Q&A Regarding Financial Results for the Third Quarter of the Fiscal Year Ending March 31, 2024

Date/Time: January 30, 2024, 17:00-18:00

Format: Live online streaming

Presenter: Osamu Fujikawa, Corporate Executive Vice President and CFO (Chief Financial Officer)

Questioner A

Q:

Recently you have announced a sale of shares of Renesas Electronics and Japan Aviation Electronics Industry, Limited ("JAE") has announced a share repurchase by tender offer. What significance do these developments have for NEC?

A:

Funds from the Renesas Electronics shares that we sold were contributed to the NEC retirement benefits trust account. We are therefore unable to make free use of the cash obtained through the sale. However, it is really significant in terms of moving toward the target of eliminating cross-shareholdings, in principle. We have been focusing on negotiations for selling cross shareholdings, and we have made steady progress to date. Going forward, we will continue to liquidate our non-core assets and reallocate the funds into growth investments. Further, we have concluded a tender offer application agreement for the public tender of JAE and we therefore plan to deconsolidate it from next fiscal year. We recognize that the arrangement of our listed subsidiaries, including NEC Networks & System Integration Corporation, will be an important issue for the Company going forward.

Questioner B

Q:

How will the losses of the Global 5G business be resolved? How much of a loss do you expect for the current fiscal year?

A:

We are working to improve profitability through appropriate control of expenses, such as development and personnel expenses. Adjusted operating profit in the Global 5G business for the first nine months of the current fiscal year has improved by over ¥10.0 billion year on year, and we are expecting it to improve, according to our plan, from a loss of ¥31.1 billion in the previous fiscal year to a loss of approximately ¥10.0 billion in the current fiscal year, an improvement of over ¥20.0 billion.

Questioner C

Q:

Telecom Services recorded lower sales and profits for Q3 after discounting one-time factors such as IP revenue and streamlining assets in the previous fiscal year and restructuring of the wireless business. Could you tell us the factors behind this? Also, what is your outlook for Q4 onward?

A:

A key factor is that capital investment by telecom operators has been weighted more in Q4 than in the previous fiscal year. In Q4 we are planning to deliver highly profitable software and to reduce development expenses, and we therefore consider the full-year earnings forecast for Telecom Services to be achievable.

Q:

What factors are driving steady growth in domestic Cross-Industry revenue in IT Services?

A:

The resilience (firefighting and disaster prevention systems) domain is growing. The next investment cycle for firefighting and disaster prevention systems is expected to come in FY25/3 or FY26/3. We are already engaged in a number of sales talks, and in Q3 we acquired a larger number of orders than expected. Furthermore, we are also making steady progress on Broadcasting / Media projects that were ordered in the previous fiscal year, and these are contributing to our earnings in the current fiscal year.

Questioner D

Q:

How do you see IT demand in Japan going forward?

A:

Currently, domestic IT demand shows no sign of slowing down. Orders are increasing steadily, and we have been able to select and win projects with high profit margins. By sector, the Public Business sector is growing strongly in projects for central government organizations, and we can also expect orders for other public projects to grow. In the Enterprise Business sector, we have seen a slight decrease in orders for manufacturing due to selecting orders for profitability, but demand for modernization and DX is extremely strong. ABeam Consulting is leading our business in the consulting domain, where we have such a large number of high-level business talks that it will be difficult to handle all of them. For the finance industry, we have had a number of large-scale projects in the previous fiscal year, and in FY24/3 we have won an even higher number of orders. In the retail / services industry we also have some major projects, and going forward we expect brisk orders for system infrastructure standardization projects centered on modernization and DX. Orders for small and medium-sized enterprises are also maintaining a high level. At this stage, we expect brisk orders to continue in FY25/3 and onward, but we will continue to pay close attention to the influence of various external factors such as situations abroad and macroeconomic trends in Japan.

Questioner E

Q:

How do you see the current state of progress on the Mid-term Management Plan 2025?

A:

In the current fiscal year, we are planning to achieve adjusted operating profit of ¥220.0 billion, which we consider to be steady progress towards achieving the Mid-term Management Plan 2025 target of ¥300.0 billion. Compared to our assumptions when formulating the Mid-term Management Plan, adjusted operating profit in IT Services has been higher than we expected, but lower than expected in Telecom Services. However, we are making steady improvements to profitability, with the global 5G business expected to make a profit from FY3/25 onward. Overall, the Mid-term Management Plan 2025 is progressing in line with the Company’s plan.

Q:

Could you explain the reason for the downward revision in the earnings forecast for Telecom Services this time?

A:

The main factors in the downward revision of Telecom Services this time were restructuring expenses following the transfer of the Wireless business, lower-than expected earnings in the IT business for telecom operators after anticipating a rather high level in the initial plan and increases in costs in the Submarine Systems business. The Global 5G business is progressing as we expected.

Q:

Aerospace and National Security (ANS) is performing favorably. How do you expect it to perform from FY3/25 onward?

A:

Currently, we have won a number of major orders, mainly related to defense. Looking ahead, we can expect to capture further orders. We expect these orders to contribute to our financial results mainly from FY3/25 onward.

Questioner F

Q:

Could you please explain about your capital allocation policy going forward?

A:

Capital allocation during the Mid-term Management Plan 2025 includes planned growth investments of ¥500.0 billion, and if these proceed as planned, we expect the investments to be slightly lower than our net cash level. If the situation with regard to growth investments changes, then we may revise our capital allocation policy; but, at this point we are aiming to prioritize investments for future growth. However, the situation could be different for the next mid-term management plan, and we intend to consider it with a view to meeting the expectations of investors.

Q:

Please explain NEC's business policy with regard to the overseas Open-RAN market going forward.

A:

Our strategy in the Global 5G business is to focus on profitability and shift into domains where higher profitability is expected, such as software and services. We will continue to monitor the status of the overseas Open-Ran market closely, and work together with our partners while focusing on profitability.

Questioner G

Q:

IT Services are showing a steady increase in profitability. What measures have been effective in this regard?

A:

We have been working on modeling SI for many years, and these efforts are steadily producing results. By establishing standard approaches rather than pursuing development for each individual customer, we are able to utilize pre-developed packages and methods, which leads to improved profitability. We have been applying this approach in a wide range of fields, including the Enterprise and Public business sectors, and we have also been developing human resources. In addition, we are also starting to see results from offerings such as common platform services for solving customers' problems.

Q:

What has been the impact of pay rises on earnings?

A:

Our personnel expenses for the current fiscal year are expected to increase by around ¥20.0 billion year on year. However, we expect to absorb this impact by passing through increases to sales prices and streamlining other expenses, so that the profit is expected to increase for the Company overall. From FY3/25 we will introduce job-based human resource management for all personnel, which will offer a competitive compensation system based on the market value of jobs. This will result in an increase in personnel expenses, but we will recover this in our business and generate higher profits.