

NEC IR Day 2023 IT Services Business Q&A

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Questioner A

Q:

Could you please discuss your future policy for the recruitment of engineers in domestic IT services?

A:

We will consider the recruitment of engineering personnel from an overall perspective that includes partner companies, in addition to employees of NEC and its Group companies. We will maintain our recruitment level of mid-career hires and new graduates at NEC, while simultaneously striving to enhance productivity. Our efforts also include the training of digital transformation (DX) personnel and reskilling in anticipation of growth.

Q:

How will you improve the profitability of domestic IT services going forward?

A:

By promoting System Integration Model (SI Model) reform, such as value pricing through the NEC Digital Platform (NDP) and its offerings, we will continue to improve the gross profit (GP) margin. We will also enhance the profitability of the SI business as a whole by striving to streamline selling, general and administrative (SG&A) expenses through data-driven management.

Q:

In international IT (DGDF: Digital Government / Digital Services), what kinds of products and services for customers will you grow?

A:

In the field of digital government, we will further strengthen our healthcare software business as a government insurance service, in addition to highly profitable services for municipalities. In the field of digital finance, we will focus on financial asset management, an area in which Avaloq Group AG excels, particularly in the software and SaaS business for core banking.

Questioner B

Q:

What is your outlook for future growth in the domestic IT services market? How is NEC positioned relative to the market as a whole?

A:

According to a market research firm, the domestic IT services market will continue to grow steadily, with a projected compound annual growth rate (CAGR) of approximately 5% from 2022 to 2025. In FY23/3, NEC's domestic IT services revenue performed favorably, growing by 7% year on year. However, we believe that this growth was due partly to some lingering effects of the COVID-19 pandemic and the impact of component shortages in the previous fiscal year. In the first half of FY24/3, our domestic IT services continued to grow substantially by 11% year on year. Our analysis shows that the primary drivers were the effect of bringing delivery forward in response to the tendency for sales to be concentrated in 4Q every year, and variations in how large projects were received from the previous year, in addition to continuing strong IT demand. In FY24/3, full-year sales from domestic IT services are forecast to increase by 3% year on year. However, we will continue to prepare resources in anticipation of sales that surpass this forecast.

Q:

In International (DGDF), you aim to increase Avaloq's adjusted operating profit margin from the FY24/3 forecast of 11% to 20% by FY26/3. What kinds of measures will you implement to achieve this target?

A:

First, we will work to streamline delivery by reducing customization as much as possible through product standardization. Second is our strategic partnership with BlackRock,

Inc., a U.S.-based investment management company. This partnership just started in FY24/3, so we don't expect it to contribute to financial results in the current fiscal year. However, a profit contribution of billions of yen can be expected by FY26/3. Third is the effect of increasing the offshore development ratio. We have set up a site in India and will expand our present team of roughly 100 people in the future. We plan to enhance Avaloq's profitability through these measures.

Questioner C

Q:

How much benefit do you expect from the improvement of profit margins through value pricing?

A:

We are currently estimating the profit margin that we anticipate from value pricing. Rather than uniformly raising all profit margins, we will attempt to effectively apply value pricing to high value-added projects and increase the ratio of those projects. We are already seeing the emergence of several projects that have reaped benefits from the application of value pricing. In this manner, we can clearly see the advantages of value pricing.

A:

It is first and foremost important with value pricing to produce value itself, so we will emphasize the appeal of this value in the form of our offerings. Prices are established in the Japanese market mostly on the basis of cost per system engineer; therefore, we anticipate a profit margin contribution of several percentage points initially. If value pricing becomes firmly entrenched in the future, we believe that it will be possible to further improve the contribution to the profit margin.

Questioner C

Q:

What will happen to traditional IT services in the future?

A:

Traditional IT services are expected to gradually decrease in the future. When on-premises hardware is replaced by the cloud, the associated service will be reduced and replaced with modernization, for example. In response to these changes in the project mix, we will carry out reskilling of system engineering (SE) personnel working in traditional IT services and strengthen our ability to respond to new areas.

Q:

Could you please discuss NEC's advantages in modernization relative to its competitors?

A:

For some years, NEC has received extremely strong inquiries for modernization and cloud migration from customers. Since around 2017, NEC has initiated strategic collaborations with Amazon Web Services (AWS) and Microsoft on cloud services. We believe that we are ahead of other companies in terms of data centers and the training of specialized engineers.

A:

The strengths of NEC lie in its historical IT and network experience and knowledge, as well as its assets. It is not possible to transition complex existing systems to the next new systems without these strengths, no matter how much planning is done.

Modernization is currently referred to as "cloud lift," beginning as an initiative to realize cost reductions by migrating infrastructure to the cloud while leaving applications unchanged. However, an increasing number of current "cloud shift" projects involve data renewal and building new applications in the cloud. This is where NEC's networks and IT hardware and software are put to good use.

In addition, NEC's continuous investment in R&D is a major point of differentiation. NEC announced its own generative AI Large Language Model (LLM) in July 2023. We simultaneously initiated development and provision of this LLM as a service. Another strength of NEC is its ability to make the development achievements of its research laboratories available as commercial services at an early stage.

Questioner D

Q:

What steps are you taking to ensure that your strategy pervades the whole Company and that frontline staff can proactively act on the strategy?

A:

For example, we started working on the transition to our SI Model more than five years ago. Our system engineers' leaders gathered and proactively discussed what should be done. Human resource development efforts have also been stepped up in tandem with the development of businesses such as the cloud. The steady emergence of case examples has boosted understanding of new initiatives, such as NDP and its offerings. Although top management determines and implements the overall framework, we work to ensure that the framework pervades the frontlines by simultaneously conducting a wide range of efforts, such as the development of actual procedures and systems, as

well as engagement.

Questioner E

Q:

NEC launched a program to utilize generative AI with its customers in July 2023. How many companies and organizations are currently participating in the program?

A:

Currently, 15 companies are participating in the program. Although we can increase their number further, the main point of the generative AI business is to supply our customers with accurate industry-specific knowledge. For example, by allowing generative AI to absorb the knowledge and specialized language of each industry, such as insurance and transportation, as well as the assets accumulated over many years by each company, we will be able to build a system tailored to an industry or a company. Once we construct a system for an industry, the system can be cross applied to a certain extent throughout the industry, so we deliberately chose the 15 participating companies from different industries.

Q:

What measures are you taking to acquire the necessary human resources to expand generative AI?

A:

In the United States, fierce competition to acquire human resources has already begun. In human resources, NEC is focused on two types of job categories. First, consultants are required because industry-specific skills are always needed to use generative AI correctly. We are collaborating with our subsidiary ABeam Consulting Ltd. to increase these personnel. Next, data engineers and data scientists are required. As with machine learning, it is crucial in generative AI to analyze what type of data it will be taught and what type of output it will generate. Consequently, in the future, we will conduct internal personnel reskilling in addition to increasing global recruitment.

A:

I'd like to add that we will begin job-based human resources management in earnest from next fiscal year. We will be able to provide the right remuneration to the right individuals, thereby reducing personnel outflows and proactively acquiring, training and strengthening human resources.