

President's Message

Building a solid platform to support sustained improvement in corporate value by balancing stronger governance with business growth



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President & CEO
Net One Systems Co., Ltd.

New Management Structure

Creating a truly effective internal control system under our new management structure

I was appointed President & CEO on April 1, 2021.

Since discovering transactions without the physical delivery of goods and other instances of previous misconduct we have conducted a thorough investigation with external experts to identify the causes of the misconduct. Our investigation identified weaknesses in the Group's internal control system. The process also served to highlight issues in areas such as operational effectiveness, financial integrity and compliance. To address those issues, in fiscal 2021, ending March 31, 2022, we began work on completely overhauling our management structure in order to rapidly build a truly effective internal control system. After discussions by the Advisory Committee, I was selected to become Net One's new President. The committee cited my long track record as a dedicated employee of the Company since being hired in the first-ever group of new graduate recruits, and my extensive experience in many areas of the business, from technology and services to marketing and management. The Company believes I can have a positive impact on implementing reform because of my in-depth understanding of Net One's history and the challenges faced by each part of the Group. Since 2020, as the head of the Corporate Planning & Management Division, I have led efforts to prevent any recurrence of misconduct and raise awareness of compliance. I was also on the list of candidates in the succession plan developed by my predecessor. I think another reason for my appointment was the work I have put into building close relationships with many employees, giving them confidence to freely speak their minds. Honest and open dialogue with employees will be crucial to overhauling the Group's corporate culture.

My mission is to build a framework to support both business growth and stronger governance. I believe that process will foster greater trust in Net One Systems. In fiscal 2021, we will push ahead with the completion of our Medium-Term Business Plan and implement a number of new measures to reinforce corporate governance. Over the next year, we will also formulate our new Medium-Term Business Plan after identifying issues that need to be addressed and deciding the best approach to solve them. From the first year of the plan, we will execute our strategies with a real sense of urgency.

New President's Mission

Balance "Governance / Corporate Culture Reforms" with "Sustained Growth" through leadership and dialogue with employees

Governance / Corporate Culture Reforms

- Governance reforms**
Board of Directors: Shift focus from business management to monitoring
Internal control system: Embed three effective lines of defense
Three-way audit system: Reinforce remit, system, cooperation
- Corporate culture reforms**
Honesty and ethics, management messaging, human resources development, promotion for the top emerging employees, new code of conduct and values

Sustained Growth

- Achieve targets in current Medium-Term Business Plan**
Accelerate Integrated Service Business
- Formulate and achieve targets in next Medium-Term Business Plan**
Generate sustained growth by capturing market opportunities

Interaction

Increase corporate value

Business Environment and Progress with Medium-Term Business Plan

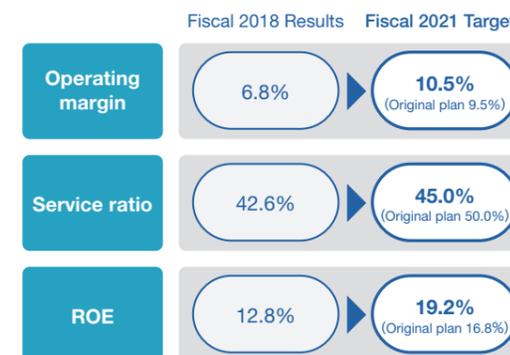
Provide value through our Integrated Service Business by accurately identifying changes in customer needs and approaches

<Medium-Term Business Plan: Fiscal 2020 Review>

In fiscal 2020, ended March 31, 2021, earnings were strong across the board, but the healthcare and smart factory markets were weak due to the impact of the COVID-19 pandemic. We anticipate continued weakness in the healthcare market in fiscal 2021, but with investment demand clearly recovering in the smart factory market, we expect to achieve our plan targets. In the public market, education boards are working to meet the requirements of the GIGA School Program, while local governments are likely to be one of the main drivers of system upgrade demand in fiscal 2021 as they work to build the next cloud-based security platforms and resilient systems. We are also seeing rising demand for remote working and learning systems that are easier to use.

