

Q&A Session for Public Business Briefing

Date/Time: September 29, 2015 16:00-17:15 JST

Location: NEC Headquarters, Tokyo

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Questioner A

Q. I believe that sales related to "My number" business were previously forecasted at 70.0 billion yen over the three years from the fiscal year ending March 2015 (fiscal 2015) to fiscal 2017. However, the sales forecast has now been raised by 30.0 billion yen. What are your sales projections for the first, second and third years? Also, what is your outlook for sales in fiscal 2018 and beyond?

A. Out of the initial sales forecast of 70.0 billion yen, we already have clear visibility for around 40.0 to 50.0 billion yen. We have reset our target higher in the course of providing support to address the recent increase in cyber security threats. We expect to attain our sales target of 100.0 billion yen in fiscal 2017 or in early fiscal 2018, although this will depend to some extent on the budgeting schedule of our customers.

Q. Can I then correctly assume that the projected additional sales related to the My Number business of 30.0 billion yen has been newly budgeted for cyber security, and that these sales will be generated in either fiscal 2017 or fiscal 2018?

A. Yes, that would be correct.

Q. Sales in the public safety domain are projected to grow substantially to around 110.0 billion yen in fiscal 2016, compared with just over 80.0 billion yen in fiscal 2015. What is behind this large growth in sales?

A. In the international market, we expect sales of the Global Safety Division (GSD) to increase from around 35.0 billion yen to roughly 50.0 billion yen. In Japan, we are projecting growth particularly in cyber security. We expect to see further investment based on the national government policy of implementing cyber security measures. In the private sector, business is gathering momentum and growing, helped partly by talk of setting up guidelines and certification bodies.

Q. Could you please discuss the current scale of your international business? I believe that NEC will continue to expand business outside Japan. What is your outlook for international business ratio of Public Business?

A. The international business currently accounts for 2-3% of the overall sales of the Public Business. We aim to increase this share to between 5% and 10% mainly by expanding new initiatives in water-related fields, critical facility surveillance, disaster readiness and other areas going forward.

Questioner B

Q. When will private-sector use of My Number begin in earnest? What are your expectations for profitability at that time? Are there any differences in business models between infrastructure implementation projects and private sector projects?

A. Regarding the use of My Number in private-sector, we are currently targeting healthcare and finance sectors. In the healthcare sector, it will depend on to what extent My Number can be adopted and how quickly deregulation proceeds. With all conditions met, we expect the market to be worth around 700.0 billion yen in the next 3 to 4 years at the earliest. We will finalize our profitability outlook in the course of formulating our next mid-term management plan. Profitability will vary over a certain range depending on the future scale of business. In terms of profitability from private-sector use of My Number-, we aim to generate same level or higher margin than government and municipality projects.

Q. I believe you have clear view of profitability for infrastructure development of My Number. Will profitability from private sector use of My Number really be higher than the infrastructure development? Also, will profitability improve if budgets are accelerated?

A. We are exploring a new business model for private-sector use of My Number, such as providing those systems as a service. If the scale of the business increases, profitability will outperform current projects. Meanwhile, we believe that the pace of business growth, competition and other factors will also have a bearing on profitability.

Q. With more than 1,000 municipalities in Japan, I believe that the fine specifications will vary for each municipality. What proportion of the development work can be standardized? Can you give us a rough estimate of the development costs in terms of project man-hours?

A. We believe that the required level of systems will vary depending on the municipality. In cases where municipalities fully operate My Number system on their own, we will provide a standardized, packaged service. Meanwhile, in cases where municipalities do not have enough resource of operation, we envision a business model that will provide the entire system as a service via cloud. Indeed, as we speak, our sales personnel are offering several different proposals to customers in conjunction with discussing service options with them.

We are considering providing a wholly integrated service, not piecemeal services as before, by setting service rules for the adoption of cloud-based services and cyber security. I cannot give you the exact proportion of development work that can be standardized, but I can say that we will work to provide a uniform service. Although we have not estimated the exact project man-hours, we currently have around several hundred to 1,000 staff members working under the direction of customers for fixed periods of 6 months to 1 year. We will continue to require large numbers of system engineers and sales personnel.

At present, we know how our existing customers, i.e., municipalities, are operating their system. As we know how they will make the changes in response to My Number, we can be reasonably certain about our profitability. For other customers, we will need to discuss their options based on the resources we can provide.

Q. Is there any chance that a project could become unprofitable?

A. We will consider every project with profitability foremost in mind.

Questioner C

Q. Could you please discuss the breakdown of sales targets for the government and municipalities, as well as the status of your competitors in each area?

A. Looking at the breakdown of our sales target of 100.0 billion yen, sales to the government account for 30% of the target, sales to municipalities account for 60%, and sales related to services such as My Number registration service for various companies account for the remaining 10%. In terms of our competitors, we are already making progress and producing results with respect to government procurement, and the intermediate server business with relevant central ministries and agencies is now gathering steam. NEC may collaborate with third-party companies, while we have strengths in intermediate servers. In our business with municipalities where we deeply understand the operations of our existing customers, we will make sure to support them. We will also try to support new customers, by using methods to enhance services, such as network implementation enhancing cyber security and remote services from external, offsite locations.

