Company Presentation for the Second Quarter of the Fiscal Year Ending March 31, 2025

Question & Answer

Questioner 1

Q&A Session 1

Q: I would like to know the details regarding the factors contributing to the increase/decrease in operating profit for this Q2. For Japan, I can understand that it's primarily due to the absence of unprofitable costs that were recorded in the previous fiscal year in the Public & Social Infrastructure and additional factors. However, in the Overseas Segment, particularly in North America, the EBITA increase is quite significant. This cannot be explained only by the rise in business transformation costs in FY2024 and absence of the structural transformation costs from FY2023. Could you clarify if there were any special factors contributing to this increase, other than the reduction of administrative costs in North America, including whether they are sustainable into H2?

A: I will break down the factors contributing to the increase in operating profit. Operating profit increased by JPY27.1 billion in the first six months of this fiscal year. Firstly, the increase is due to higher sales, etc., which account for approximately JPY10 billion.

The increase in business transformation costs in FY2024 and the absence of structural transformation costs from FY2023 have resulted in a net profit increase of around JPY11 billion. Other positive factors include a foreign exchange impact of JPY3.6 billion and an absence of unprofitable projects totaling JPY3.8 billion in the Public & Social Infrastructure. There was also a strategic investment increase that had a negative impact of JPY1.4 billion, so all of these factors combined resulted in a net profit increase of JPY17 billion.

North America EBITA, in particular, increased by JPY5.6 billion YoY even when excluding the effects of foreign exchange rates. This improvement is due to significant reductions in administrative costs. We implemented drastic changes to our management structure at the end of FY2023. Notably, we restructured by reducing high-salary positions and taking other measures, resulting in a leaner structure. We believe this should support the sustainability of these improvements in profitability.

Q&A Session 2

Q: I would like to ask about the outlook for capital investments in data center business presented in page 14 of the presentation material. At the beginning of FY2024, you said it will be the same level as FY2023, but this is now JPY401 billion, which is about JPY10 billion higher in JPY terms. This is a capital investment exceeding the level of sales.

If this level continues each year through FY2027, it could reach about JPY2 trillion. With demand remaining strong, is the intention to keep capital investments at this level? Or do you plan to manage and adjust investments to some extent, potentially reaching JPY1.7 trillion as an upper end? Could you clarify the nuance of this JPY1.5 trillion or more goal for FY2027?

A: The USD2,908 million investment plan for FY2024, as disclosed here, is based on our decision to proceed within this range. As you noted, the current revenue from our data centers are about JPY300 billion, so our investments indeed exceed our current revenue level at present.

Forecasting data center demand for three to four years from now is very challenging, so we have chosen not to update the figure of “JPY1.5 trillion or more,” and decided on the most recent investment plan at this time.

Regarding investments for subsequent fiscal years, we will make annual decisions based on a thorough assessment of current demand trends and status of AI data center demand, including GPU, at the appropriate times.

Q&A Session 3

Q: For my final question, I'd like to hear about the future vision for the data center business.

Looking at just the past one year, financial costs have surged due to business combination with NTT Ltd., negatively impacting your EPS, and this has been a concern for the stock market.

However, this time you have shown profit growth, and data center revenue grew significantly as well, so perhaps next year or the year after, free cash flow turns positive.

Considering that you're enduring short-term challenges with debt, I would like to hear, not only about the quantitative three-year EBITDA target of JPY190 billion, but about the benefits of your ability to provide vertical integration from infrastructure to application development, or other aspects where you have unique advantages that bring benefits for your company in the medium to long term.

A: Through the business combination with NTT Ltd., we gained two benefits. First, we achieved scale. With JPY4.3 trillion in consolidated net sales, we have risen to the sixth largest position globally among IT service providers. This scale positively influences both our business with clients and our relationships with partners.

The second benefit is the expanded business portfolio. This includes our data center business, and also tech solutions, a business of selling Cisco and other routers with network engineers, which we now bring in-house.

