

Q&A Regarding Financial Results for the Fiscal Year Ended March 31, 2024

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Format: Live online streaming from NEC Headquarters, Tokyo
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(Representative Executive Officer)

Questioner A

Q:

Orders for IT Services in FY24/3 increased 3% year on year on an annual basis. Will IT Services revenue in FY25/3 be connected to the increase in orders in FY24/3?

A:

While orders for IT Services increased by 3% in FY24/3, the backlog of orders at the start of FY25/3 was up 6% from the start of FY24/3. Accordingly, solid growth is expected to continue going forward.

Q:

Will revenue growth in the Global 5G business in FY25/3 be greater in Japan or internationally? Additionally, could you please explain the feasibility of profit improvements in Telecom Services?

A:

Domestic revenue in the Global 5G business in FY25/3 is forecast to return to FY23/3 levels. Moreover, international revenue for FY25/3 is estimated conservatively. In terms of the profit improvements in Telecom Services in FY25/3, the total amount of profit improvements originating in FY24/3 is expected to be ¥20.0 billion. This amount combines an improvement of ¥5.0 billion related to the transfer of the Wireless business and a one-time factor of ¥15.0 billion in FY24/3. Also, the improvement of ¥12.8 billion in the Global 5G business includes nearly ¥10.0 billion expected to come from improvements in development costs and SG&A expenses. Combined with the ¥20.0 billion in improvements originating in FY24/3, an improvement of ¥30.0 billion has been added to Telecom Services as a whole as of the beginning of the fiscal year. The remaining ¥10.0 billion will come from improvements in operations. Profit improvements in Telecom Services are positioned in our plans as target levels that must be achieved. However, for the Company as a whole, we have factored in around ¥10.0 billion as a contingency within adjustments.

Questioner B

Q:

Considering the level of the backlog of orders in domestic IT services, does this mean that you have set a conservative revenue outlook for FY25/3? Your plans also indicate that profitability will not improve very much from FY25/3 to FY26/3. Are you expecting any increases in costs?

A:

Given the effects of rising wages and cost increases in FY25/3, our outlook is somewhat conservative. As a non-binding target, we seek to improve profitability by 1 percentage point every year. Moreover, there are no particular factors that will reduce our profitability. In FY24/3, Company-wide costs increased by around ¥20.0 billion due to pay rises, but the effect was fully absorbed by profit improvements. In FY25/3, we anticipate cost increases of around ¥25.0 billion to ¥30.0 billion, but we expect to absorb this impact mainly by passing it on to prices.

Questioner C

Q:

Is the defense field projected to continue to perform strongly in FY25/3? Additionally, could you please describe how increases in the government's defense budget and company policies to boost profitability will affect this business?

A:

The defense field is expected to continue performing strongly in FY25/3. The government has revised its policy on defense equipment. Proper recognition is now given to companies that supply high-quality products and cutting-edge technology and profit margins of up to 15% are now permissible. NEC has been advancing research and development from a long-term perspective and would like to position Aerospace and National Security (ANS), including the defense field, as a core pillar of its business.

Questioner D

Q:

In ANS, NEC won orders of over ¥500.0 billion in FY24/3, and its operating profit margin has improved to 12%. What is your outlook for profit margin levels going forward?

A:

While the government has established a maximum profit margin of 15% in the defense field, we can expect to generate a profit margin of 12-13% in our plans.

Q:

In International DGDF, large improvements in adjusted operating profit and the adjusted operating profit margin are expected. You have factored in an improvement of ¥6.0 billion

from FY24/3 to FY25/3, and an improvement of ¥12.0 billion from FY25/3 to FY26/3. What are the main factors behind these improvements?

