

Q&A Regarding Financial Results for the Second Quarter of the Fiscal Year
Ending March 31, 2023

Date/Time: October 28, 2022 17:00–18:00 JST
Location: Live audio streamed from NEC Headquarters, Tokyo
Presenter: Osamu Fujikawa, Executive Vice President and CFO
(Representative Director)

Questioner A

Q: In the summary of financial results on slide 20 of the presentation materials, "Others" is a significant factor in increased sales and profits. What is the cause of this?

A: We recorded a gain of around ¥6.0 billion on the sale of NEC Embedded Products. In addition, our consolidated subsidiary ABeam Consulting performed strongly. Furthermore, a ¥3.0 billion negative impact from component shortages occurred in the previous fiscal year but not this year, so that also counted as a factor of increased profits.

Questioner B

Q: When did shipments of 5G base stations for overseas customers begin? Approximately how much in sales do you plan to record for them in the current fiscal year?

A: We began overseas shipments in Q2. For the whole year, we expect them to contribute around 10% of our global 5G sales forecast of ¥82.0 billion for this fiscal year.

Q: How is the demand trend for 5G base stations in Japan?

A: Telecom operators in Japan have been curbing capital investment during the first half of the current fiscal year. Over the whole year, their capital investment is planned to be on par with the previous fiscal year, and therefore we expect a recovery in the second half.

Q: You have recorded a one-time loss on the booking of a strategic project in the global 5G business. Is there a risk of similar losses occurring for other customers? What kind of countermeasures are you taking to avoid this risk going forward?

A: Regarding the booking you refer to, initially we expected to accept it at a strategic price; however, as negotiations with the customer dragged out, the yen depreciated more than we expected and the price of components increased sharply, driving up costs. We therefore made a conservative allowance for this. For future global 5G projects, we believe we can prevent losses from occurring by anticipating the risk of cost fluctuations in our pricing and including contract conditions.

Questioner C

Q: Did you accept the global 5G booking at a strategic price because competition is severe? Looking ahead, you have said that you will not allow losses to occur, but if you don't provide strategic responses amid severe competition, won't you be unable to capture orders?

A: The reason we accepted this particular booking at a strategic price was because it is important to build an international track record first. We accepted the project at a strategic price at the initial introduction stage, and we do not intend to offer the same conditions for all projects going forward. Please consider it a strategy to accelerate the establishment of our global 5G business.

Q: When do you expect to recover the cost of strategic projects, and in what way?

A: The Open RAN market has already started in Europe, while in India, for example, the start has been delayed due to a delay in frequency spectrum auctions. In North America, many telecom carriers have entered the verification stage, and it is taking time to ascertain introduction based on various costs such as electricity consumption and maintenance. If a pilot case emerges, then it will spread confidence in the market, so it is important first of all to create a successful case. Once the market is established, we are confident we can recover the cost.

Q: You recorded a significant decline in profit for the first half, so it will require a considerable recovery in the second half to achieve the full-year earnings forecast. How do you intend to recover?

A: We have had strong orders for IT services since the second half of the previous fiscal year. In the Public Solutions Business, we have seen orders return not only in the public and healthcare sectors, but also for SMEs. In the Enterprise Business, we continue to see strong orders for the finance and retail/services sectors, and network services have also recovered significantly in Q2. We will ensure that this buoyant trend in orders for the first half is reflected in our earnings going forward. DX demand is steady, and our consolidated subsidiary ABeam Consulting is reaping considerable benefits from this. First-half orders at ABeam Consulting have been favorable, up by around 20% year on year.

For the second half, in particular Q4, we think the important point is how much can be accumulated in effective orders that will be recorded as sales in the current fiscal year. At the end of the first half, we have made steady progress accumulating effective orders compared with the previous fiscal year, and we are therefore in a position to achieve a solid recovery in the second half.

Questioner D

Q: With regard to Network Services, you are planning on a ¥15.2 billion year-on-year improvement in adjusted operating profit atop an increase in sales in the second half. However, have Q2 5G base station sales in Japan recovered from a heavy decline in Q 1 during Q2? Could you give your outlook for the full year?

A: Q2 sales of 5G base stations in Japan recovered to around double the level of Q1. During the first half, telecom operators tended to curb their capital investments; however, for the full year, their capital investment is to be around the level with the previous fiscal year, and we therefore expect an even greater recovery in the second half. However, the degree to which this trend can be captured in our earnings will be difficult to ascertain until near the end of the current fiscal year, also considering that shipments in previous years have been heavily weighted toward Q4.

Q: Could you explain the impact of component shortages on earnings?

A: Component shortages have been easing gradually since late in the first half. In terms of the overall trend, it feels as though the peak of the shortage has passed. The negative impact of component shortages started to emerge from Q2 of last year, mainly in system platform-related products such as servers. From Q3, the situation deteriorated sharply, but we continued to apply rigorous management on a weekly basis, with the result that we have managed to curtail the negative impact on operating profit in the first half of the current fiscal year to about minus ¥0.5 billion compared with the previous fiscal year. If we can keep the impact at the current level for Q3 of the current fiscal year, then we expect to see positive growth for Q3 year on year. However, since our countermeasures started to take effect from Q4 in last year, we don't expect much difference in Q4 from the previous fiscal year.

