Q&A at IR Briefing for Financial Results for the First 9 Months of Fiscal Year Ending March 31, 2021

February 1, 2021

NEC Networks & System Integration Corporation

Questioner A

Q: You revised full-year forecasts upward. Were there changes in GIGA school projects in the digital solutions (DSL) business such as an increase in the ratio of network establishment whose profitability is not low, contrary to the prediction that the sales mix would worsen due to the low profitability of the GIGA school projects mainly dealing with products?

A: Orders received for the GIGA school projects totaled 29 billion yen on a consolidated basis. It includes not only those at a subsidiary whose results are consolidated into DSL, but also orders for our ESS (engineering and support services) business which were received at our regional bases. Orders for each were 14 billion yen to 15 billion yen respectively. Sales of GIGA school projects in the first nine months were about 1 billion yen for DSL and about 10 billion yen for ESS.
Under these conditions, the GIGA school projects mainly for equipment showed low profitability as you pointed out. However, profitability did not differ significantly between network establishment for the GIGA school projects and regular system integration projects. Furthermore, improvements made through learning effects, volume effects and the like have produced results in the course of advancing the GIGA school projects. The profitability of the GIGA school projects as a whole, including equipment projects, are low compared with that for the Group. However, we have improved its profitability from our original estimate.

Q: How did DX-related orders progress in the first nine months? Have there been any changes to the Zoom-centered content?

A: DX-related orders received amounted to about 9 billion yen on a consolidated basis, including about 6 billion yen for DSL and about 1.5 billion yen for each of the other two segments. Zoom continued to account for about one-third of the orders received. Orders for other cloud services and the like, including file server services, started growing as well.

Q: I’d like to know the medium- and long-term direction of DSL. What is the component ratio for DX and workstyle innovation that you aim to achieve in this segment? I’d like to also ask you about your approach to small and medium enterprise customers, which have increased recently?

A: We have no established long-term numerical targets at this stage. However, we are hoping

to increase the ratio of DX and other service operations which already account for about half of DSL at the moment. We are hoping to strengthen the system integration business by combining it with the service business, rather than transforming the system integration business into the service business. We are thinking in that way.
Businesses for small and medium enterprises is a field we have not been able to address very much in the past. We are advancing those businesses by focusing on inside sales. They have started to expand steadily.

Questioner B

Q: Increasingly, you are acquiring new customers with Zoom as the initial entry point. How much is cross-selling and up-selling to them contributing to your results at this stage?

A: Our DX customers, centered on those who came to us through Zoom have increased ten times from the about 1,200 companies at the end of March 2020 to about 12,000 companies at the end of December 2020. We are continuing to gain new customers at a good pace at the moment. The Zoom Global Partner Award for fiscal 2020 that we received from Zoom is proof of the great results we have been achieving with Zoom. Cross-selling and up-selling to customers employing Zoom as a gateway has not produced big figures yet. We are working on moving those operations into full swing now. Inside sales is our way of increasing sales to small and medium enterprise customers. We are also aiming to expand businesses for large enterprise customers, starting with identifying about 50 companies as our targets and growing our business with our consulting services as a starting point.

Q: How is the distributed satellite office business progressing?

A: There are a dozen or so projects now in progress, including those that led to orders and others in the proposal stage. This is a business worth billions of yen, including the related services necessary for distributing work, such as solutions for automating operations. We believe we can expect the business to grow further.

Q: Orders received by K&N System Integrations Corporation or KNSI and net sales posted by the company increased substantially in the first six months. Did this momentum continue in the third quarter? Were there any changes to this momentum?

A: Results for KNSI continued to rise in the first nine months in the same way as in the first six months.

Questioner C

Q: You raised your full-year operating income forecast substantially by 2 billion yen, even when excluding the 1 billion yen in reserve for unexpected COVID-19-related risks that you did away with. Is improvement in the profitability of GIGA school projects that is greater than your original estimate a main reason for this forecast revision? Are there other primary factors?

A: As you pointed out, the improving profitability of the GIGA school projects is a main cause for the revision. There are other key factors, too, such as the growth of net sales and cost reductions advancing faster than our forecast.

Q: There has been special demand for GIGA school projects this fiscal year. Do you think you can keep the volume of orders received at the same level, making up for this surge in the next fiscal year?

