

## Question & Answer

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### **Supplementary Explanation of the Company Presentation for the Third Quarter of Fiscal Year Ending March 31 2024**

There are two points that did not come up in the Q&A session at the Company Presentation for Q3 of FY2023, and that we are often asked about in subsequent interviews, so we would like to explain these points first.

Firstly, I would like to explain the situation of NTT Ltd. for the full year in terms of the cumulative total for Q3.

Net sales for Q3 of FY2023 totaled JPY916.3 billion. Compared to the cumulative total for Q3 of FY2022, this is an increase of JPY7.9 billion. This includes the positive effect of foreign exchange rate of about JPY45 billion, and the negative effect of the transfer of the China and Hong Kong businesses of about JPY22 billion. If we exclude these effects, it was actually a decrease of about JPY13 billion.

As for the breakdown by business, the data center business has been performing well, and JPY201.2 billion was the result for Q3, which is an increase of JPY15.5 billion YoY. This includes the positive effect of foreign exchange rate of about JPY10 billion, and the negative effect of the transfer of the China and Hong Kong businesses of about JPY13 billion. If we exclude these effects, it was actually an increase of JPY18.5 billion.

Telecommunications Terminal and Network Equipment totaled JPY484.6 billion, which is an increase of JPY2.9 billion YoY. This includes the positive effect of the foreign exchange rate of about JPY24 billion and the negative effect of the transfer of the China and Hong Kong businesses of about JPY3.4 billion. If we exclude these effects, it was actually a decrease of about JPY16 billion.

The IT infrastructure business other than the data center totaled JPY230.5 billion, which is a decrease of JPY10.6 billion YoY. This includes the positive effect of the foreign exchange rate of about JPY11.4 billion and the negative effect of the transfer of the China and Hong Kong businesses of about JPY5.9 billion. If we exclude these effects, it was actually a decrease of about JPY16 billion. This is due to a decrease of telephone conference service, etc.

The second point is about financial expenses. Financial profit and loss, etc. were negative JPY46.9 billion, a decrease of JPY36.5 billion YoY. This decrease is due to the impact of the increase in financial expenses resulting from the consolidation of NTT Ltd.

In the section of interest expenses reduction measures, I explained at the time of the announcement of the Q2 financial results that the expense reduction effects of about JPY3.5 billion is expected from H2. Of which, about JPY1.5 billion was reduced in Q3.

The financial profit and loss for Q3 deteriorated by about JPY4.3 billion from Q2. The main impacting factor was a foreign exchange loss of approximately JPY3 billion on foreign-currency-denominated assets held in Japan, due to the appreciation of the yen at the end of Q3 compared to the end of Q2.

As for foreign-currency-denominated assets, the yen is currently falling back, but if the yen goes up again, a large amount of foreign exchange loss may occur. We would like to respond according to the situation.

## **Questioner 1**

### **Q&A Session 1**

**Q:** Regarding financial profit and loss, the yen will probably weaken again in Q4, so is my understanding correct that the foreign exchange gains will lead to the recording of financial income?

**A:** Yes, that's right.

**Q:** So, would it be correct to say that financial expenses in Q4 should be assumed to be a level similar to Q2?

**A:** It partly depends on the exchange rate, but I think financial expenses will increase slightly because of a slight increase in borrowings. You are right that if the yen depreciates, it will work positively on foreign currency denominated assets and negatively on interest expense.

**Q:** I understand.

## Questioner 2

### Q&A Session 1

**Q:** I have two questions. Please let me ask one at a time. First, regarding the business combination costs, it looks as if progress has been a bit delayed since Q2. Can you tell me if there are any specific factors, if any, that are causing the delay?

**A:** We have only spent JPY7 billion in the cumulative Q3 out of our JPY19 billion annual plan, but this delay is not due to any particular problems with the business combination. Major expenditures include costs for the integration of the bases, and we intend to implement this in Q4 as planned.

**Q:** Now that the end of FY2023 is approaching, do you feel that there is a change in the sense of scale toward the outlook for FY2024 and beyond, such as that there is likely to be more to do for overseas business combination or that it is likely to be done more efficiently than the level you initially assumed at the beginning of the fiscal year?

**A:** Now we are doing what we can for the shift to the new operating model scheduled for April. As indicated on page 12 of the Company Presentation material, the business combination cost for FY2024 and FY2025 will be between JPY10 billion to JPY20 billion, but our feeling is that a rather large portion of this cost will be spent in FY2024.

