

Questions & Answers at the Financial Results Briefing
for 1H of the FY Ending March 2024

October 30, 2023

NEC Networks & System Integration Corporation

Questioner A

Q: What sense of direction do you have from the second half to the next fiscal year in terms of profitability in each segment?

A: In the DX Solutions (DXS) segment we will make progress in improving profitability through growth in strategic areas such as work style DX, but in addition to that, we believe we can drive improvements in existing areas. Meanwhile, the downturn in COVID-related demand at our call center subsidiary will start to contract from the second half of this year.

For the Network Solutions (NWS) segment, we think conditions in the first half will continue in the second half, and we are not optimistic about this fiscal year. In terms of specific businesses, the social infrastructure business will get into full swing during the next fiscal year and we expect future improvements in that sense, but we believe the tough conditions seen this year in business aimed at telecommunications carriers will continue, and we have implemented measures to improve profitability on that premise. Regarding 5G and local 5G, the build up of the market is lagging two years behind what we initially expected, but there is a sense that the number of projects is increasing a little at a time, and we expect it to contribute to improved profitability in the future. In the Environmental & Social Solutions (ESS) segment, we have made progress in working through equipment projects that place downward pressure on profitability, and with an extensive backlog of orders, we expect profitability to improve as we work through these projects at an accelerated rate.

Q: Next year will be the final year of your current medium-term management plan. What are your chances of achieving the profit targets you set in the plan? I think conditions are tough in terms of business aimed at telecommunications carriers, but it seems there are growing expectations with some areas showing solid performance such as DXS and ESS. What is your thinking on this?

A: Our forecast operating profit for this fiscal year is 24 billion yen, and we want to build upon this as a base. Recently the expansion of sales has finally gotten into full swing, and that will continue to accelerate in the next fiscal year toward achieving those targets. At the same time, we want to set our sights on the 34 billion yen profit target

laid out in the Medium-term Management Plan by properly managing business operations where volume is growing.

Q: Regarding improved profitability in the DXS segment, in the first half you saw improvements even with increases in the area of SI and construction projects that involve lower profitability than the service area. Does this indicate that profitability has also been improved in the area of SI and construction projects?

A: Up until last year, we were impacted by a decline in highly profitable business in our existing areas of operation, but this has already run its course, and at the moment the sales mix has improved with an increase in business in strategic areas such as next-generation network security where our strengths lie, and profitability has also improved in the SI and construction area.

Questioner B

Q: What is the recent status of improvements regarding profitability at the time of order receipt? In addition, for overseas projects you also secured orders in the first quarter, but how is the profitability of your overseas projects?

A: One of the management metrics used in the sales division is profitability at the time of order receipt, and we have improved this by around one percentage point companywide. Going forward we will drive further improvements to this metric by expanding the business we do based on the profitable consultant-type approach. Profitability in the overseas business varies by project, but we have managed to curb the emergence of unprofitable projects which have significantly pushed profitability downward in the past through strengthened project management and other measures, and we will continue to improve the profitability of the overseas business going forward.

Q: For what kinds of projects is the consultant-type approach increasing a lot?

A: It has mainly been for DX utilization related to remote work and work style innovation aimed at regular companies, but in the future we believe there is ample room for growth in business aimed at local governments, which have recently been the focus of attention. The center of the consultant-type approach is work style DX, and it is expanding the doorway to providing next-generation network security.

Questioner C

Q: You mentioned that the social infrastructure business in the NWS segment would get into full swing in the next fiscal year, but what changes have occurred compared with the first quarter?

A: The social infrastructure business in areas such as space, defense and marine has gained momentum, and the projects we were expecting to secure orders and post sales for starting in the first half to cover the difficulties in the carrier business have been pushed back to the next fiscal year. Currently, equipment-related projects have increased ahead of others, but since high value-added projects will surely follow, we are looking to the next fiscal period to work hard on them.

Q: According to the Bank of Japan's Tankan poll of business confidence and other sources, the market appears to have remained at a high level, but how does NESIC view demand trends among customers?

A: While the increase in DX demand for telework that we saw while COVID-19 infections were on the rise has slowed, demand has now fallen from the peak, and our impression is that it has actually heated up further. At our Nihonbashi office, which is a hub for co-creation with customers and partners, activity is booming with the number of visitors having reached capacity, and there is a sense that demand is spreading from regular companies to local governments, schools and other organizations.

Questioner D

Q: In the Others segment, orders have increased significantly in the second quarter (three months). What do those orders entail and what continuity is involved?

A: To facilitate SI including future system building and updates, we are increasingly securing equipment-related orders preemptively, and those orders are recorded under "Others." As for how these projects differ from the equipment projects in specific segments, projects that require any level of business line support such as kitting and installation are recorded under the corresponding segments, and projects that only involve the delivery of equipment are recorded under "Others."

Questioner E

Q: What level of SG&A expenses are you expecting for the second half?

A: We have strategically increased SG&A expenses, with an increase greater than that in the first half of the previous year, and our approach will be the same in the second half

as well. We will pursue a well-rounded policy of properly investing in areas that need it, and improving efficiency wherever we can. Note that compared with the first half, in the second half we will allocate a substantial investment to mission-critical system development, and we expect the figures to be slightly larger in the second half. However, we will still strive to improve efficiency wherever possible.

Questioner F

Q: While DXS orders appear weak due to a reactive decline from pandemic-era demand at a subsidiary and other factors, you mentioned that there has been growth in areas of focus. Could you provide some more insight into specifically what kinds of orders are seeing growth? Is it things like generative AI and cloud services?

A: The main source of growth is the utilization of DX in work styles and revisions to networks and security to accommodate that. AI and cloud computing are of course elements at play, but as with license sales, they are not sold on their own, so we work to create mechanisms in which they are utilized. An example of this would be a video system for visualizing digital content.

Questioner G

Q: SG&A expenses have increased significantly in the previous and current fiscal years. What should we expect in the next fiscal year? Business growth aimed at meeting the targets set in the Medium-term Management Plan is expected. In addition to that is it correct to assume that the degree of increases in SG&A expenses and company-wide eliminations will shrink?

A: In terms of how we will incur expenses, we will aggressively spend on accelerating growth, but will also adopt a well rounded approach in which we hold off on spending in some areas where appropriate. We view the next fiscal period as one for reaping the results of our efforts, and while we cannot say for certain that this point, we do not see the degree of increase being on the level of the past few years.

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