Under our new model for providing support for managed service providers (MSPs), we have completed a new platform that allows our partners to leverage their individual strengths to create shared value together. New services developed through this collaboration with partners, backed by our proprietary intellectual property, will support Japan's broader shift to digital transformation and also translate into growth in Net One's market share. Our refurbishment business model is also attracting increased attention. We aim to further boost market competitiveness in the refurbishment space while also increasing the number of products with maintenance support add-ons. We expect to achieve our operating income and operating margin targets by continuing to accelerate value-added business and improving productivity.

Medium-Term Business Plan KPIs



<Business Opportunities and Risks>

At the moment, many of our customers do not want to build new systems from scratch. Their real need right now is how to get the best out of existing ICT platforms. Also, amid the current shift to digital technology, they increasingly see spending on ICT as an investment, not as a cost. Accurately identifying and responding to these changing customer needs and approaches will translate into new business opportunities for Net One. Our Integrated Service Business can handle all areas of corporate ICT investment plans, from planning and system installation to operation, allowing us to deliver complete system optimization instead of linking up piecemeal system improvements. We believe this business model is well-placed to accurately meet current market needs.

To convert these business opportunities into growth, we have to increase and enhance the Group's human resources. Redeploying engineers to services is a particularly urgent task. We aim to leverage our engineers' strong technical skills to help customers solve ICT issues. Put another way, our engineers will need to acquire the ability to apply and adapt their technical skills to services, which will be a major challenge. In recruitment, we will target qualitative and quantitative improvements in human resources. Specifically, we will put greater emphasis on hiring people who can capture business opportunities for the Group, aiming to cultivate distinctive Net One personnel who are committed to "customer success."

Reforming Governance and Corporate Culture

Acting on the recommendations of external experts and implementing our own initiatives to restore and rekindle trust in Net One

<Measures to Address Recommendations of External Investigative Committee>

The greatest risk facing Net One is loss of stakeholder trust. To avoid that risk and rekindle trust in our Group, we are implementing the following measures in response to the recommendations of the external investigative committee.

■ Governance

To prevent internal controls from becoming formalities, we partially revised the Basic Policy of Internal Control System - the Group's primary regulations governing internal controls - and updated related rules. We also stepped up efforts to increase understanding and raise awareness of internal controls across the Group through messaging to our workforce and communication between employees and the management team.

The Board of Directors will also adapt its role to focus more on monitoring activities such as business control and oversight instead of pure business management. Closer cooperation with independent outside executive directors will be key to that change. We are currently discussing with independent outside executive directors about how to achieve a high level of cooperation, such as timely sharing of information, exchanging opinions with directors and carrying out dialogue with executive officers. Looking further ahead, we plan to increase the ratio of independent outside executive directors to 50% and select independent outside executive directors to chair management and advisory committees to create a corporate governance system with powerful supervisory capabilities.

■ Business execution framework

To clearly separate control and oversight functions from business execution, we have appointed executive officers without board positions to head all business divisions. And in a first for Net One, we are restructuring our organization along defensive lines. We have incorporated three defensive lines (see page 40, Chapter 3: Establishment of the Internal Control Enhancement Council, for more details), each with clear and specific roles: the first line is a sound business framework and the second is a robust supervisory, support and oversight system.

■ Three-way audit system

We are also radically overhauling the third defensive line: internal audits. The focus of internal audits will be shifted from process audits to organizational audits, and the results will be shared with all employees in the Group. At the same time, we are overhauling the role of the Internal Audit Office itself, including reflecting the recommendations of the external experts in the office's revised role. The Internal Audit Office will be staffed by a mix of people, including personnel with marketing and engineering backgrounds and executive officers. Ultimately, we plan to include work experience in the Internal Audit Office and the Risk Management Office as part of employee career paths.

Furthermore, we have appointed a certified public accountant (CPA) as a full-time independent outside auditor & supervisory board member. By adding a CPA to existing business-focused audits, we aim to ensure trust in the Company's financial information. We have also replaced the Company's accounting auditor. The new auditor has been selected to conduct audits with an emphasis on regular communication with senior managers and frontline teams.

