

NEC IR Day 2022 Global Business (Including DG/DF) Q&A

Date/Time: September 8, 2022 14:00-14:50 JST
Format: Webcast via Zoom webinar
Presenter: Akihiko Kumagai, Senior Executive Vice President
Naoki Yoshida, Senior Vice President

Questioner A

Q: In the Submarine Systems market, there are three main companies including NEC who are competing globally. What is NEC's area of strategic advantage? What is your outlook for profitability going forward?

A: We have the latest technologies that will be able to cope with increasing requirements for massive communication capacity going forward. With the advance to multicore fiber and so forth, we can realize a significant increase in capacity. By offering this as a high value-added solution, we can differentiate ourselves from other companies. We are also taking other steps to improve profitability, aiming to achieve an operating margin of 10% by 2025.

Questioner B

Q: On page 11 of the presentation, you've presented average annual growth rate for revenue of three companies that you've acquired in Europe in the Digital Government/Digital Finance (DG/DF) business. Are orders progressing as planned, given that they are the leading indicator?

A: All three companies are expecting orders during the first half of this year to increase year on year, discounting exchange rate effects, and this situation is expected to continue going forward. At Avaloq, annual recurring revenue (ARR) is used as a leading indicator for management, and the company's pipeline exceeds its previous year's results considerably. The market itself is also trending towards a shift to SaaS and cloud services, and we expect to be able to secure growth potential by leveraging the advantages of our competitive software.

Q: NEC has assumed a stronger yen than the actual current exchange rate in its exchange rate assumption for this fiscal year. Could you explain the impact of this on business performance?

A: For the Global Business overall, if the current weak yen trend continues, the business performance for this fiscal year may be higher than forecast. However, the Company's Global Business makes transactions not only in US dollars, but with various foreign currencies, and there is also the cost of making payments in US dollars to be considered. This makes it difficult in some ways to estimate how great the net impact will be. We are focusing on how to grow our actual business, regardless of foreign exchange rate fluctuations.

Questioner C

Q: In the Submarine Systems business, you have recently captured a large project, and the outlook going forward looks favorable. Are there any risk factors?

A: Recently, we have captured a string of large projects, mainly as the core of our customer base has shifted from the conventional telecom operators to major IT platformers such as Google, Apple, Facebook, and Amazon. Based on customers' investment plans, which anticipate an increase in dedicated lines for the 5G era with a massive increase in capacity, we do not see any major risks.

Our business model for Submarine Systems in the case of major projects is to record revenue over a three-year period from the receipt of the order on a percentage-of-completion basis. We have already received the orders for the revenue recorded for this fiscal year, and the majority of the revenue for the next fiscal year has also been ordered. We can be almost certain of revenue for the next three years, and beyond that, we expect a pipeline at least four or five years into the future based on information such as our customers' investment plans. Therefore, we do not think there is any major risk.

Questioner D

Q: On page 16 of the presentation regarding the improvement of profitability in DG/DF business, how much do you plan to increase the respective ratios of the SaaS/software and offshoring going forward? How much will this move contribute to improving profitability?

A: Currently, the ratio of SaaS/software is 77%, but we plan to increase this to more than 80% by FY2025. At NEC Software Solutions UK, it is already over 80%, and the other two companies plan to increase their ratios to around the same level. In recent orders for SaaS/software projects, we have won contracts with profit margins that greatly exceed previous levels. Moreover, in offshoring, we have been making use of operations in India and we are seeing an effect of several hundred million yen per year. We anticipate a planned increase in profit of 6.0 billion yen by increasing the ratio of offshoring from 29% in this fiscal year to 40% in FY2025.

Questioner E

Q: In the Service Provider business, you have received several major projects from the second half of the previous fiscal year through to this fiscal year. To what degree will these contribute to the business performance targets in the Mid-term Management Plan?

A: From the second half of the previous fiscal year, Netcracker has received several major orders. Most of these have been incorporated in the plan, but there are also some projects that will help results to exceed the targets. Netcracker's business model is to make multi-year contracts that take about five years from receiving the order, so not all of the projects will contribute to revenue in the first fiscal year. However, most of their revenue is expected to be recorded during the remaining three years of the Mid-term Management Plan period. We believe that

Netcracker can drive growth to exceed the business performance targets for the Service Provider business in the Mid-term Management Plan.