Q&A Regarding Financial Results for the Second Quarter of the Fiscal Year Ending March 31, 2025

Date/Time:	Tuesday, October 29, 2024, 17:15-18:15 JST
Format:	Live online streaming from NEC Headquarters, Tokyo
Presenter:	Takayuki Morita, President and CEO (Representative Executive Officer)
	Osamu Fujikawa, Corporate Executive Vice President and CFO (Representative Executive Officer)

Questioner A

Q:
Why was adjusted operating profit for International DGDF (Digital Government/Digital Finance) flat in Q2, compared with a strong increase of ¥3.3 billion in Q1 YoY? Could you please discuss whether profit is likely to continue improving in 2H FY25/3?

A:
Excluding special factors, adjusted operating profit increased by ¥3.2 billion in Q1 and by ¥2.7 billion in Q2, showing the same extent of improvement in both quarters. The special factors in Q1 included unprofitable projects in the previous fiscal year, as well as highly profitable projects and structural reform in the current fiscal year. In Q2, the special factors included provisions. The improvement in profit is expected to continue in 2H FY25/3. We anticipate that earnings may even surpass our annual plan.

Q:
Why did adjusted operating profit for Aerospace and National Security (ANS) decrease by ¥1.8 billion in Q2? Could you please discuss whether there are any risks in 2H FY25/3?

A:
In Q2, we experienced some delays in areas such as the inspection and acceptance of products. However, we are not concerned, as these will become positive factors in Q3. Additionally, there was a decline in Q2 following a rebound from highly profitable projects recorded in the previous year. In other areas, forward-looking development expenses and costs to strengthen resources were recorded ahead of schedule. In terms of revenue to be recognized for the current fiscal year from 1H revenue and the order backlog (hereinafter, the “effective order backlog”), we have already secured the necessary orders to meet our annual plan. Therefore, we expect to fully achieve the plan.

Questioner B

Q:

What kinds of specific synergies do you expect from the latest reorganization? Also, what kinds of issues will these synergies solve?

A:

As digital standardization progresses at municipalities, construction work based on the Construction Business Act will be needed. Previously, resources were scattered across the NEC Group. By centralizing nationwide construction functions at NEC Networks & System Integration Corporation (hereinafter, "NESIC"), we will be able to provide integrated solutions from the upstream to the downstream.

Furthermore, we will implement the IT solutions of NEC Nexsolutions Ltd. on top of the business foundation of NESIC, which has strong network expertise. This integration will enable us to provide detailed support for operations, including construction work needed by municipalities and small and medium-sized enterprises (hereinafter, "SMEs"). By conducting integration that encompasses NEC's fire and disaster prevention capabilities and business for SMEs, we will be able to build an enterprise capable of delivering unique digital transformation (DX) solutions with construction work capabilities on a nationwide scale. Furthermore, we expect to enhance efficiency and increase profits by concentrating resources, including distributors.

Questioner C

Q:

As of the end of Q1, the effective order backlog for Domestic IT Services increased 4% year on year, which was lower compared to other companies. Meanwhile, the value of orders has experienced strong growth. What is your outlook for the top line?

A:

We feel that the momentum behind orders has been very strong. Because we have many large projects spanning several years, the certainty of top-line growth from the next fiscal year onward has been increasing. We see this as a positive trend. We are working not only to improve earnings, but also to expand our share of customers' investment allocations and move into new business areas, with efforts led by BluStellar. Additionally, revenue from BluStellar in 1H FY25/3 increased by about 30%, contributing to overall revenue and profit growth for Domestic IT Services as a whole.

Questioner D

Q:

Could you please provide order trends for each sector, looking ahead to 2H FY25/3? Also, although orders have been steady, could you please share any factors that you believe could present risks?

A:

In the Public field, we are concerned about resources due to the extremely large volume of upcoming orders. While skillfully allocating resources, we will manage orders to ensure that we have no loss-making projects. Aside from this, there are no other significant issues.

Questioner E

Q:

A few days ago, the news media reported that base station equipment in the domestic base station market would be replaced with equipment manufactured overseas. Could you please provide an update on these developments, including the future direction of the base station business and software trends centered on Japan?