Globally, we believe there aren't many players that can provide a full stack service, from data centers to applications. In particular, with our data center business, we are not simply in real estate, but we also deliver IT services on top of it, which gives us a unique strength, so moving forward, we plan to expand the business that delivers even more added value to our clients. In this sense, as we are in a highly unique position globally, we focus on offering greater value to the clients, aiming for an approach that, by doing so, also contribute positively to our company's profits.

Questioner 2

Q&A Session 1

Q: Regarding GTSS, is the main reason for the increase in EBITA the effect of revenue growth? Or were there any additional profitability improvements due to the scalability of the data center business or other factors?

A: The EBITDA margin for data center business for the April to September period was 34%, whereas it was 38% a year earlier, so the Q2 margin remains slightly lower.

When we take on large clients in data center business, we carry out initial design and construction work, such as rack installation, a process we refer to as "fit-out." The gross margin on these fit-outs is low, whereas the gross margin on the data center usage fees is higher, so depending on the timing of a fit-out, profit margin tends to be slightly lower.

Moving forward, we expect improvement in EBITDA, so we aim to further boost profits in H2.

Q&A Session 2

Q: Regarding orders for the July to September period on page five of the presentation material, many segments show a decrease. In terms of Public & Social Infrastructure , I believe this is due to a high figure in FY2023, leading to a reactionary decline. On the other hand, is the reason why GTSS orders have nearly halved any accounting changes, or is this due to a reactionary decline from large data center-related orders?

A: As you noted, from July to September last year, we received relatively large data center orders. This is not due to any accounting changes; we see these kinds of quarterly fluctuations are typical.

Q&A Session 3

Q: North American investors are quite familiar with the data center business, so there are opinions that moving them off balance sheet could lead to some profit leakage. Nevertheless, do you intend to continue pursuing the off-balance-sheet approach?

A: Amid the current situation where interest-bearing debt is rising and financial costs are increasing, we need to devise a way to manage the net debt/EBITDA ratio and improve ROIC, which is now depressed by data center business, in the medium to long term.

Rather than moving everything off the balance sheet, we plan to move some of them at a certain scale, while maintaining a balanced perspective.

Q: I see, in terms of the capital efficiency, a certain level of off-balance structuring is needed.

Questioner 3

Q&A Session 1

Q: There was a media report about the data center REIT the other day, so I assume that compared to three months ago, the consideration process has likely progressed. Could you please share your current policy, including any plans or the scale of this initiative?

Regarding the data center REIT, while there might be a slight reduction in your net sales, I think it will probably generate profit from asset sales earlier than regular data center business. Could you share how you view this impact for the FY2024 and FY2025?

A: We are currently examining detailed aspects, such as which data centers to target, the scale in terms of monetary value, and the structuring. Each of these points is currently under thorough review.

As you can infer, we can't provide precise numbers. However, our approach is to take a balanced, multifaceted approach to select target data centers and proceed with the off-balance-sheet measures while also using external capital.

Our goal in using REITs is not to generate one-time, substantial gains. Essentially, we consider this approach as an important methodology to enhance our financial ability to capture the growing demand for data centers.

Q&A Session 2

Q: I would like to ask about the SAP business of GTSS. My understanding is that rather than handling large SAP projects, your company's approach, especially in Germany, has been to serve a wide range of companies, including mid-sized businesses.

Has there been a change in your approach to SAP recently, resulting in larger projects, which is why you highlighted SAP business as promising?

A: As I mentioned earlier, GTSS consists primarily of the data center business and SAP business, along with some other infrastructure-related businesses, such as submarine cable projects.

Of the JPY418.8 billion in net sales, approximately JPY180 billion comes from data center business. The remaining roughly 60% comes from business solutions, which conducts business of expanding our SAP services globally.

Demand for migrating SAP to the cloud remains robust, and we are fully capitalizing on this demand. Also, in addition to our focus on SMEs, we are now strengthening our SAP offerings for large enterprises as well.