**Q:** I understand.

### Q&A Session 2

**Q:** Secondly, I think the tax rate has been increasing due to the effect of consolidation of NTT Ltd. At the beginning of the period, I believe that your company's tax rate plan was given as an assumption that it would increase slightly from FY2022's rate of just over 31%. However, looking at the cumulative Q3 results, I feel that the annual tax rate will not be more than 30% or so, unless some big special factor occurs in Q4. Are there any special factors expected for Q4? Or is it more natural to think that the tax rate will remain at this level? Can you tell us your view on this?

**A:** In Q4, we are anticipating the sale of the data center, and we are assuming that we will be able to take advantage of the loss carried forward. Due to this, we think the annual tax burden rate will improve and the annual tax rate will be closer to the rate we forecasted in the initial earnings forecast.

**Q:** I see, so I guess the tax rate for Q4 will change at least from the rate for the period up to this Q3 due to that special factor, but as a result, is it going to drop to about the level you originally expected? Or is that level difficult to achieve based on the progress so far? Also, I would like you to comment on the direction of the tax rate for FY2024, if you have anything to comment on.

**A:** It is a tax rate, and it is actually different for each country, so it is difficult to predict the tax rates themselves. But at least in Q4, because of the factor I just mentioned, the tax burden rate will show an improving trend. On the other hand, the tax burden rate of NTT Ltd. is high. The companies in the red cannot be included in deferred tax assets because they cannot expect future taxable income, which is making the tax burden rate worse. We are hoping to improve the tax burden rate in FY2024 through business withdrawal or profit enhancement in relation to such companies.

**Q:** I understand.

### **Questioner 3**

#### **Q&A Session 1**

**Q:** I would like to ask about the current progress of the structural reform costs that are shown in the middle section of page 12 of the Company Presentation material, as well as what you're thinking for Q4 or FY2024. The EMEA and LATAM is already making a lot of progress, while the NTT Ltd. seems a bit slow, so please explain your views toward Q4.

**A:** The structural transformation costs are as shown in the material, and we are spending on schedule to achieve the annual plan of JPY7 billion for EMEA and LATAM and JPY19 billion for NTT Ltd. If anything, I think one of the key points is whether or not it will end completely in FY2023. Although some measures that require negotiation or coordination with the other party may remain, we do not expect to continue the expenditure at this level in FY2024 and beyond.

#### **Q&A Session 2**

**Q:** Regarding the business environment in Japan, the Company has announced that the business environment remained generally solid, but if we look at the Q3 accounting period only, I think that the profit margin and profit appear a little weak compared to the previous year. I would like to ask for your explanation about the Financial and Enterprise businesses, in particular.

**A:** As for the Financial business, there was an increase in profit due to higher sales, but it remained at the similar level to the previous year due to the absence of the high-margin projects we had in Q3 of FY2022. Therefore, there is nothing to be concerned about.

As for the Enterprise business, the operating income for the accounting period decreased by JPY0.6 billion YoY, but this decrease is due to expenditures to strengthen offerings.

We are working to achieve our annual profit target, and we believe that there will be no particular concerns about the net sales and operating income of businesses in Japan moving forward.

## Questioner 4

### Q&A Session 1

**Q:** I think that the margin levels in both North America and EMEA and LATAM, excluding structural transformation costs, are returning fairly steadily. In North America, although the profit itself has not increased, the margin seems to have returned firmly, while in EMEA and LATAM, I believe that the margin level has been rising following solid profit growth. Are we seeing the specific effects of structural transformation to date and reductions in costs have led to the increase in margins? Or is it because the business itself is improving? May I ask you to explain the factors that have contributed to the improvement in margins and whether they will continue in the future?

**A:** With regard to North America, the margin level is showing an improving trend as you said, due to an effect of the structural transformation, as well as to our careful examination of projects with an emphasis on profit margins.

Also, in EMEA and LATAM, net sales are increasing mainly in Spain and Germany. It is difficult to pinpoint what is going well, but we have a strong sales force, especially in Spain, so I think we are winning better projects now.

**Q:** Then your view is that, in North America, you have also received some large orders this time, and if you can accumulate these orders steadily, you can raise the margin level a little more, is that right?

**A:** The large project we won in North America is a continuing project from the existing one with long contract period, and this will serve as our foundation. However, what we are aiming for is projects with high added value and high profitability, such as digital projects. There are still many projects we need to acquire in the future, so we are not very optimistic. As I mentioned before, we are now gradually securing those orders that had been delayed due to delays in clients' decision-making. However, the situation is still severe, and we will have to continue our efforts to steadily accumulate high added-value and high profitability projects such as digital projects, and generate profits from them. We do not feel relieved at all because we were able to secure a large project in this Q3.

