April 17, 2023

To all concerned.

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Q&A for the Financial Results Briefing Session for the First Nine Months of the Fiscal Year Ending May 31, 2023 (Excerpts)

On April 11, 2023, we held an online financial results briefing for the first nine months of the fiscal year ending May 31, 2023. This document summarizes and makes public the main points of that Q&A session. Some amendments have been made for clarity.

Q1: In light of the order backlog at the end of the 3Q, the revised 4Q standalone sales forecast appears somewhat low. Have you factored in the possibility of customers once again requesting deliveries to be postponed and those sales being carried into next fiscal year?

A1: Looking back, this was a particularly challenging year for forecasting results. The revised forecast figures look realistic given how business has progressed in the first to third quarters, however, and we believe we are highly likely to achieve them. We do not believe postponed sales are likely.

Q2: When are orders likely to recover in the IoT related business?

A2: We assume steady recovery from the 4Q or next fiscal year, and believe that future order trends look promising.

We believe high-end image sensor related sales in particular will continue to grow, and from image sensor market data, we can see that our existing high-end image sensor manufacturer customers' market shares are growing.

Additionally, the technological gap between our image sensor manufacturer customers and other such manufacturers is wide enough that bridging it in just five to ten years would be challenging, so we assume our customers' market share will continue to expand for the time being. Thus, we expect that even if image sensor production remains flat across the entire market, our customers' shares are likely to increase within that, thereby growing their sales and leading to more capex demand. We are confident that that would lead to increased demand for our products.

Q3: Could you explain the background behind the SG&A increase in the third quarter?

A3: The first reason behind the SG&A increase was an increase in commissions paid to overseas sales agents as our overseas sales grew. The second reason was an increase in marketing costs after we strengthened our marketing process as part of our MTP. We intend to proactively spend on marketing where necessary, and the current increase is within what we would consider an acceptable range.

Q4: How much impact will the downward revision have on the next fiscal year? Also, Chinese investment in image sensors has surged: is that likely to have any impact?

A4: It is currently difficult to put concrete numbers to the impact on next fiscal year.

Image sensors have specialties that set them apart from other semiconductors, so we expect orders to trend upward from the 4Q, but we do not believe that Chinese image sensor demand will be a factor.

As we understand it, Chinese image sensor manufacturers rarely have production lines of their own: production and testing happens instead at external foundries or test houses. Image sensor manufacturers and logic chip manufacturers are important customers to those foundries and test houses, but they tend to prioritize those customers they consider of highest importance. Seeing as small-scale Chinese image sensor manufacturers use only spare capacity in those busy production lines, it is unlikely that they exert much influence or control over them.

With that backdrop, and without information confirming that Chinese manufacturer investment has increased significantly, we reserve judgement on Chinese trends until we have more market information.

Q5: Could you explain the progress of your efforts in the automotive sector in the IoT related business?

A5: From a management perspective, orders and sales for inspection illuminators for the auto industry have grown significantly year on year due to growth trends both domestically and abroad. A future increase in auto-related demand is tangibly close.

Also, those devices are new, advanced devices, and our image sensor manufacturer customers are the only ones who can produce those advanced devices, so we believe our path to success lies in strengthening our relationships with existing customers and expanding our share with them.

Q6: What technological issues have you had with Pupil Lens Modules overseas? Can we assume that you have already resolved them?

A6: Until now, we have mainly sold Pupil Lens Modules domestically, and we developed a fixed idea of how customers use them. We began talking to overseas customers with that idea in mind, but became acutely aware of the differences between the technologies desired by domestic and overseas customers.

Currently, we have cleared up approximately 90% of the technological issues brought up by overseas clients, and we are in talks with customers on how to manage the remaining 10%. That said, starting at 90% has shortened delivery times and cut back on costs, and actually been advantageous for customers. We are in the process of finalizing whether customers will adjust the remaining 10% of issues in their production process, or whether we will resolve them on our side.

Capabilities, price, and delivery times are all important in order to attract customers, and we do our best to balance those points and give our customers the optimal proposal for them. We could resolve 100% of all technological issues, but we are also considering internally whether doing so would actually be in the customer’s interest. We have mostly resolved the technological issues, so please be aware that we are currently at the stage of negotiating delivery times and prices with customers.

Q7: How far do you expect your illuminator share to increase among domestic customers?

A7: Domestically, we expect to take orders for both conventional illuminators and a newly developed model of illuminator. Currently, we are the only company capable of producing the functions of the new model, and we believe the technological advantage should increase our domestic share as well as improve the profitability of our illuminators sold domestically.

Over the past two years, our domestic illuminators have struggled to increase both share and profitability, but that experience has made us stronger, and led us to this new model.

Additionally, we are very thankful that we were essentially able to release the right product at the right time – just as the image sensor market begins to growth further. We hope to increase orders and deliver financial results.

Q8: Has there been any development in new customers for auto-related image sensors in the IoT related business?

A8: We have often debated which companies to class as new customers, but we have noticed that the technological gap in the design and production processes of our existing customers versus other companies is far wider than we expected. We believe it would be difficult for other companies to catch up in just five to ten years: our existing customers are in a highly advantageous position in the image sensor market. As a result, although we hope to take on more customers and are currently looking into prospective customers, we do not believe it would be wise to focus on that at the moment.

Even the American companies we originally targeted as new customers for the auto image sensor field generally consider image sensors just one aspect of a larger comprehensive car system that they offer to their customers. We thus do not believe they are likely to put much effort into strengthening image sensors development or production, and consider it possible that they would buy image sensors from other companies and use those in the comprehensive car systems they sell to customers.

We hope to keep up communication with companies beyond our existing customers and, given the opportunity, create a team to pick out new customers, but we do not believe now is the time for that. We believe the right choice for us currently is to focus on our existing customers and increase our share among them.

Q9: Could you explain how inquiries for your overseas illuminators have progressed?

A9: Currently, overseas capex is sluggish. That was one of the reasons for our downward revision, but as we communicate with overseas customers, we have come to understand that our customers are not at all pessimistic about the situation. They feel certain that the market will trend toward growth again in the future, and we agree.

Even if the image sensor market hits a ceiling, we predict that the overseas share of the market will grow, and capex for increased production will become a necessity to our customers. They seek to grow not just mobile-related production, but automotive-related as well, and we seek to support them and take on more orders. Given current market conditions, we are not currently in a position to actually take orders, but we expect orders to come in from the 2H of this fiscal year.