

Q&A at IR Briefing for Financial Results for the
First Half of Fiscal Year Ending March 31, 2019

NEC Networks & System Integration Corporation

Date: October 31, 2018

Questioner A

Q: You have reported that you had received orders for large overseas projects in the Social Infrastructure segment, but some of your past overseas projects were not profitable. How do you perceive the risk in the current projects? Have you changed the way you manage projects?

A: In the past, immediately after recognizing some projects as unprofitable, we improved our internal screening system to prevent loss-making projects by, for instance, tightening the approval criteria. We have not incurred any major loss-making projects from orders received since we improved the system. Additionally, upon the recognition of unprofitability of the current projects, we have further improved our approval system by expanding the range of screening that I, the president, perform directly, which includes projects other than those involving a large amount of money. We are also checking again for any problems associated with project management for ongoing orders that we received in the past.

Q: You have established a joint company (KNSI) with KDDI. Do you think you will be able to expand the 5G business through this joint company?

A: First, we funded KNSI for the purpose of placing base stations for the current 4G. We can expect to benefit significantly from the ability to increase the efficiency of the process by performing from, our strength, the base station area design (designing the efficient and effective placement of base stations by taking into account the radio wave characteristics and geographical factors), to installation work, and from the ability to absorb large changes in business sizes, which have been a challenge in the base station business. As for 5G, while we are yet to anticipate specific activities, we intend to be prepared for the new generations to come.

Q: You are probably developing a new medium-term plan. You are positioning the current year as the year of solidifying the foundations for the new medium-term plan. Will it be a plan for benefiting actively from the foundations? Can you give us a clue?

A: We are currently having active discussions about the plan itself, but I will explain our intended direction and our policy for the discussions.

First, we are making growth investments in the current fiscal year as well, and we believe that we must keep making forward-looking, long-term investments for our

business growth. Accordingly, while the new medium-term plan itself will be for three years, we will foresee the society of about 10 years into the future and develop the plan retrospectively from there.

Furthermore, we are currently operating businesses in the three market-linked segments of Enterprise Networks, Carrier Networks, and Social Infrastructures. The DX technology and cutting-edge technologies, on which we are currently focusing, are commonly related to the three segments in some cases, and similar resources are scattered around. As a result, the plan for the three years will tend to be a small one that does not differ significantly from the current plan if each organization discussed the plan separately. For this reason, we are holding cross-organizational discussions on specific themes for the new medium-term plan. Based on this, we will define in which fields we will grow our businesses and hope to develop a clear plan.

Questioner B

Q: You have reported that your orders received for work-style innovation –related area were strong. Will this change the profitability?

A: By developing the work-style innovation-related business, we believe that profitability will gradually increase as the consulting and SI businesses grow more than the hardware business. We recognize this as one of the reasons for the recent rise in profitability.

Q: Has there been any change in the lead time due to, for instance, deadlines being moved forward to meet the requests of customers who wish to implement work-style innovation right away?

A: We have not recognized a significant change in the lead time. Meanwhile, we feel that negotiation cycles with customers have become shorter as ICT investment has been steady on the whole, and we have therefore been increasing proposals not only for work-style innovation, but also for security and servers.

Q: Recently, orders received have increased significantly. Are there problems securing resources as a result?

A: We consider securing engineers to be an important issue and are focusing not only on recruitment, but also on engineer development training. In addition, we are working to develop and retain engineers from a global perspective through, for instance, the active exchange of human resources with iSGM, our overseas subsidiary in Myanmar, which has strengths in the software field and a large pool of young, skilled human resources.

Q: You have been rapidly establishing a string of alliances with external companies,

including the new joint company with KDDI, the LPWA business with Sony Network Communications and Orix, and the use of CVC. What are the backgrounds of accelerating such external collaboration?

A: The new company and LPWA business have been created from our relationships with a wide range of customers. We have an understanding of each other's strengths from the past, and the corporate managers have maintained good communication. This is the reason why we were able to smoothly establish the alliances when such business plans came up. While such activities are important, we consider it essential to capture venture companies' technologies for our future growth, which is the reason why we have been actively using CVC.

Q: The profitability of the Carrier Networks segment decreased from the previous year. What are the reasons for this?

A: The decrease in profitability is the result of an increase in expenses for growth such as the preparation for new businesses and the foundation of new base station companies. The profitability of the business itself is therefore not necessarily declining.

Questioner C

Q: Concerning the profitability of the Enterprise Networks segment, the operating income to sales increased significantly in the first half of the fiscal year, but it is expected to decline in the full-year forecast. Do you expect profitability to decrease in the second half of the fiscal year?

A: We hope to raise the profitability of the Enterprise Networks segment from the initial forecast for the fiscal year. Meanwhile, we believe that we must carefully observe the Carrier Networks and Social Infrastructures segments.

Q: The orders received in the Carrier Networks segment grew considerably during the first half of the fiscal year. Please explain the trends in the Carrier Networks segment, such as the non-carrier business field, and the new company (KNSI) established jointly with KDDI.

A: While business for carriers has also been growing recently, the segment growth was led largely by non-carrier fields. For KNSI, we are currently working to secure construction personnel, and we expect the trend of KNSI will remain as that has been seen so far during this current fiscal year and clear contributions will appear in the next fiscal year onwards.

Q: The Social Infrastructures segment has been struggling for the past several years in terms of financial performance, and profit growth also appears difficult in the first half of the current fiscal year, partly due to the loss projects. What is the situation besides

these projects?

A: The profit from the Social Infrastructures business has been mostly at the same level as the previous year if the impact of loss projects is excluded. The segment maintains a stable business size as its base, and we believe it is important to prevent extra costs by improving project management. Meanwhile, we have been receiving more orders overseas. We believe that there is room for growth in the disaster prevention system business and the broadcasting and CATV business, in which we excel, and we hope to gradually grow these businesses.

Q: You have excluded the 10 billion yen for the new mega-solar plant, which was included at the beginning of the fiscal year, from the forecasts. Does this mean that you will not take the order for the unprofitable mega-solar plant project since other orders have been increasing recently? Can we expect an improvement in profitability in the next fiscal year as a result of this?

A: Regarding orders of mega-solar plant projects that we will receive from now on, we will undertake a thorough examination and make careful decisions in view of profitability and risks as part of our efforts to improve profitability.

Questioner D

Q: You mean that you will not change the initial full-year forecast for orders received after excluding the 10 billion yen for the new mega-solar plant project. What will you use to make up for the exclusion?

A: We do not plan to use a specific field of business to compensate for the exclusion. Orders for both Enterprise Networks and Carrier Networks increased in the first half of the fiscal year, and the performance of the Social Infrastructures segment is also exceeding the initial plan thanks to orders for large projects received. We think that we will be able to reach the initial forecast overall without the mega-solar plant project.

Q: Operating income for the first half of the fiscal year exceeded the forecast. Please explain the causes.

A: The difference in the operating income for the first half from the forecast was caused primarily by an improvement in the cost of sales ratio of Enterprise Networks exceeding the assumption and the increased efficiency of SG&A expenses, a reflection of the efforts of all administrative staff. The increase in the profitability of Enterprise Networks has already been developing since the second half of the previous year, and we expect that it will remain in the high level in the second half of the current fiscal year.

Q: My impression is that NEC has been engaging in a range of new activities. How do you think your businesses and relationships with NEC have been changing as a result?

A: We do not see any major changes in our relationships with NEC. Meanwhile, NEC has more sophisticated technologies than we do in fields such as face recognition and AI, and we hope to strengthen our collaboration in such fields.

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