

## Questions & Answers for NESIC IR Day 2024

June 16, 2024

NEC Networks & System Integration Corporation

### **Management based on awareness of the cost of capital and the stock price**

Q: Regarding capital efficiency, we believe that cash will continue to accumulate as the rate of profit increases and working capital efficiency improves going forward. What do you plan to use the cash for? You consider DOE to be an indicator for determining dividends. Is it possible that dividends will be increased?

A: We increased DOE to 5.3% this fiscal year forecast. When our capacity to create cash has improved further, we will consider increasing DOE accordingly and conducting a stock buyback. We are also considering investments including M&A activities. From the viewpoint of capital efficiency, we will use leverage when investing if necessary.

Q: You mentioned that you also aim to improve the asset turnover ratio in the improvement of ROE in the future. What measures do you plan to take to achieve this?

A: Our issue is the long accounts receivable collection period. We will enhance the efficiency of working capital by improving this. As it stands now, the cash conversion cycle is around 90 days. We would first like to improve it to around 86 days, which is the FY2022/3 level. Regarding the cash generated in this process, we believe that the asset turnover ratio can be improved by using it as I explained when answering the previous question.

Q: In the Network Solutions (NWS) Business, you intend to increase ROIC first and then aim to achieve the growth of net sales. We believe that progress in the improvement of this segment will lead to an increase in the standards of the company as a whole. What is your view regarding the time it will take to achieve this?

A: I think that we can move it to the right column (net sales growth) of the portfolio chart if the capital expenditures of telecom carriers recover several years after we return to profitability through the structural reform of the business targeting telecom carriers. We are also working to create a market on our own by enhancing initiatives regarding a unique business that will not be affected by the investment trends of telecom carriers. I think that we can move the business to the right column in the not too distant future by reliably managing the portfolio for each of the business divisions and SBUs in the segment.

Q: Regarding portfolio optimization, do you mean that sale of businesses with low profitability will not be excluded from your options?

A: The sale of low-profitability businesses is an option. However, we will not sort businesses based simply on ROIC. If the ROIC of a business is low at present but it is expected to grow in the future, we will choose to enable it to consistently grow. Conversely, if the ROIC of a business is high but its growth potential is poor, we will invest in other businesses.

Q: Please tell us your thinking about the protection of minority shareholders, including outside directors and NEC related business, as a listed subsidiary.

A: From the viewpoint of the protection of minority shareholders, the outside directors are one-third of the members of our Board of Directors. Regarding our relationship with NEC, we have established and operate a Special Committee. The operations of the Special Committee are controlled strictly, and we understand that it is functioning fully. However, we also understand the requests of investors. We will continue to consider them.

Q: We feel that the necessity of collaborating with NEC is greater than ever before due to the change in the growth themes. What do you think?

A: We intend to do businesses by leveraging the technological capabilities and assets of NEC more than ever. In NWS and Environmental & Social Solutions (ESS), there are fields where accelerating our collaborations with NEC in the execution of business would be more effective. Our relationship with NEC is declining numerically, but we hope that we can reinforce it as win-win relationship.

### **<DX Solutions (DXS) Business>**

Q: Regarding strategic areas, significant expansion was achieved in the previous fiscal year, and you plan to expand them in the same way this fiscal year. Are we correct in understanding that we can expect them to be expanded further from FY2026/3 onward? If that is the case, what areas do you think will be growth drivers?

A: We believe that we can expect these business areas to continue expanding. At present, the areas of workstyle innovation through DX, which is appropriate for hybrid workstyles, and beyond 5G network security associated with the shift to cloud computing have grown significantly, and these two areas account for approx. 70% of the strategic areas. We believe that these areas will grow further and the other areas that are still small in scale (data analysis and utilization, digital twins and local government DX) will also begin to keep pace with them after one or two years.

Q: To what extent do you think the GPM of DXS will improve? In addition, while we believe that expansion of strategic areas is the key to the improvement, how much higher is their profitability compared to the existing areas?

A: This fiscal year, we would like to improve it by around two percentage points from the 22.0% in the previous fiscal year. As it stands now, the GPM of the strategic areas is two to three percentage points higher than existing areas on average. We will of course improve the mix by enabling these areas to grow, as you pointed out, but we would like to make improvements each area, including existing business areas, such as the reduction of equipment-related projects whose profitability is low.

Q: You introduced an offsite BPO initiative (p. 6). How much do you expect this will increase net sales and improve profitability?

A: While it is difficult to say how much offsite BPO will contribute to the improvement of profitability by itself, we believe that the initiative, including the improvement of resource efficiency and the use of AI, will contribute to the improvement of profitability. The target GPM improvement of approx. two percentage points in the current fiscal year reflects our expectations that offsite BPO will have this kind of effect. While the initiative is still small in scale because we have just started it, we would like to continue to go forward with it and establish it as soon as possible so that it will begin to produce a certain volume of net sales.