**Q:** I understand. Thank you.

## **Questioner 5**

### **Q&A Session 1**

**Q:** I would like to ask you two questions. The first question is concerning orders, and I would like to know the current status of the Enterprise business, including the scale of the super-large project won in FY2022, and which area is growing.

**A:** We had a large project in the retail and consumer goods sectors in FY2022, so there was a reactionary decline. We haven't disclosed the specific amounts, but if you look at the results for Q3 alone, orders decreased by JPY26.3 billion YoY, so this indicates that the project's value exceeded this figure. Therefore, I hope it is understood that, there were some slightly positive gains, but the reactionary decline derived from that one project was significant. One area that is growing in the Enterprise business is the area of payment. In the area of payment, the number of transactions made through CAFIS is also increasing. We are also receiving a great number of inquiries from the automotive industry and retail industry, and, what's remarkable more recently, is the inquiries for consultation services related to sustainability management, where we start with consultation and then proceed with visualization.

**Q:** I understand.

### **Q&A Session 2**

**Q:** Second question. As for the impact of Zengin System glitch, can I assume that there weren't any factors, such as additional outsourcing in Q3, that led to increased costs? Also, in terms of compensation, my understanding is that under the current situation, it would be enough to bear the portion of the transfer reversal fee or other incurred fees. I think the cost of anything more than that is something that cannot be piled up to like hundreds of millions of yen, so can I assume that we don't have to be concerned much with such costs recorded in Q4?

**A:** Regarding the additional costs after the glitch, of course, there are costs for comprehensive inspections and preparations for the full-scale start, but they are not in an amount that would significantly affect the overall financial results. Regarding compensation, because of our relationship with Zengin-net, I am unable to discuss further details here because it relates to our legal responsibility.

**Q:** I understand. Thank you.

## **Questioner 6**

### **Q&A Session 1**

**Q:** This will have an impact on capital expenditures in FY2024 and beyond, but for example, if the data center is to be a data center that utilizes AI rather than a traditional data center, the power supply capacity, etc. should be a little different, so I would like to know if it will affect the amount of capital expenditures for FY2023, and for FY2024 and beyond?

**A:** First of all, as for the data centers planned for FY2023, we are building them in different variations, but we are not anticipating at this point the costs associated with introducing large, high-performance GPUs for equipping them with generative AI, etc.

Currently, to some extent, we are looking at what we will build in the pipeline for FY2024 and beyond considering the situation, and as far as we are aware, any increases in costs and capital expenditures associated with AI have not materialized so far. I think we will probably consider them in the future. We are now looking at medium- to long-term data center investments while closely monitoring them.

**Q:** Even if there is no change in design, in terms of cost, do you see any changes? For example, increase in unit costs for construction companies or the effect of inflation?

**A:** There are no new add-ons to what is planned for FY2023. We are making an overall plan for FY2024 and beyond that takes into account the slight increase in prices, so we are not seeing a major impact at this time.

**Q:** I understand. Thank you.

## **Questioner 7**

### **Q&A Session 1**

**Q:** I would like to ask questions slightly related to the data centers we just talked about. I heard that you will be selling the assets soon in FY2023, but since you mentioned that you were thinking about REITs as well, please tell us what you plan to do in FY2024. And I believe that you are making the series of moves considering capital expenditures and asset recycling. With demand so strong, do you think that in FY2024, the amount of overall capital expenditures will possibly decrease, through such measures as asset sales and off-balance sheeting? Do you expect the capital expenditures for data centers to increase or decrease?

**A:** As for the sale of the data center in FY2024 and the REIT, we are just now in the process of formulating a business plan, and deliberating on them. We expect the capital expenditures for FY2024 to be the same as or slightly higher than the capital expenditures planned for FY2023. As I mentioned at the Company Presentation for Q3, we plan to determine the direction to take going forward, while discussing with NTT Corporation as well.

### **Q&A Session 2**

**Q:** My second question. Looking at the NTT Ltd.'s net sales on an actual basis, which you explained at the beginning of this session, it seems to me that the situation is quite difficult except for the data center business. First of all, is this progress within your assumptions, on a local currency basis? Then, I think it will be in FY2024, but at what point and how will it bottom out and turn positive? What are the conditions for that? How should I assume them and what are your thoughts on them?