■ Reforming corporate culture

We have been reforming Net One's corporate culture since fiscal 2020. Specifically, we reinforced our Management Philosophy to reposition it as our corporate philosophy and established a new Code of Conduct. Every employee is required to make a declaration they will adhere to the Code of Conduct. Adherence to the code is also reviewed on a regular basis. To ensure these measures have a lasting impact, we have to introduce a human resources system that evaluates performance based on our Corporate Vision and Code of Conduct. We are currently conducting an assessment of our human resources system, including using input from external experts who are taking an objective look at the historical goals and outcomes of the system. Based on the results of the assessment, we will foster a new corporate culture by reforming all personnel systems and embedding our Corporate Vision across the Group, while also enhancing communication with employees.

<Internal Reforms Based on Recommendations of External Investigative Committee>

The so-called fraud triangle of "rationalization," "motivation" and "opportunity" accurately describes Net One's recent cases of misconduct. To eradicate this triangle from our business, we will implement a range of proprietary internal reforms in parallel with the above measures that address the recommendations of the external investigative committee.

Eliminating "rationalization" will involve continuous communication about the importance of "personal discipline" through direct messaging and the actions and stance of senior management. The goal is to encourage self-discipline in order to foster an organizational culture where employees resist even the smallest irregularity. In the case of "motivation," many investors have told us that Net One has perhaps focused too much on results-based performance. Our human resources system and target-setting process are anchored by behavioral standards, but we do have an incentive system as well. In some areas of our organization, that led to a downward spiral. Other areas of our organization work to achieve steady growth while keeping a close eye on resources, so the approach has been inconsistent across the Group. The "opportunity" aspect of the misconduct arose from weakness in supervisory systems around the illegal activity. Awareness of legal compliance is high in our organization, but the misconduct highlighted a disconnect between operational rules and legal regulations.

The latest misconduct also suggests that measures to prevent any recurrence, released in March 2020, failed to adequately address the cause and effect of the illegal activity. We suddenly imposed strict rules on frontline employees without asking some important questions, such as how did we get to this point, why were the employees' actions wrong, and why did changes need to be made? That approach risks creating inconsistencies that stop employees from doing their jobs. To address those issues, in April 2021, we reopened dialogue with our employees to clear the air. We have not watered down any "red line" rules, but we are making some targeted adjustments to make work processes smoother, while also building trust and fostering the corporate culture needed to support compliance. Instead of tying up employees in red tape, we will create a flexible, truly effective rules-based framework that only comes into play when it is needed. I will continue to regularly update you about how all these reforms are progressing.

Sustainability

Contributing to a sustainable society through a value creation story that reflects Net One's unique business characteristics

<Tackling issues faced by society>

During our next Medium-Term Business Plan, we will continue to update Net One's materiality while communicating our roadmap, goals and message for tackling and solving issues faced by society. For example, on the face of it, our business does not appear to have much connection with climate change, but virtualization technology can help customers reduce energy consumption. By providing technologies and solutions that solve issues for customers, we also contribute to society as a whole. This is one of the ways Net One can have a positive impact. We are currently trialing ways of using virtualization technology to reduce energy consumption and we plan to present proposals to customers in the future. In addition to providing ICT services and capabilities, we aim to partner with customers to solve social issues. This is a new way that Net One can create value.

<Enhancing human capital>

Human resources are one of the Group's most important types of capital. We are working to reinforce human capital in various ways, including work style innovation and skills training.

■ Human resources training

In our new human resources training strategy, we have added more programs and content related to compliance and accounting. Until now, our emphasis in training has been on frontline business, but we recognize that we have to fundamentally change our whole approach to achieve our aim of balancing governance with business growth. We also plan to add expertise in governance, internal controls and compliance to criteria for promotions. Furthermore, we will invest in long-term training for new graduate employees, such as providing basic skills training every few years. From their tenth year with the Company, when they become mid-level managers, we want graduate recruits to be comfortable with the common language of accounting and governance and be able to lead collaborative projects that drive business growth. We have positioned personnel training based on a longer-term perspective as a key part of efforts to reinforce the business base.