Information security measures are absolutely essential to municipalities handling My Number. When facing a cyberattack, My Number system must be isolated and separated from the network. NEC's Software-Defined Networking (SDN) technology can facilitate this sort of isolation and separation and has been successfully field tested at a variety of municipalities. NEC currently has a market share of around 20% at the municipality level. Going forward, we also intend to harness SDN and other technologies to reach out to the customers of our competitors.

Q. How do you intend to expand your business domain in the field of Advanced Metering Infrastructure (AMI) for water?

A. Rather than provide AMI ourselves, our efforts are premised on forming partnerships with existing AMI vendors. We intend to provide value by aggregating the detailed data held by AMI vendors.

Questioner D

Q. What is your profitability in the public safety domain? Could you please discuss any profitability targets you may have for fiscal 2018?

A. Earnings are firm in the public safety business in Japan. Although the profitability of our international public safety business is not quite high at the moment, we believe that the international business offers prospects for high profitability provided that the scale of business increases in the future. We cannot comment on any targets for fiscal 2018 until we formulate our next mid-term management plan.

Q. The Public Business is implementing initiatives such as "One to Many" and solutions in order to boost its profitability. What level of profit margin can the Public Business expect to generate through these initiatives? What do you think is falling short at this time?

A. Public Business has brought forward its target under the "Mid-term Management Plan 2015" and its operating margin is already approaching nearly 10%. It has consolidated its 18 business divisions into 14, streamlined the low-margin businesses, and concentrated on high-margin businesses. The Public Business intends to maintain an operating margin of 10%, its target for fiscal 2016, in the years ahead. At the same time, the Public Business must balance profitability with investment. The key will be to conduct service businesses that are embedded in the operations of our customers, without succumbing to price competition. We intend to work together with partners who possess in-depth knowledge of business domains. Our success will hinge on our ability to increase the areas where we support our customers in business operations.

Q. I believe that you have several key areas to target in your business in Japan. However, how will you go about developing business internationally? It appears that your business is focused on specific countries and regions such as Argentina and the Middle East. Won't you need to form alliances to develop your international business more broadly?

A. Our initiatives outside Japan have just begun. We have achieved several success stories in cities such as city surveillance system in Tigre, Argentina and garbage collection optimization in Santander, Spain. If we are able to produce results in terms of tangible benefits such as value and efficiency, we will see more projects that will allow us to replicate our successful initiatives in different geographies. We are confident in our ability to expand our business worldwide by elucidating the benefits of these initiatives through field tests and replicating those benefits internationally.

Questioner E

Q. How much R&D investment are you executing and what is your target? Also, could you please describe your growth drivers in fiscal 2021 and beyond?

A. R&D investment accounts for around 3% of net sales every year. The global market will drive our growth in 2020 and beyond. By “global,” we don’t merely mean markets outside of Japan, but we are thinking of the entire global market, including Japan. Our Global Safety Division (GSD) in Singapore has talented engineers who are developing solutions that can be expanded globally, such as airport solutions. In some cases, these solutions could even be imported back to Japan. We are seeking solutions that can be marketed globally, regardless of whether they originate in Japan.

Q. There are some companies that are transplanting their business models in one country to other parts of the world. Will NEC also narrow down the countries where it is strong and focus on those countries? Also, do your R&D activities primarily consist of basic development, or activities that are more closely related to your businesses?

A. Almost all of our R&D investment is closely related to our businesses. NEC’s Central Research Laboratories carry out the basic development aspects of our R&D activities. The future vision for our global business is that the Asia/Pacific region (APAC) will take center stage, but there are some businesses, such as water-related businesses, where Europe and the US will be predominant. Water leaks are occurring in older cities in Europe and the US because of water pipe deterioration. This presents business opportunities for us in diagnosis of water pipe deterioration and other related products and services. Regional considerations will play a part in determining the starting point for operations depending on the business. Nevertheless, we will execute a strategy that ensures that our profits are not squeezed by spreading ourselves too thin.

Questioner F

Q. Looking at the mid- to long-term direction of the Public Business, could you please discuss the factors behind the projected sales growth for fiscal 2016 to fiscal 2018? Sales from firefighting emergency radio systems and defense-related sales are projected to decrease. Will you be able to sufficiently compensate for this decline with sales related to My Number and the public safety?

A. We believe that sales related to My Number and the public safety will sufficiently cover the decline in sales of fire prevention radio systems and other items.

Q. Will your profit margins decline as your international business grows?

A. One of our profitability targets is a double-digit profit margin. Accordingly, we are taking steps to ensure that we maintain a profit margin of 10% every year. Our crucial priority is to envision a new growth path by balancing profitability with investment. That is why we intend to create future businesses through investment in tandem with maintaining a profit margin of 10%.