January 30, 2018

Earnings Presentation Q&A for Q3, the Fiscal Year Ending March 31, 2018

Date/Time: January 30, 2018 18:00-18:30 JST
Location: NEC Headquarters, Tokyo
Presenters: Takashi Niino, President and CEO
Isamu Kawashima, Executive Vice President and CFO

Questioner A

Q. Could you please provide your initial forecasts and current outlook for the impact of the suspension from contract bidding processes?

A. Under our initial forecasts, we had expected a full-year impact of around ¥60.0 billion on revenue and around ¥15.0 billion on operating profit/loss. Under our current forecast, we are expecting an impact of around ¥40.0 billion on revenue and around ¥10.0 billion on operating profit/loss. Looking at the impact on Q3 results, the suspension had an impact of around ¥7.0 billion on revenue and ¥1.5 billion on operating profit/loss. In Q3, the impact on revenue was around ¥10.0 billion less than initially forecast, while the impact on operating profit/loss was around ¥2.5 billion less than initially forecast.

Q. Could you please comment on the current status of the Public business?

A. Let me provide some additional comments on Q3 results in comparison with the previous year. The Public Solutions area came under pressure partly due to the impact of the suspension from contract bidding processes in firefighting and disaster prevention solutions. In the Public Infrastructure area, revenue from aerospace and defense and broadcasting media increased year on year. There have been no major changes against forecasts.

Questioner B

Q. Could you please discuss the differences between Q3 results and forecasts and the reasons for those differences?

A. Overall, revenue and operating profit/loss outperformed forecast by around ¥20.0 billion and ¥10.0 billion, respectively. Of this amount, revenue from the Public business was ¥7.0 billion above forecast due to the outperformance of Japan Aviation Electronics Industry, Limited. Operating profit/loss in the Public business was approximately ¥4.0 billion below forecast mainly due to unprofitable projects in the Public Infrastructure area, despite some improvement of Japan Aviation Electronics Industry, Limited. Revenue from the Enterprise business was largely as planned. Operating profit/loss in the Enterprise business outperformed forecast by around ¥1.0 billion, despite making additional strategic investments. In the Telecom Carrier business, revenue underperformed forecast by around ¥3.0 billion, primarily in the international business, but operating profit/loss was largely in line with expectations. Revenue in the System Platform business was ¥16.0 billion above forecast mainly due to large-scale projects in hardware. As a result, operating income in the System Platform business outperformed forecast by around ¥6.0 billion. In the Others business, revenue was largely as planned, but operating profit/loss fell below forecast by around ¥3.0 billion because of the recording of a provision of approximately ¥3.0 billion related to small-scale storage battery systems. Adjustment was ¥10.0 billion above forecast as a whole, reflecting the allocation of a total sum of around ¥70.0 billion in business structure improvement and strategic investment costs to various segments, in addition to the positive impact of around ¥3.0 billion from cost efficiency.

Q. The operating profit ratio in the Enterprise business was nearly 10%. Does this reflect any special factors? Or does the Enterprise business now have the true strength needed to consistently generate a profit ratio in the upper single digits or very close to 10%?

A. The operating profit ratio of nearly 10% was achieved through efforts made in this business; it was not necessarily attributable to special factors.

Questioner C

Q. Have there been any major changes in the IT services order trend in Q3?

A. The IT services order trend in Q3 rose 1% year on year. We have seen positive order growth in the finance sector, as well as a solid rebound in orders from the retail and services sector. In other areas, the order trend declined slightly year on year, due in part to the impact of the suspension from contract bidding processes. As a result, the overall order trend was mostly unchanged year on year.

Q. Excluding the impact of the suspension from contract bidding processes, what was the approximate change in the order trend from the previous year?

A. The order trend rose around 3% year on year excluding the impact of the suspension from contract bidding processes.

Q. Could you please discuss the monetary value of unprofitable projects and how long you expect those projects to continue?

A. In Q3, unprofitable projects amounted to around ¥5.0 billion. The unprofitable projects mainly reflect the fact that in the course of carrying out systems tests for public infrastructure projects, we decided to record provisions after finding that certain project costs will be greater than initially anticipated. We don’t have any other similar projects at this time, but we believe that it will be fairly difficult to completely reduce the number of unprofitable projects down to zero. Therefore, we believe that the realistic approach is to manage unprofitable projects within a certain range. We have made all of the provisions that are needed at this time. However, we cannot completely rule out the possibility of other unprofitable projects arising as we advance various projects. We believe that we have addressed all of the projects that will have a bearing on financial results for the current fiscal year.

Q. In your forecasts for Q4, the Enterprise business is the only segment projecting lower profit on higher revenue. Are these conservative forecasts?

A. Since we are consciously executing strategic investments, some of those investments will have an impact on Q4 results. Meanwhile, the Enterprise business has been improving structurally. With this in mind, we would like you to interpret these forecasts as including development investments.

Questioner D

Q. Business structure improvement and strategic investment costs have been allocated from Adjustment to each segment. Could you please comment on which segments these costs have been allocated to? Previously, business structure improvement costs of ¥10.0 billion and strategic investment costs of ¥8.0 billion had been budgeted for under Adjustment.

A. For the full year, the sum total of business structure improvement and strategic investment costs is ¥18.0 billion. The allocation mix of these funds to each segment is as follows: We have allocated 20% of the funds to the Public business, 20% to the Enterprise business, 20% to the Telecom Carrier business, 10% to the System Platform business, 25% to the Others business, and 5% to Adjustment, mainly for corporate staff-related costs.

Q. Does the target for personnel expense reduction laid out in the new mid-term management plan include the structural reforms to be implemented in FY2018/3?

A. The structural reforms in FY2018/3 have a different character than the initiatives we will undertake under the new mid-term management plan. The measures we carried out in FY2018/3 were design to upgrade and expand existing internal programs for a limited period— they were measures intended to augment the shift of resources to accelerate growth. We expect these measures to have a positive impact in FY2019/3.