### **<Network Solutions (NWS) Business>**

Q: What are the differences in profitability of the businesses and what initiatives to improve their profitability in the future have been established?

A: "Network business" is basically an SI business, which is affected in part by the operating rate, but we expect this business to remain on the same level as before. It was in a difficult situation in the previous fiscal year due to a rapid decrease in the investments of telecom carriers. We took countermeasures in the previous fiscal year, such as a shift of resources. We believe that it will return to the normal profit level in the near future.

The profitability of social infrastructure does not normally differ from the telecom carrier business. It is possible, however, that we will have more competitors as it expands into private sector markets in the future, in addition to the public sector. However, we possess special technologies, so we believe we will be able to improve profitability further in the future. Additionally, for the beyond 5G network business, we will aim to achieve profitability that is higher than existing businesses partly because we will operate it as a service business through co-creation with customers.

Q: What ideas do you have about the net sales and profitability of NWS in and after FY2026/3? While we expect that it will continue to be affected by the difficult circumstances regarding the investments of telecom carriers, we believe that the social infrastructure business will pick up steam. What do you think about each of these things?

A: It is believed the telecom carrier business will begin to recover around 2026 to 2027. However, we believe that the overall amount invested will remain almost flat. For example, if the amount being invested in base stations recovers, the amount being invested in other areas will be reduced. Only K&N System Integrations Corporation (KNS), our subsidiary, is working on base stations. While other areas mainly include businesses attributed to the increase in data traffic (construction of optical networks and maintenance and operation areas), we believe that we can keep this area around the current level without significant fluctuations. We believe that we can achieve the growth of the business by expanding areas including services for local NCCs as well as mission-critical areas for governments and public areas, which I explained today and which are new areas, in addition to base stations.

Regarding social infrastructure, it is difficult to make short-time forecasts partly because there are cases where a major project is delayed by one or two years. However, because we work in an area where large investments are made in both the public and private sectors, we believe that it will expand in the long term.

Profitability declined in the previous year partly because the telecom carriers suddenly stopped investing. We believe, however, that profitability will not decline any further and we can improve it because the structural reform has been completed to a certain extent and strategic areas will be expanded in the future.

### **<Environmental & Social Solutions (ESS) Business>**

Q: What is the background behind the improvement of the backlog GPM? Can we expect that the GPM during order acceptance will continue to improve?

A: Regarding the increase of orders and backlogs, we believe that we are receiving many projects, including large-scale projects, by allocating resources more efficiently. On the other hand, regarding the improvement of profitability, we understand that initiatives including the strengthening of project management and stricter evaluations during order acceptance have enabled us to prevent unprofitable projects and enhance our business execution capacity. We will work to continue to improve.

Q: Is it possible to improve the GPM of ESS to a level above 20% as in the other segments?

A: There are high barriers to overcome to quickly catch up with the other segments, such as the large number of projects that we must bid for. However, regarding the provision of services after introduction, the renewal of projects, and other aspects of the business, we work to get it close to the other segments, including improvements implemented by leveraging existing strengths. This fiscal year, we will make these and other efforts to improve our GPM as an improvement in the operating margin.

Q: When will immersion cooling take shape as a real business?

A: We need to conduct further verifications to provide high-quality services as a real business, partly because of the evolution of CPUs and the resulting evolution of servers, such as the increase in the amount of heat generated. Having said that, we would like to launch it as a business around the second half of the period of the next medium-term management plan.

Q: You mentioned that the expansion of strategic business areas has been delayed. Do you think you can aim for the initially planned value of 40 billion yen during the next medium-term management plan?

A: While the medium-term management plan is being considered, I would like to aim to expand to the level of the previous target. Regarding strategic areas, we think it is important to expand both strategic and existing areas by adding DX to existing businesses to provide high value-added services instead of simply expanding DX business. We believe this will also enable us to improve profitability.

Q: I have a question about the green business. What is in high demand, other than the demand related to data centers (which use immersion-cooling technologies)?

A: At present, building management is attracting increasing attention, among other areas. The visualization of power reveals issues, and we link them to our proposals. We would also like to work on PPA services, among other efforts, from this perspective.

Q: I have a question about fire-fighting networks. What competitors do you have? What are your competitive advantages over them?

A: Regarding fire-fighting networks (command boards and radios), our major competitors include Fujitsu General, Hitachi and Oki Electric Industry. Our strengths lie in that NEC products are highly competitive and that we need to customize products before providing them instead of only delivering standard products, which means that we are familiar with our customers operations.

Q: Regarding immersion cooling, it seems that you will provide container-type products.

Why did you choose container-type products, which it is assumed will be used outdoors, in moving forward with the business?

A: We offer both services for container-type products and for products for indoor use. We will proceed with both. Regarding container-type products, we believe they are appropriate for responding to distributed computing with a view toward the progress in the shift to edge computing.