A:

The news media reports covered equipment replacements due to quality problems with base stations manufactured by other companies. The equipment delivered by NEC is second to none in terms of performance, quality, and cost performance, and is not being considered for replacement. Furthermore, we do not anticipate any significant negative impacts, as we expect continued demand for building additional base stations. Meanwhile, in the software domain, NEC has been selected as the sole vendor by NTT DOCOMO, Inc. to provide virtualized radio access network (vRAN) technology for commercial use, with deliveries set to begin in FY26/3. In addition, we will collaborate with OREX SAI, INC., a joint venture with NTT DOCOMO, Inc., to market this technology internationally.

Q:

Previously, NEC had allocated between ¥400.0 billion and ¥500.0 billion for M&As. I estimate that NEC will use approximately half of this allocation to make NESIC a wholly owned subsidiary. Could you please discuss NEC's approach to the remaining half of the investment allocation for M&As?

A:

Given NESIC's strong operating results and financial condition, and cash and deposit holdings, we believe that growth investments of approximately ¥400.0 billion are possible. While we must consider issues such as the exchange rate level and implementation feasibility, we are constantly exploring M&A opportunities to demonstrate NEC's delivery capabilities, particularly in the peripheral areas of DGDF (Digital Government/Digital Finance) and Netcracker Technology Corporation, and the Group's shared global systems originating from Japan.

Questioner F

Q:

Could you please discuss the sustainability of profitability improvements in Domestic IT Services Business?

A:

In the current fiscal year, we have been improving profitability through the expansion of BluStellar, along with undertaking continuous monitoring from the perspective of improving profitability using the data-driven business management platform that was deployed in the previous fiscal year. There is room for improvement throughout IT Services Business. Therefore, we are working to deliver results surpassing our annual plan. We are not satisfied with our current profit level, so we will continue working to make improvements.

Q:

The Ministry of Defense plans to budget for a satellite constellation beginning in the next fiscal year. Could you please discuss your outlook for new business opportunities in the space-related business?

A:

ANS has experienced steady growth in demand across existing areas, including IT, cybersecurity, radar, and communications. As we anticipate this demand to persist in the next fiscal year, we are rapidly strengthening our resources. Given that it takes several years to establish a satellite constellation for commercial use, we view it as a project that is additional to our plans. We will first seek to achieve firm growth in our existing businesses, and then aim to double the amount of revenue over the medium term.

Questioner G

Q:

Why did Social Infrastructure's adjusted operating profit more than double compared with the previous fiscal year?

A:

In Telecom Services, profit will improve by around ¥20.0 billion in the current fiscal year, due to factors such as one-time expenses in the previous fiscal year. In addition, we are planning to improve annual expenses by more than ¥10.0 billion, as a result of improved control of SG&A expenses through personnel shifts and concentrating development on key software domains. These improvements have progressed as planned through 1H FY25/3.

Questioner H

Q:

AI agents capable of coding in place of people or enhancing added value to improve revenue are gaining traction in the Japanese language market. Is there potential for these trends to contribute to cost reductions or revenue growth?

Additionally, in the telecom business, is there any possibility that NEC will expand business while factoring in conditions in certain regions where the political situation is viewed as unstable?

A:

Over the past three years or so, NEC has been advancing the development and practical implementation of AI agent technology under the “AI Orchestrator” banner. We believe AI agents are effective for both reducing costs and expanding revenue through new services using generative AI, and we have high expectations for them. In particular, we expect AI agents to become a highly effective solution when integrated with software and services.

The telecom business is becoming increasingly important in the submarine cable and satellite fields, and we believe there are strong expectations for Japan as a neutral country. The submarine cable and satellite fields, which serve as digital infrastructure, are vital elements for protecting national infrastructure and economic national security, including cybersecurity. International expectations for these fields are high, particularly from the U.S. Notably, these fields were key discussion topics when U.S. Secretary of State Antony Blinken recently visited NEC’s headquarters, so we are strongly aware of these expectations.