

NEC IR Day 2020 Q&A

Public Infrastructure Business

Date/Time: September 14, 2020 11:30-12:00 JST

Location: NEC Headquarters, Tokyo

Presenters: Noritaka Taguma, Executive Vice President

Questioner A

Q. Listening to the example of the driver's license renewal system, my understanding is that you are shifting from simply taking customer orders as I heard in another session to a sales model centered on value proposals. As you explained, central government agencies with strong intentions have traditionally made it difficult for NEC to insert itself between users and public institutions and take the lead in building its position. Is your sense then that the COVID-19 situation has increased momentum for those efforts in anticipation of a "new normal", and that NEC has begun laying the groundwork for taking the lead in creating new services? Can you tell us if, in the medium to long term, this will change how you deal with customers in your business with central government agencies, how you position yourselves, and how you take the lead?

A. Regarding the question of whether things will change, the answer is yes. To elaborate slightly, in the area of social infrastructure we do not see our work as simply a matter of "taking customer orders." As I explained earlier, we have taken on a great number of world's first and industry first challenges, but the situation over the past 20 years or so has been one in which the customers themselves do not really know what they need. The fact that what we ended up delivering was primarily SI and hardware was, I hope you will understand, the result of our working closely with our customers and responding to their needs. As we continue doing so, we believe new service businesses will come out of our proposals describing how the world will change going forward. And while the "new normal" is certainly a key phrase behind the

necessity for that change, I think it represents an acceleration of something that is already happening. As low birth rates and aging bring about a drop in population, falling tax revenue and a gradual decline in national strength, the main issue for Japan will be how it utilizes the private sector to solve social issues. The driver's license example you mentioned earlier is a response to both an increase in the elderly population and a drop in the number of available workers. My view is that these responses are accelerating under the guise of the "new normal."

Q. While your business currently centers around SI and hardware, going forward you will be attempting to build service-driven and other new business models. Can you give us some idea of the numbers behind the ratio of services to existing business, both current levels and the levels you seek in the medium to long term?

A. While I think other business domains will see quite significant acceleration, unfortunately the social infrastructure field is probably more conservative. We will consider this issue in greater detail as we draw up our mid-term management plan, but my personal sense is that targeting services to reach about 10% of sales revenue by around 2025 is probably an appropriate level. Note that the current scale of our service-type business as part of segment sales overall is extremely limited.

Questioner B

Q. You explained that this year represents a transition period for the defense business. What is your outlook for the next fiscal year, and the one after that? I believe this field differs from those under COVID-19-related priority budget allocations, but will those low levels continue going forward? Please tell us about some of the short term trends, including which areas, if any, will see an increase and why they will recover.

A. As you are aware, there is no direct connection between COVID-19 and the defense budget. In the defense domain, the question of how national security moves in the long term is key. Conditions surrounding Japan are said to involve, in the near term, a security crisis that includes economic moves resulting from the impact of COVID-19, so a major drop seems unlikely. Areas with room for growth include precisely the space, cyber and electromagnetic wave domains. As you know, Japan has already launched a space defense squadron. I think we can expect to see enormous business in this area while working out how to achieve this, including partnerships with the U.S. and other countries. The space, cyber and electromagnetic wave domains are all areas with which we are familiar, and we plan to put forth our best efforts in those fields.

Q. Keeping in mind Q1 and Q 2, can you tell us if the broadcasting industry has turned downward against plan in the short term? I get the impression that the broadcast industry's investment capacity has worsened somewhat, and I have some doubts about whether Japan's broadcast industry can make the kind of wide-ranging investments needed to aggressively fund the next generation, including promoting greater use of IT. Could you please tell us whether there is anything being delayed or accelerated?

A. Let me talk first about the short-term situation in the broadcasting and media domain. As with the space and defense fields mentioned earlier, the broadcast industry domain saw a slight operational loss in Q1. That said, profit levels in the first half have recovered to levels above those forecast for the first half in the full-year plan. Orders are a combination of single and multiple fiscal year orders, rather than just single-year orders, so I think we have done a good job of catching up on fulfillment. I get the sense that the growing challenges in the broadcasting industry are also accelerating with the "new normal." In other words, as the broadcasting domain increasingly merges with the network and media fields, the broadcasting and media industries are

fighting for survival, which in turn is driving efforts to integrate. I think NEC has ample opportunities for business by offering proposals that show how transformation can be generated and what it means to cooperate across industry lines. Imaging platforms, for instance, are something that in fact we have been working on for more than 10 years. NEC has already integrated its broadcasting and media business units, and I get the feeling that the times have finally caught up with us.

Questioner C

Q. This question is about the space and defense business. In your revenue outlook, you note the potential of cyber and other segments, and that in terms of profitability, you will aim for double-digit profits. Previously—and this is an example from another company—there were media reports of distorted contracts for defense-related work under which the vendor was required to return any budget amounts left over if the work was completed on budget, but was responsible for paying any cost overruns. Can you tell us if there has been any improvement in these kinds of contracts, how profitability looks today and what kind of profitability you can expect going forward?

A. NEC's defense business has reached levels that compare favorably to our social infrastructure business as a whole. That said, national policy dictates that the business be handled in cost rollup form, so we cannot plan on 15% or 20% as would be the case with civilian industry. As a result, we hope to contribute to NEC's growth by improving the quality of our profits, whether in the form of recurring profits or capital efficiency.