Questioner E

Q: On slide 16 of the presentation materials, there is the a) one-time loss recorded for the booking of a strategic project for the global 5G business. To what degree has this been factored into the downward revision of the adjusted operating profit forecast at the time of the Q1 earnings announcement?

A: Part of the one-time loss was visible at the time of the Q1 earnings announcement; however, subsequent deterioration due to the impacts of exchange rate fluctuations and high component prices as the period until contract execution grew longer were not factored in at the time of the Q1 earnings announcement.

Q: The full-year earnings forecast for the Public Solutions Business was revised downward at the time of the Q1 earnings announcement. Could you explain why Q2 results are

higher in both sales and profits year on year?

A: The factors behind the increase in sales include an increase in sales of volume-sales products. In particular, with the easing of the components shortage, we are now much more able to ship servers and business PCs. The associated SI and other services have also been recorded in sales. Everything has not yet recovered compared to last year, but both orders and sales have been on a recovery trend in Q2. Orders have recovered in firefighting and disaster prevention, while orders for SMEs are also showing a recovery undertone and rising overall. In the Public Solutions Business, we will aim to achieve results on the upside of our downwardly revised earnings forecast at the time of the Q1 earnings announcement.

Questioner F

Q: How do you view the rising concerns of an economic recession going forward? You have said that orders are strong and that you have a sense of expectation for the second half; but are there any factors that could have a negative impact on earnings?

A: We expect the global economic slowdown following fiscal tightening in Europe and the United States to continue. On the other hand, the Japanese economy is trending firmly, and for the time being we do not see any major impact on the Company's business. In relation to DX in particular, we expect a solid performance trend not only at ABeam Consulting, but in the core DX domain overall. However, it is possible that various external environmental changes could occur going forward, and we will continue to respond rapidly to the component shortages and exchange rate fluctuations that have occurred in order to minimize their impacts.

Questioner G

Q: In Network Services, orders in Q2 have turned around to a 10% year-on-year increase. Was it orders in Japan or international orders that are behind this?

A: Both orders in Japan and international orders made a positive contribution.

Q: Looking ahead, do you plan to target strategic orders, even if they are of low profitability, with a view to building up a track record in the global 5G business?

A: It will be on a case-by-case basis, and depend on the situation. However, if we were to target strategic projects going forward, we would at least manage them to ensure they are within the range of overall profitability increase in the overall 5G business, including in Japan. At this point, we do not have any such strategic projects.

Q: Global Business Q2 sales and adjusted operating profit were both up year on year. Could you explain the background to this? Also, with the newly revised full-year forecast for

adjusted operating profit, the plan will require a considerable increase in profit in the second half. What are you expecting?

A: Excluding foreign exchange effects, the submarine systems business and Netcracker are contributing to higher sales. Regarding the forecast for second half adjusted operating profit, first of all, due to the nature of its business, Avaloq receives highly profitable license revenues from many customers at the end of the year. Moreover, Avaloq's development investment for future business expansion was conducted mainly in the first half, which makes the difference between first half and second half amounts appear even greater. Finally, Netcracker has continued to see strong orders since last year, so it can be expected to record greater profits from the second half onward, provided it can deliver on the orders. In other factors, the wireless backhaul business is expected to record a rebound increase comprising shipments that it had been unable to make until now, thanks to a considerable easing of the component shortage. Given this situation, our earnings this year are concentrated in the second half. We will achieve the goal by implementing proper risk management.

Questioner H

Q: Are the barriers to entry in the Open RAN market higher than you expected? Do you see the market starting up all at once, or in a gradual process? Please tell us your medium- to long-term outlook.

A: In North America and India, the delayed start of the Open RAN market is connected to delays such as issues concerning the frequency spectrum auctions. Customer expectations for Open RAN remain as high as ever, and the market trend also remains the same. The market is expected to start once cases of introduction appear and preparations are in place.

NEC also plans to steadily execute the projects it has won, and if we can demonstrate the superiority of Open RAN, then customers who monitor the trends will begin to move and we will engage strongly with them.

Questioner I

Q: Your full-year forecast for adjusted operating profit of ¥185.0 billion does not include a downward revision of ¥4.0 billion in the earnings of NEC Networks & System Integration Corporation (NESIC) or part of the strategic project in the Network Services Business. Therefore, these factors will weigh even further on profits. How will you counteract these negative factors?

A: The downward revision of the earnings forecast for NESIC is a risk factor that we did not see at the time of the Q1 earnings announcement and has newly emerged this time. The upward revision of ¥2.0 billion for the earnings forecast of JAE was also not seen at the

time of the Q1 earnings announcement, so putting these two together results in a negative impact of ¥2.0 billion. We will absorb this across the entire Company, including through corporate actions, and we have factored in an upside to the adjusted amount. As for the one-time loss on the booking of a strategic project in the Network Services business, we will take a variety of measures within the Network Services business during the second half with the aim of making a recovery. If we are unable to make a recovery, we will implement further corporate measures to achieve a Companywide adjusted operating profit of ¥185.0 billion.