NEC IR Day 2023
Progress of Mid-term Management Plan 2025 and Financial Strategy Q&A

Date/Time: Thursday, November 30, 2023 13:00-13:45 JST
Format: Webcast via Zoom webinar
Presenter: Osamu Fujikawa, Corporate Executive Vice President and CFO (Representative Executive Officer), Member of the Board

Questioner A

Q:
How will you improve the adjusted operating profit margin of IT Services from the FY24/3 forecast of 9.8% to 12% in FY26/3?

A:
The core digital transformation (DX) business will contribute the most to improving the operating profit margin. We have largely completed the development of the product lineup and put a system in place by making growth investments over the past two years, so the core DX business can be expected to contribute to improved profitability moving forward. Customers have great expectations for core DX, and we intend to capture a surge in demand. Although core DX's contribution to financial results for the current fiscal year is still not large, we will work to further improve its profitability with a view to achieving our target for FY26/3.

Questioner B

Q:
Low-profit businesses with an operating profit margin of less than 7% are forecast to be reduced from 14 businesses at the start of FY24/3 to 10 businesses by the end of FY24/3. Which segments have a large number of such businesses? What kinds of specific measures are you implementing to address them?

A:
Businesses classified as low-profit businesses are found both in the IT Services and Social Infrastructure segments and are not concentrated in either segment. The 4 businesses expected to complete their rehabilitation and be declassified as low-profit businesses in FY24/3 have been steadily improving their profitability based on a highly specific improvement plan. I've been regularly monitoring 6 or 7 of the remaining 10

businesses in accordance with a predetermined time frame, and I anticipate that they will definitely be able to complete their rehabilitation and be declassified as low-profit businesses. For the other businesses, I've gone into each business unit, analyzed the actual situation, and have been implementing countermeasures. For example, I've been working closely with a specialized corporate task force on businesses that will be considered for carve-outs. As CFO, I've made a commitment to the improvement of our low-profit businesses. Therefore, I would like to implement solid measures to reach our goal of reducing low-profit businesses to zero by FY26/3.

Questioner C

Q:

Why did you include -¥42.0 billion as a buffer for adjusted operating profit under "Gap" in the financial forecast by segment for FY26/3?

A:

Following the formulation of the 2025 Mid-term Management Plan, we were impacted by factors such as component shortages and foreign exchange fluctuations. It is difficult to foresee how and when these risks will occur, and to what extent they will impact NEC's financial results. In the 2.5 years since formulating the Mid-term Management Plan, besides the incidence of external factors, some businesses have not progressed as much as we had anticipated. In light of these circumstances, we believe it is necessary to factor in a buffer. As our commitment after factoring in such a risk buffer, we will ensure that we achieve our targets for FY26/3 of revenue of ¥3,500.0 billion and adjusted operating profit of ¥300.0 billion.

Questioner D

Q:

Looking ahead to FY26/3, NEC anticipates significant growth in profits in international IT Services (DGDF: Digital Government / Digital Finance) and expects revenue growth in the global 5G business. Is there any risk of not reaching these goals?

A:

Although there are certain risks associated with DGDF and Social Infrastructure, we are conducting appropriate management in light of those risks. For example, in Social Infrastructure, we will minimize risk by curtailing global 5G investment and costs, while capturing opportunities in growing areas such as software. Basically, in cases where risks occur, the risk will be compensated for within each segment. Company-wide perspectives and external factors that cannot be currently foreseen are factored into the "Gap" part of our financial forecast by segment as a buffer.

Questioner E

Q:

NEC has set quite ambitious targets for adjusted operating profit and EBITDA for FY26/3. However, your ROIC target is 6.5%, which I believe is low in comparison to your profit growth. Could you please discuss your approach to invested capital, M&As, and other such factors?

A:

ROIC has been steadily improving as planned. In FY26/3, we forecast an ROIC of 6.5% assuming M&As are undertaken, and 7.0% assuming no M&As are undertaken. That said, no decisions on M&A deals have been made at this time. We will update our financial strategy, including our future investment plans, as needed. In the previous year, our credit ratings were upgraded by one notch. We will continue to maintain our financial soundness. Having done so, we have every intention of making growth-oriented investments. Our ultimate goal is not an ROIC of 6.5%. We will first ensure that we meet the targets we have committed to, and then strive even higher.

Questioner F

Q:

I have a question about capital allocation. In comparison to its industry peers, I believe that NEC's cumulative shareholder returns of ¥200.0 billion from FY22/3 to FY26/3 are low. If you decide not to carry out a large-scale M&A, will you shift your policy and redirect cash to dividends or share buybacks?

A:

Our overarching policy of prioritizing investment in pursuit of growth, provided that growth opportunities arise, has remained unchanged. Although it will depend on whether or not surplus cash is generated as well as the status of financial results and M&As in the future, we may reassess our policy in the next Mid-term Management Plan.

Questioner G

Q:

The Mid-term Management Plan has so far been progressing steadily. As the backdrop to this progress, have external factors such as a favorable domestic IT market and an increase in the defense budget played a major role? What kinds of measures will you implement as self-improvement efforts?

A:

Beginning with the stage of the previous Mid-term Management Plan, we have been incorporating external factors into our strategies and making various self-improvement efforts in anticipation of future growth in demand. In IT Services, we have taken steps such as promoting DX and developing a common platform, which have produced good results. In Aerospace and National Security (ANS), we have been working to improve ROIC, in addition to curtailing unprofitable projects. In the future, we will proactively increase and shift human resources in core DX and ANS, along with acquiring and developing talented human resources by expanding job-based human resource management to the whole Company from next fiscal year. Efforts will also be made to raise the sophistication of our management infrastructure and implement data-driven management as a means of improving profitability. We will ensure that we achieve the 2025 Mid-term Management Plan's goals by executing what has to be done steadily and without fanfare.