April 27, 2018

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

Date/Time: April 27, 2018 18:30-19:20 JST
Location: NEC Headquarters, Tokyo
Presenters: Takashi Niino, President and CEO
Isamu Kawashima, Executive Vice President and CFO

Questioner A

Q. What were your business structure improvement expenses in the Telecom Carrier business for the fiscal year ended March 31, 2018? Have these expenses changed from your forecast as of January 30?

A. Business structure improvement expenses in the Telecom Carrier business totaled ¥3.0 billion. We had expected these expenses to be ¥2.0 billion at the Q3 earnings announcement on January 30, but they were ¥1.0 billion higher than forecast. This was due to additional business structure improvement expenses recorded overseas in the mobile backhaul business.

Q. Looking at page 28 of the presentation, can I correctly assume that NEC has an actual earnings capability of ¥90.0 billion excluding one-off items in operating profit for the current fiscal year (the fiscal year ending March 31, 2019)? Does this figure include items such as gains on the sale of assets? From here, I believe that you will need to increase operating profit by ¥30.0 billion in order to reach the projected operating profit level of ¥120.0 billion for the fiscal year ending March 31, 2020. Could you please discuss how you will achieve this growth?

A. We believe that NEC has an actual earnings capability of ¥90.0 billion excluding one-off items in operating profit for the current fiscal year. With the positive impact of structural improvements projected at approximately ¥30.0 billion for the current fiscal year, the starting line for operating profit for the fiscal year ending March 31, 2020 will be approximately ¥120.0 billion. In other words, we believe that this level of operating profit can be attained without achieving any substantial profit growth in our businesses. We will consider how to achieve even more growth over and above this level. At the same time, we would like to make the investments needed to achieve our most important target: operating profit of ¥150.0 billion in the fiscal year ending March 31, 2021.

Q. You have estimated business structure improvement expenses at ¥40.0 billion for the current fiscal year. Will ¥40.0 billion cover all of the expenses? Is there any chance that you may need to record additional expenses as you implement structural improvements during the year?

A. At this time, we believe that the ¥40.0 billion figure will cover all of the expenses. However, we will need to continue to look closely at the mobile backhaul business. Our first priority is to restore profitability in this business. I believe that we will need to consider and draw up a roadmap for the future of the mobile backhaul business within the current fiscal year.

Q. You noted that the positive impact of structural improvements will enable NEC to achieve the projected increase in operating profit of ¥30.0 billion from the company's actual earnings capacity in the current fiscal year to the fiscal year ending March 31, 2020. Wouldn't it be difficult to achieve this goal through the personnel cuts of 3,000 employees alone? Does this mean that you will achieve the goal by combining structural improvements with other factors?

A. Of the business structure improvement expenses of ¥40.0 billion planned for the fiscal year ending March 31, 2019, we expect that ¥30.0 billion will be related to personnel expenses. We believe that this portion of expenses will translate into a positive impact on earnings in the fiscal year ending March 31, 2020.

Questioner B

Q. Could you please discuss what kinds of business structural improvements were made in the fiscal year ended March 31, 2018?

A. Of the ¥10.0 billion in business structure improvement expenses for the fiscal year ended March 31, 2018, ¥3.0 billion was used for the international Telecom Carrier business. The remaining expenses of ¥7.0 billion were for expanding what we call "the second career system" in Japan (i.e., resource shift expenses). The ¥7.0 billion in expenses in Japan were recorded as actual results in each segment, not just the Telecom Carrier business.

Q. Will NEC manage to avoid any decreases in revenue over the next two years as it seeks to achieve the goals of Mid-term Management Plan 2020? Notably, in the Public and Enterprise businesses, I feel that NEC has been unable to adequately grow revenue even under strong IT market conditions last year and this year. Could you please discuss how NEC will grow revenue in each business and which areas are most promising?

A. Looking first at the Enterprise business, we don't think that the IT services area has underperformed. We have continued to invest in fields related to IoT and AI since the fiscal year ended March 31, 2018, and we expect to record a commensurate decline in earnings in line with those investments. In the Public business, Japan Aviation Electronics Industry, Limited, a consolidated subsidiary mentioned in the presentation materials, expects to see a slight decline in revenue in the current fiscal year versus the fiscal year ended March 31, 2018. Looking to 2020, a wide range of businesses have finally got under way and actual businesses, such as safety and two-way radio solutions, have started operations. Therefore, we expect revenue to increase in the next one or two years. The Public business can be divided into the Public Solutions area and the Public Infrastructure area. The Public Solutions area bore the brunt of the impact of the suspension from contract bidding processes in the fiscal year ended March 31, 2018. Therefore, we plan to drive revenue growth centered on the Public Solutions area in the current fiscal year.