■ Targets and performance evaluation

We introduced a new job description system in fiscal 2020 to create clear, common expectations and roles in target-setting. This visualization of the necessary skills and expertise for each job grade now allows employees to independently build their own career paths. Due to the different nature of work in business divisions, there is some inconsistency about expectations and roles between each division. We are closing these gaps in order to create an even fairer performance evaluation system that is supported by employees. We also plan to introduce entirely new performance benchmarks. Customers give positive feedback about our employees' problem-solving abilities. But that alone will not be enough to take the Group to the next level. It is vital that Net One employees shift from "reactive" to "preventative" thinking. With technology becoming more advanced each day, we will put greater emphasis on problem-prevention abilities in our human resources strategy.

■ Work style innovation

We have upgraded tools and systems through work style innovation, but there is still room for improvement in integrating analog and digital elements of the workplace environment. As remote working gains momentum, managing work processes is becoming a wider social issue. The idea that "working hours" is the same as "time in the office" is losing ground in modern Japan, but what is the best way of managing personnel and their activities as flexible working becomes more common? And how should we communicate with employees? Communication is vital to fostering corporate culture and supporting the mental health of employees. Our customers also urgently need to answer these same questions. We plan to explore and identify the best approaches to continue providing a reference point for customers.

Financial and Investment Strategy

Rewarding shareholders, employees and society with rising returns, backed by an appropriate capital policy

We announced a new capital policy in May 2021. We lifted our consolidated dividend payout ratio target from 30% or more to 40% and set out clearer goals for increasing shareholder returns and uses of retained earnings.

To continue generating growth under the next Medium-Term Business Plan, we will scrutinize operating costs as part of our shift to services. Until now, we have not invested that heavily in facilities or R&D, but as the shift to cloud-based computing gathers pace and customers no longer require their own facilities, we will need to own and operate proprietary facilities to support service provision. After governance issues severely impacted Net One's corporate value, we will invest aggressively in measures to restore corporate value and adapt to changes in the operating environment. In terms of KPIs, our current Medium-Term Business Plan uses ROE, and we plan to continue using that benchmark going forward. We are also looking at adopting EPS, which has been suggested by many of our investors.

Meanwhile, we have appointed our new CFO. He will lead efforts to drive business growth and increase corporate value through an appropriate capital policy. He has experience and expertise in corporate governance from his work implementing measures to prevent any recurrence of misconduct, as well as strengths in the financial field. Under his leadership, we will gather information to explore and develop our financial strategy to take the Group forward.

These efforts will be anchored by a commitment to generating returns for three stakeholder groups: returns for shareholders who support our vision, strategy and business, returns for employees through opportunities for personal development, and returns for the wider community. In this way, we aim to grow with stakeholders to create shared prosperity.

Medium- to Long-term Vision

Transform Net One into a corporate group that generates steady growth, while building our position as a professional team of experts

Our purpose is to help transform society through ICT proposals born out of repeated in-house real-world testing by a professional team of experts. All our employees, not just those in engineering divisions, contribute to Net One's value as a company. I believe that everybody who works at Net One should be part of our professional team of experts (TAKUMI in Japanese) – in sales, our people have the expertise to optimize costs while satisfying the needs of customers, while in back-office departments, our employees have the expertise to actively leverage the specific characteristics of their work in real-world ICT system testing.

We will enhance this expertise to lift profits, while also building a governance system that ensures trust in Net One. In this way, we aim to build a platform that supports sound growth. This is our vision for the medium and long term. The ultimate goal is to transform Net One into a corporate group that generates stable profit growth and consistently increases corporate value, instead of a cycle of instability with peaks and troughs. Over the next year, we will review Net One's past business strategies to carefully study and visualize their impact and outcomes. Based on the results of the review, we will develop a new strategy to reinforce the Group's position during the next Medium-Term Business Plan and lay out the roadmap for future growth. I hope we can count on your continued support as we work to realize this vision.