**A:** Yes, about the data center business, I think it will continue to grow. In other areas, for example in the high-value-added services other than data centers, managed services are actually seeing positive growth, even excluding the impact of foreign exchange rates. We would like to continue to grow in these areas.

The area affecting the overall performance is the Telecommunications Terminal and Network Equipment, which decreased slightly in Q3 as well, for example. The impact of supply chain issues are still lingering, and although the performance has improved compared to the past, it has not yet reached a sufficient level. Once the supply chain issues are settled, I think we will be able to move it in a positive direction. For Telecommunications Terminal and Network Equipment, we are working to increase the profit margin by adding value, not just selling the equipment, by additionally offering software and services such as maintenance services. We are currently working to improve profitability.

**Q:** Thank you.



## Questioner 8

### Q&A Session 1

**Q:** Regarding data center business, in the case of other companies in Japan, the profitability temporarily deteriorated along with the increase in electricity rates around last year, but your competitors said that they have been able to pass on the price sufficiently and are seeing improvements in profitability now. Now please tell me, for your data center business as well, if the burden is increasing due to higher total cost including financial expenses, can you pass on the price to clients in real time?

**A:** I would like to take it as advice. We are thinking about making the price fair, but at the moment, we have not been able to transfer part of the financial expenses to the price and take the gross margin. We would like to consider it going forward. By the way, in terms of electricity, as you mentioned, the contract is made so that the portion of the electricity price increase can be passed on to the price. In terms of financial expenses on the other hand, for new data centers to be built in the future, we are making price quotations to clients in a way that will allow us to recover them at the current interest rate. However, for contracts made before the interest rates rose, we are trying to keep down the impact of the increase in financial expenses by such means as increasing the unit price of net sales in line with inflation.

**Q:** Is it not possible to raise the unit price for existing clients as well, with individual contracts? Or is it that the contract period itself is long, such as for two or three years, therefore price changes are not possible after the contract is signed?

**A:** What I explained was a story in general, and how it will be handled also depends on the contracts with individual clients. Of course, we are taking the opportunity to negotiate with our clients on price hikes.

**Q:** I see. The easiest solution is to raise the unit price, but from your company's point of view, does that seem quite difficult? Do you feel like you can't raise even 10%? Not even about half?

**A:** I cannot answer as far as a percentage.

**Q:** I understand that it is not easy. That's all from me.

## Questioner 9

### Q&A Session 1

**Q:** Regarding generative AI, I would like to know the current status of utilization and provision of business opportunities to clients, including the comparison with the previous quarter.

**A:** There are three points. The first point, as you can see on page 15 of the Company Presentation material, is co-creation with clients. Considering the contribution to new businesses for our clients, we are generating over 100 cases of proof of concept (PoC) through co-creation. Specifically, we are working with a cosmetics manufacturer and the pharmaceutical industry overseas, and we have begun projects with Toyota Motor Corporation and other companies in Japan. In FY2023, there were some co-creation PoC projects that resulted in the acquisition of actual projects, although the value is still small.

The second point is establishment of our production technology, and we utilize generative AI in our system development. Through automatic generation of codes or automation of tests through the use of generative AI, under certain conditions, it has been verified that productivity has been improved by 40% to 70% as stated here. We will continue our activities to expand the use of AI globally. Especially in the area of outsourcing, such as BPO, there is a high affinity for the use of this generative AI, and we would like to expand our business there as well.

The third point is expansion of existing businesses, and we incorporate AI into existing SI and investment assets. One example of expanding an existing business with generative AI is Trend Explorer, about which we have recently issued a news release. We had been analyzing Japanese-language data from the former Twitter, X, to predict trends, but now we have launched a new service that takes this to the next level. Until now, marketing has been search-based, in which keywords are used to search for something and dig deeper, but AI will enable discovery-based marketing, in which new, unknown events are discovered. Furthermore, by incorporating generative AI, the service is capable of planning promotional strategies, etc., and is aimed at revolutionizing the marketing industry.

We still do not have much to say about how much sales we can achieve in the future, but we are making steady progress, and in parallel with this, we are also strengthening our efforts in governance, which is an important issue. We are working on both fronts.

## Questioner 10

### Q&A Session 1

**Q:** I would like to check one more time on the measures to reduce financial expenses. You said there was a reduction effect of JPY1.5 billion in Q3 compared to the case where nothing was done. As the expected effect for H2 is JPY3.5 billion yen, is it correct to understand that the remaining effect of JPY2 billion will be expected in Q4? Or, this is a minor detail, but as the JPY1.5 billion from Q3 carries over to Q4, the new effect that will emerge in Q4 will be JPY500 million?

