

Q&A Summary of the IR Business Briefing of Furukawa Electric Co., Ltd.

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Contents: Communications Solutions business

Speaker:

Hideya Moridaira, Corporate Vice President and General Manager of the Communications Solutions Division

Observers:

Kiyotoshi Nagai, Corporate Vice President and Deputy General Manager of the Communications Solutions Division

Shinji Asao, General Manager of the Optical Fiber and Cable Products Division

Toshihiko Ota, Corporate Vice President, General Manager of the FITEL Products Division

Jun Nishihashi, General Manager of the Broadband Solutions Business Division

Akihiro Fukunaga, Director, Corporate Senior Vice President and General Manager of the Finance & Global Management Division

Q: Concerning the robust optical fiber and cable demand environment in North America, how will you increase net sales and profit through your sales, marketing and production activities?

A: First, we will focus on increasing shipment volumes by improving optical cable productivity in North America. Also, we will make the optimum proposals to customers while gathering information through the sales division and agencies in North America.

Q: North America is host to the OFC (Optical Networking and Communication Conference & Exhibition). What strengths do your new ITLA products have, and how will you increase sales?

A: Through a fusion of optical and electrical (IOWN, etc.), we will contribute to accelerating the fusion of optical and electrical at data centers, for example. Also, following advances in high speed, large volume communications, 400G is becoming realistic, and while responding to wider bandwidths and increased channels, we will address the requests for larger volume. Specifically, we will support medium to long-distance networks using ITLA and pump lasers. For short-distance networks, we will use new technology such as DFB lasers .

Q: You have worked to improve optical cable productivity, including stationing Corporate Vice President Kiyotoshi Nagai at OFS in North America, but specifically, what actions are you taking and has productivity improved?

A: We are focusing on 3 initiatives (①Personnel hiring and training, ②Improve quality and

③Other improvement measures). In FY2020, COVID-19 caused increased employee turnover, thus weakening production operations. For this reason, no improvement was realized in initiatives ② and ③, and as a result, performance at OFS did not improve as expected. Turnover has finally declined, and recent operating levels have improved by about 40% compared to Q1 of last year. Moreover, we expect further improvement of about 20% this year. North America optical cable orders doubled in April and May compared to the last year, and we have also received orders for rollable ribbon cable, which is an area we have placed particular effort. Going forward, I expect these trends will lead to solid results.

Q: Are all of the manufacturing facilities at the North America site currently operating? Also, as operating levels increase, depreciation expenses will also rise, but do you still expect a v-shaped recovery in profits?

A: The capital investments and equipment installation conducted from FY2017 are already complete. Currently, we are working to set up the manufacturing facilities and improve the parameters. Some of the equipment was purchased from outside of the United States, and COVID-19 caused delays in the dispatch of the engineers needed to adjust the equipment. However, these issues have now been resolved. Directed at achieving a v-shaped recovery, we will continue to focus on the level of improvement realized through the personnel related initiatives mentioned earlier.

Q: Are you taking any actions for the work environment in North America, such as improving employee compensation?

A: Temporary staff make up about half of direct employment, and by converting some of the temporary staff to full-time employees, we reduced the temporary staff ratio to about 25%. Also, both mental and physical improvements have been made, including the establishment of awards and an incentive program.

Q: Is the forecast optical cable capacity shown on page 6 based on both improved productivity of existing facilities and the start-up of new (already installed) facilities? Also, taking into consideration the higher profit and higher fixed expenses, such as depreciation and personnel expenses, resulting from the increased operating levels, what is your outlook for profit improvement?

A: In response to your first question, your assessment is correct. In response to your second question, the profit improvement has been incorporated into this year's forecast.

Q: Are you facing any difficulties in producing high value added products (rollable ribbon cable) in North America?

A: Last year, we faced difficulty establishing production. Basically, the North America operations are an integrated production system that includes everything from manufacturing the optical fiber to cable production, and we faced difficulty establishing mass production and stabilizing quality within the unique ribbon production process. Through support from Japan and improvements to the workplace capabilities, quality has been improving since Q4 last year. Orders are also strong, and as productivity improves, the business should be able to contribute to net sales and profit.

Q: Within the Communications Solutions segment, to what extent have factors such as productivity improvements been incorporated into this year's operating income forecast of JPY 4.5 billion? Also, there is still a large gap between this forecast and the FY2016-FY2017 operating income of JPY 14.0 billion level. What are the factors behind this gap?

A: Compared to FY2016, the net sales are forecast to be higher in FY2021. Falling optical fiber prices around the world have had a major impact, and prices are about 50% lower compared to FY2016. Although shipment volumes are increasing, the falling prices have been a factor in the deteriorating profit margins. Based on this, we are working to lower the cost of manufacturing and shift to high value added products.

Of the improvement in operating income (increase from JPY ▲0.2 billion last year to JPY 4.5 billion this year), about 50-60% is due to higher optical cable productivity in North America, and we are placing our greatest effort here.

Q: Assuming North America optical cable productivity reaches the ideal level, how much profit can you expect to generate?

A: Assuming 100% of estimated capacity is achieved, it should be possible to generate profit of almost JPY 10 billion (for the segment as a whole). Including expanded sales of high value added products and growth of the solutions business, I believe we can set our sights on this level of profit in the future. I hope to present an outlook when we announce the medium-term management plan next spring.

Q: Going forward, what will the balance be between capital investments and depreciation expenses?

A: For optical fiber and cable, the major investments are ending from late FY2020 through

the first half of FY2021, and going forward, depreciation expenses will increase. For the time being, we will focus on maximizing the current production capacity, and (concerning the timing of future investments,) consideration will be made based on future advances in technology development. For FITELE products, we will continue to increase production capacity of the current ITLA products this year and invest in the next generation products. We expect net sales to increase 20-30% this year as we enter the investment recovery phase. We expect to start recovering the investments in the next generation products from 2022-2023.

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