Q. In the Global business, I believe that the new businesses that will enter this field are a mix of businesses that are facing issues and businesses that seem likely to grow but are in fact experiencing weak growth. I believe that it will be fairly difficult to entrust these businesses all at once to people outside the company. I think management will have to make difficult decisions such as withdrawing from businesses. Don't you think that these sorts of matters should be decided by the president?

A. The new Global Business Unit was formed by reorganizing NEC's international businesses, which had been spread out among various segments, under one management framework for integrated sales and manufacturing. To do so, we transferred to the Global Business Unit entire business departments engaged in international businesses in each segment. Going forward, we cannot count on making big changes by merely following NEC's past approaches. Therefore, as part of our new strategic concept, I have searched for business leaders from outside the company who have the potential to change NEC. The approaches taken by Akihiko Kumagai, the new head of the Global Business Unit, are not necessarily aligned with our past approaches, and we have started to see cases where we have decided to execute initiatives from a new perspective—initiatives that we had previously been unable to implement. With a new management team, including myself as CEO, Executive Vice President Toshiya Matsuki, and CFO Takayuki Morita, in addition to Mr. Kumagai, we would like to push ahead with businesses from new perspectives that we didn’t have before. Moreover, we would like to bring onboard globally minded human resources that we had previously been unable to reach.

Questioner C

Q. NEC has forecast an improvement of ¥17.0 billion in the overseas profitability of the Telecom Carrier business in the current fiscal year. Could you please go over the factors behind this improvement?

A. The main factors behind the forecast improvement of ¥17.0 billion in the overseas profitability of the Telecom Carrier business are as follows: (1) the absence of business structure improvement expenses of ¥3.0 billion recorded in the fiscal year ended March 31, 2018; (2) the projected positive impact of ¥3.0 billion from those business structure improvements; (3) an unprofitable project of ¥3.0 billion arose overseas in the fiscal year ended March 31, 2018, but we have already taken response measures and do not expect such a project to occur in the fiscal year ending March 31, 2019. In addition to these factors, we are also projecting improvements in Telecom Operations and Management Solutions (TOMS) and Software-Defined Networking (SDN). Specifically, we expect to reduce investment in expanding SDN-related sales and are forecasting improvement supported by the positive impact of sales growth.

Q. Will the mobile backhaul business return to profitability in the fiscal year ending March 31, 2019?

A. We expect the mobile backhaul business to remain slightly in the red based on a projected sales decline from the fiscal year ended March 31, 2018, despite the positive impact of structural improvement.

Q. NEC has explained that it envisions operating profit of ¥120.0 billion for the fiscal year ending March 31, 2020. Therefore, NEC will need to increase operating profit by ¥30.0 billion from the fiscal year ending March 31, 2020 to the fiscal year ending March 31, 2021, as it works to achieve the goals of Mid-term Management Plan 2020. In which segments do you expect to generate higher earnings? What is your outlook for the contribution of Japan Aviation Electronics Industry, Limited?

A. We have factored in a contribution of ¥16.0 billion from Japan Aviation Electronics Industry, Limited in the fiscal year ending March 31, 2019. Japan Aviation Electronics Industry, Limited is forecasting operating profit of ¥20.0 billion in the fiscal year ending March 31, 2019. However, since NEC has adopted IFRS, we must account for differences in accounting standards. Specifically, these differences involve the amortization of intangible assets and certain other items. Looking at the increase of ¥30.0 billion in operating profit from the ¥120.0 billion level in the fiscal year ending March 31, 2020 to the fiscal year ending March 31, 2021, we expect to generate an increase of ¥20.0 billion from the international business. More specifically, we expect to improve profitability in the Public Safety area. Not only are we already seeing a positive impact from Northgate Public Services Limited, which we acquired in January 2018, but we will also consider additional M&As. In Japan, we expect earnings to increase by ¥10.0 billion based on the materialization of digital government-related projects and projects for the 2020 Tokyo Olympic and Paralympic Games.