**A:** This is a comparison with the case where nothing was done, but I have explained that H2 will be JPY3.5 billion, with actual effect of JPY1.5 billion in Q3, which means JPY2 billion is expected in Q4. Please understand that due to the timing of the implementation of the measures, they are divided into JPY1.5 billion and JPY2 billion.

**Q:** I understand. Also, I think you said at the time of the last results presentation that there would be no more additions and that this would be the end of it, but is your policy still the same?

**A:** We are expecting no more additions, at the moment, but toward the end of the fiscal year, we will continue to examine the measures we can take while keeping an eye on the exchange rate and interest rate situation.

**Q:** All right. I understand. Then, JPY3.5 billion multiplied by 2 equals JPY7 billion, so the annual financial expenses would be roughly JPY7 billion, which means a little less than 10% of the overall financial expenses will be cut off, and that's the end of the effect, is that right?

**A:** If the measures taken in FY2023 are converted to a full year, the effect will be JPY7 billion based on a calculation, but I hope you understand that we will start the consideration of measures for FY2024 from now on.

**Q:** I understand. Since you have set EBITDA as a growth indicator, you may be asking us to think about it in the long term even if there is no profit in the short term, but you are accumulating significant debt even though the ROIC from the data center investment is low. Isn't there a discussion internally about the viability of operating a business where the cost of capital persistently exceeds the ROIC?

**A:** We are currently discussing the business plan internally, and we would like to present it to you after discussing various issues in that process.

**Q:** I understand. I would be happy to discuss this at the time of the full-year results presentation. Thank you.

## Questioner 11

### Q&A Session 1

**Q:** Since the topic of generated AI came up, I'd like to confirm something about it. On page 15 of the Company Presentation material, there is a migration of COBOL. I think it will probably be used in core systems for banks, etc. I would like to ask whether there are clients who use COBOL when generating codes but are refusing to use generative AI for migration.

**A:** Well, as you said, we have a lot of COBOL assets, and we also have clients using mainframes, so migration of these assets is an issue for us. So far we do not have any clients who are refusing to use generative AI for COBOL migration.

However, it is important to know who owns the assets, or whose software they are, and we are considering using our own environment, such as tsuzumi, to study our own assets and create them so that we do not violate copyrights and the like. I think that the clients who are not willing to use generative AI are probably concerned about violation of copyrights and such, so we are planning to use it while taking such measures.

**Q:** I understand. Let me ask you one more question. Regarding data utilization such as databases, data warehouses, and data lakes, since your company sells Snowflake, etc., I think you're providing those services to some extent. How much demand is there in Japan?

**A:** Well, it is difficult to say quantitatively, but we continue to receive a lot of interest and inquiries about the data utilization. There continues to be proposals in which Snowflake is used. In addition, to answer the question in relation to generative AI, there is a demand for secure use of generative AI, and clients do not want to put their information in the public domain, so we are using LITRON, etc., as described in the Company Presentation material, to have it study information that is not disclosed externally and derive answers from it. We expect that demand for such services will increase in the future.

**Q:** You will be using generative AI, then is it correct to say that demand for analyzing not databases, but the unstructured data is also emerging?

**A:** Yes, that's right. As you can see in the material, we are in the process of determining what kind of information to study and what kind of information to use in combination with AI in co-creation with our clients. We call it the strategic PoC, and we are receiving a great number of inquiries. In particular, since tsuzumi is sold on its compactness and is very good in Japanese, we have received a great number of inquiries, especially from domestic clients.

**Q:** Thank you.

## **Questioner 12**

### **Q&A Session 1**

**Q:** I would like to know the results of the strategic investments up to Q3, your outlook as to whether you will use them as planned for the full year, and what you are using them for.

**A:** Although this is not included in this Company Presentation material, we are planning to make a strategic investment of JPY32 billion in FY2023, as I mentioned before. In this context, a total of JPY20 billion has been used by the end of Q3. This is as planned. The contents are divided into two parts. One is JPY26 billion allocated to strengthen the focus technologies and industries, and the other is JPY6 billion allocated to create next-generation businesses. There have been a great number of orders received using the assets and offerings, etc. created through these strategic investments. It is difficult to quantify, but we believe that the effects of these efforts have been felt on a scale of tens to hundreds of billions of yen.