A:

The most important factor was the improvement at Avaloq. In FY25/3, revenue is expected to increase by almost 10%, with plans to increase the adjusted operating profit margin to 14%. In addition, a target has been set for increasing the adjusted operating profit margin to nearly 20% by FY26/3, and steady progress is being made toward this target. Avaloq has been implementing various initiatives, and it is making steady headway with its alliance with Blackrock. Moreover, it has been accelerating efforts to develop new customers and expand partner projects in the Asia-Pacific (APAC) region using NEC's sales channels, along with streamlining costs by shifting to the cloud. Furthermore, Avaloq is advancing the utilization of offshore resources. Through these efforts, Avaloq will improve its profit margin.

Looking at other factors, existing international subsidiaries, other than three European companies, were unprofitable in FY24/3 and reduced profit levels. The main components of the improvement from FY24/3 to FY25/3 will be an improvement of roughly ¥4.0 billion at Avaloq, and the remaining amount will come from improvements at existing international subsidiaries.

Questioner E

Q:

What is your view of trends in domestic IT demand in FY25/3?

A:

Modernization will be a major focus. We expect that modernization will account for a significant portion of IT investment in Japan in the near term. In FY24/3, customers in the financial field made progress on modernization-related decision-making and investment. Looking ahead, we expect similar trends to emerge in the manufacturing sector. Demand for supply chain-related IT development is also expected to materialize. In our view, demand from medium-sized enterprises is also strong and should grow. We expect that FY25/3 and FY26/3 will be critical in determining our success in the digitalization of the national government and local governments.

Questioner F

Q:

Could you please share your outlook for orders for ANS? Also, why will the adjusted operating profit margin in FY25/3 decrease from FY24/3?

A:

In FY24/3, we received orders of over ¥500.0 billion for ANS, including many multi-year projects. In FY25/3, we expect that orders received will return to normal. Considering

additional factors such as resources and production capacity, we are planning to receive orders of ¥400.0 billion in FY25/3. Beyond that, we expect the trend in orders received to stay in the range of ¥400.0 billion to ¥500.0 billion.

The adjusted operating profit margin is projected to decrease in FY25/3 owing to highly profitable projects in FY24/3. Over the medium term, we will make improvements to ensure that we can consistently generate a profit margin of around 12%, while working to enhance our QCD (Quality, Cost, Delivery) evaluation.

Q:

Could you please explain the background and key points of the changes to segment figures in Mid-Term Management Plan 2025?

A:

We have revised the Others segment. The revisions were made due to the deconsolidation of Japan Aviation Electronics Industry (JAE) in FY25/3. Because IT Services and Social Infrastructure are growing firmly, we believe we can compensate for JAE's profits with this growth. Therefore, we have made no changes to our Company-wide targets.

Questioner G

Q:

ANS has already won orders of over ¥500.0 billion in FY24/3. Will revenue in FY26/3 exceed ¥400.0 billion?

A:

The revenue forecast for FY26/3 is ¥350.0 billion. However, the FY26/3 target of ¥400.0 billion is achievable, and we are seeing some upside in our progress toward this target. The key to achieving revenue above our target is to secure resources. We believe that securing the necessary resources will allow us to achieve a business scale exceeding ¥400.0 billion.

Q:

What kinds of benefits do you anticipate from using generative AI internally, such as raising operating efficiency? Could you please go over the estimated cost savings during the Mid-term Management Plan 2025 period?

A:

Generative AI is already being used in a range of fields. Unless we fully utilize generative AI, we risk falling behind other companies. Our previous experience in the software development field has shown that generative AI is effective in the demonstration trial phase. We are also using generative AI in the cybersecurity field. We have already trained our generative AI on the chat records of 40,000 employees and the knowledge gained from this experience will be extended to our customers.

Questioner H

Q:

Looking at the foreign exchange rate, the yen is currently trading at around ¥156 to the U.S. dollar. What are your thoughts on the impact of the foreign exchange rate on NEC and Japan's economy as a whole?

A:

We have a business structure that is designed to reduce the foreign exchange rate impact to the greatest extent possible. Every ¥1 depreciation versus the U.S. dollar increases operating profit by about ¥0.3 billion annually. Therefore, the exchange rate does not have a large impact on NEC's management. Meanwhile, we hope that the current sharp currency rate volatility and the weak yen will gradually return to normal.