A: We are studying our budget for the next fiscal year now. We are not ready to discuss anything specific yet. However, we are sure that the reactionary fall from the GIGA school projects that we will experience will be huge. We are currently studying the feasibility of an approach to make up for the surge by cross-selling and up-selling to Zoom and educational customers, whose numbers we were able to increase in the current fiscal year, and promoting the growth of our businesses for telecommunications carriers, because we can expect those businesses to stay strong and to contribute to not only KNSI's business growth but also our businesses overall. There were customer restraints on our businesses, such as PBX replacement, in the current fiscal year. We think we can expect those businesses to start moving again when conditions related to COVID-19 improve. We are studying our budget, hoping to turn the operating income of 22 billion yen that is forecast for the current fiscal year into a start for achieving greater growth.

Q: I think you are likely to achieve the numerical targets for the Medium-Term Management Plan this fiscal year ahead of schedule. Will you revise the Medium-Term Management Plan if that happens? Or will you revise just the numerical targets for the next fiscal year?

A: We will review our targets for the next fiscal year, the final fiscal year of the Medium-Term Management Plan, as the forecasts for the next fiscal year.

The next fiscal year is the final fiscal year under the current Plan. At the same time, the year is the run-up to our next Medium-Term Management Plan. We consider it to be an important year during which we will examine and discuss our further growth toward the future.

Questioner D

Q: For the revised full-year forecast, why does the contribution of the revised operating income look small compared with the increase in net sales in your revised full-year forecast for the network infrastructure or NWI business? I understand you are expanding growth investment related to 5G. Is this effect due to 5G investment and other similar investment?

A: We kept the revision of the operating income forecast for NWI small, considering a growth investment increase in the fourth quarter and our sales mix. We are investing in the 5G field in various ways now. We plan to accelerate investment without limiting it to the current fiscal year if doing so is necessary.

Questioner E

Q: You delayed the posting of growth expenses to the second half at the end of the first half. Will you incur these expenses according to the plan under the present conditions? Tell us also what you plan to do with growth investments in the next fiscal year.

A: Our growth investments amounted to a little more than 4 billion yen in the first nine months. We estimate our growth investments in the fourth quarter will be a little less than 3 billion yen. We are planning to spend a total of 7 billion yen according to plan. We cannot tell you anything specific about the next fiscal year yet as we are discussing the budget for the fiscal year now. However, the next fiscal year is not only the final year of our Medium-Term Management Plan, but also the run-up to our next Medium-Term Management Plan. We think that increasing growth investment is a possibility if investment is necessary to achieve growth in the future.

Q: Your operating income rose sharply in the current fiscal year, partly due to a decrease in the provision for loss for unprofitable projects. Regarding profit in the next fiscal year, if there is no improvement in growth expenses, do you expect to see an increase in net sales, which will be a growth driver?

A: The about 28 billion yen posted for GIGA school projects in the current fiscal year will have an impact on our net sales in the next fiscal year. At the same time, we expect a positive effect from cross-selling and up-selling, centering on DX, to new customers acquired through GIGA school projects and Zoom operations, the launch of local 5G services, and increased sales including 5G to telecommunication carriers. Predicting a sharp growth of profit as we expected to achieve in the current fiscal year is difficult, but we are thinking about raising our profit forecast, beyond the baseline 22 billion yen forecasted for the current fiscal year, expanding net sales for the more profitable projects I just mentioned, improving the sales mix by lowering the sales ratio of the relatively low-profit GIGA school projects, which are included in net sales for the current fiscal year, and continuing cost reduction.

Q: What is the current state of your business with KDDI?

A: KNSI, our joint venture with KDDI, is continuing to perform strongly. We understand its market share rose steadily from the previous fiscal year. We believe we can continue to expand our KDDI business with KNSI at its center.

Questioner F

Q: There have been various criticisms of Zoom, including regarding the suspending of account activities in specific meetings. Are these criticisms negatively affecting your business? Also, tell us about the effects of influential video conferencing services operated by other leading companies.

A: We are aware of various criticisms of Zoom. They have had no significant impact on our business, though. We are dealing in other services that compete with Zoom, too. We believe we can sufficiently address changes in the competitive environment because we are advancing proposals based on the needs of customers.

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