NEC IR Day 2020 Q&A

Enterprise Business

Date/Time: September 14, 2020 10:10-10:40 JST
Location: NEC Headquarters, Tokyo
Presenters: Kazuhiro Sakai, Executive Vice President

Questioner A

Q. In NEC's adjusted operating profit from last fiscal year to this fiscal year, you forecast an expansion of revenue and reduction in expenses amounting to an increase of 7.6 billion yen. What are the assumptions behind that breakdown? It was explained that in the near term revenue would face some difficulties, but if, for example, it should turn out that the effect of increased revenue for this fiscal year will not have the expected effect on profit, or should revenue fall, how will you make up the difference?

A. As NEC plans for a 10.0 billion yen increase in sales over last year, we also expect profit to increase by 3.6 billion yen, even including a drop in the number of large projects. We expect profits from that 10.0 billion yen in increased sales to amount to about 2.0 billion+ yen, with the remainder coming from expense reductions, lower cost of sales and others. While the impact of COVID-19 represents a risk for sales, it will also accelerate movement in contactless solutions projects in the New Normal VCI (NEC Value Chain Innovation) businesses, and we hope to gain sales back by capturing those deals. Even with difficulties everywhere, we can also expect a reduction in expenses through work-from-home efforts as part of living with the coronavirus. Together, we estimate these factors will bring a 7.6 billion yen year-on-year increase in profit. The ratio of sales growth to cost cuts, though, is subject to change going forward, and is something NEC will work to control as it moves business forward.

Q. There was an explanation of the difference in profit margins between *the new DX (digital transformations) segment and the existing on-premises business, but page eight of the briefing materials indicates that the balance of sales will rapidly shift to the new segment. I believe it will take a certain amount of time before profits can be extracted from the new segment, so when do you expect profit margins from the new segment to overtake your conventional business? What kind of conditions will bring about an increase in profit margin?*

A. That is something we are currently reviewing for the next mid-term management plan, but for now we picture new segment margins switching places with the conventional model in fiscal 2023. We explained that the new segment will require investment in development, which will bring down gross profit margins, but at present NEC believes that conditions will continue to allow it to maintain current profit margins, and that those margins will rise further once asset-based effects begin to appear. We hope to bring the business to that point within one or two years.

Questioner B

Q. On page nine of the materials, you describe the ratio of cloud/AI platform projects outstripping the market. Is that something you have done intentionally? I get the sense that NEC's enterprise business has underperformed other IT vendors; is that the impact of switching platforms?

A. Today, almost all system upgrade projects involve moving to the cloud. As NEC has shifted to the cloud, it has worked to develop hybrid cloud services that include public clouds such as Amazon's AWS, Microsoft's Azure and others, in addition to its own cloud. We then worked to capture projects by strengthening our AI and security features and strategically shifting resources. The IT domain is split between SI services and platforms, but NEC's SI service business continues to grow, and we believe we have secured a certain position for ourselves.

Q. Do you have any concerns about business dropping off once the process of modernization and lift & shift has come full circle? Aren't you concerned about a drop in your conventional SI business going forward?

A. Sustaining our position once lift & shift has advanced is an issue, but under the assumption that investment will head toward the digital native domain, NEC will not only listen and respond to its customers' requirements, but will put assets in place as we shift to providing best practices. Under the assumption that there is a risk of conventional SI business dropping, NEC will also work to develop digitally-oriented human resources, put offerings and assets in place, at the very least maintaining our market share and taking on the challenge of increasing it further.

Questioner C

Q. According to page six of the materials, your revenue base in Q2 will be on par with Q1, recovering gradually in the second half. What changes do you forecast in the IT market?

A. This page indicates that NEC expects the impact of COVID-19 in Q2 will be about the same as in Q1. In addition to COVID-19, Q1 was impacted by a drop in large-scale projects, but we do not believe Q2 will be as bad. The impact of COVID-19 has been mostly in the form of project discontinuations and extensions, affecting NEC in the first half with some impact remaining in the second half, but we think that will gradually be alleviated. As with manufacturing, the IT market is also seeing restrained capital investment, but it is also moving aggressively to respond to the new normal, and overall, we assume that IT investments will maintain their current levels.