentioned that recent business inquiries have been brisk. What kind of projects do you expect will increase for the next fiscal year?
A: In the enterprises market, there are more and more cases for doing business with major customers in the DX and working style fields, and offering service models are steadily becoming established. Based on past and current activities, we feel that we have established some brand power. DX-related inquiries from local governments are also on the rise, and we have been actively responding, such as by installing dedicated showcases for customers to view.

Questioner D
Q: In the NWS businesses, it appears that the business for carriers has declined. How much of a decline is this?
A: Orders in the first half of the year declined by slightly more than ten percent, and sales declined by around eight percent. This was a reactionary fall from a large order and significant product business achieved by subsidiaries in the previous year. Excluding those factors, the decline in orders was minor. As we only operate the base station business through a joint venture with KDDI, our understanding is that we are less likely to be affected by control on investment in that area.

Q: Regarding the impact of semiconductor and material shortages, in the second quarter of last year you suffered a negative impact on sales amounting to around 5 billion yen. How was the second quarter this year? Are the shortages on track for improvement?
A: In the second quarter of this year, sales that had been delayed from earlier periods due to semiconductor and material shortages had a positive impact of around 2 billion yen compared with the previous year, while newly emerging delays had a negative impact of about 2 billion yen. We also believe that material shortages have an impact on smaller projects that we have not entirely ascertained, and we think there is also an impact from orders. In light of these factors, the impact from semiconductor and material shortage is similar to the previous year, and has not improved.

Q: You mentioned that product business-related orders for financial institutions had increased. In general the shift to cloud computing has advanced in the finance industry, and this seems to run counter to that trend. What products have increased?

A: The products that have increased for the finance industry are not mission-critical systems but instead network-related products. The increase in the product business is temporary, as these products are updated periodically and SI is implemented following such updates.

Questioner E

Q: Regarding the losses in Thailand, what is your reason for determining that additional losses will not occur? Additionally, there was also unprofitability in Myanmar and seems to have been a string of losses from overseas operations. How will you respond?

A: For the project in Thailand, all of the losses that were the result of the customer making changes to their investment plans have been accounted for, so no further losses will be incurred.

Regarding project management, we have developed and strengthened our management framework for both overseas and domestic operations, and we are also responding to these latest issues.

Q: What level of tolerance do customers have for passing down prices due to exchange rate effects? What is the status of passing on the rise in prices?

A: It is difficult to raise prices after entering into a contract, so increases in procurement prices after a contract is signed can affect profits. Since things like license fees are one-year contracts, the affects can be eliminated at the time of contract renewal. In the first half of the year there was limited progress on renewals and the yen weakened further after contracts were signed, so we have seen almost no effects from passing on prices, but we believe we will make more progress passing on prices in the second half of the year as contracts steadily come up for renewal. Additionally, for project-type orders, we are considering innovations such as making contracts that incorporate exchange rate fluctuations. Currently there are also rising prices of goods apart from exchange rate factors, and we will continue to take action that includes responding to those issues.

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