Additionally, we are seeing an increasing use of ServiceNow as a front-end for SAP. While also making use of engineers we acquired through M&A, we are enhancing our business offerings that integrate ServiceNow with SAP. We are expanding our SAP-related business to capture these significant trends.

Q&A Session 3

Q: I would like to know more details about the business that adopted Oracle Alloy that you mentioned. I think your strategy for domestic data centers has been to target certain clients, but could you clarify who you aim to target and how you plan to expand the business?

A: We have been involved in domestic data center business for some time, and recently, we built the Mitaka EAST data center, which still has some available space.

Our strategy for domestic data centers has primarily focused on large clients, including large enterprises and government agencies, and we operate the business focusing on providing secure IT services spanning from system operation and maintenance to the facility.

While our policy remains largely unchanged, now that there is an increasing demand for GPUs, so in some cases, we are providing a portion of space to hyperscalers. However, the ratio of hyperscalers in domestic data centers is considerably lower than that in overseas data centers, which is around 60%.

As for the purpose of introducing Oracle Alloy, there are a very large number of clients who use Oracle databases in on-premises environments, and a large number of these clients use Exadata or other appliances for so-called data analysis. We believe Oracle Alloy, with its Oracle Cloud Infrastructure (OCI) capabilities, is an ideal solution for migrating such on-premises environments to the cloud.

In addition, by combining Oracle Alloy with our existing OpenCanvas assets, we can effectively address needs that also include DevOps, data analytics, and more. We believe this approach will allow us to deliver highly valuable services to our clients.

Questioner 4

Q&A Session 1

Q: Regarding the order environment in Japan as a whole, as well as internationally, particularly in North America and Europe, has anything changed compared to three months ago?

A: Regarding the order environment in Japan, there has been little change over the past three months. We expect steady demand to continue. One key challenge for us domestically, we believe, is the shortage of resources. To address this, we acquired a company called JASTEC in April, and we are committed to meeting demand by reinforcing our workforce.

In the Public & Social Infrastructure, along with our so-called business for central government and ministries, we're seeing gradual growth in areas termed "quasi-public sectors," such as health and disaster prevention, which involve public-private partnerships. We aim to expand in these areas by also leveraging our strengths in financial infrastructure.

In the Enterprise, CAFIS, our credit payment processing business, has been performing well. It is growing steadily as expected, aligning closely with our initial projections.

Overseas, the order environment varies by country. In North America, observing our competitors, IT investment has been somewhat restrained over the past year, but demand appears to be gradually increasing in recent months. In North America, we consider ourselves challengers, so regardless of the order environment, we have assembled a strategic team focused on securing large-scale projects. As a result of these and other efforts, our order pipeline is now strengthening.

In Europe, the UK and Germany are particularly tough markets, both for the industry and our own business. In Spain and Latin America, we aim to expand our business by successfully meeting market demand.

In APAC, conditions vary by country, but countries like Australia face some uncertainty and have been a challenging market for us as well.

The reality is, we are encountering more difficulties in the regions with tough market conditions, and for the UK, Germany, and Australia, we think a fundamental reform is necessary. Therefore, in Australia, we have recently appointed a new regional president to lead recovery efforts.

Q: Regarding the overseas markets, there are regional differences, and overall, would you say the situation hasn't changed much compared to three months ago?

A: Yes, that's correct. There hasn't been a significant change. Our response efforts are making gradual progress. For example, in Germany, we're seeing some recovery in orders, and we are actively working to control costs to increase profits.

Q&A Session 2

Q: I would like to ask about SG&A expenses. Looking at this quarter's financial results, it seems there hasn't been a significant change in gross profit trends compared to Q1, but SG&A expenses have declined significantly YoY. You mentioned administrative cost reductions earlier, but can we expect substantial reductions to continue into H2?

A: The largest reduction in SG&A expenses came from administrative costs in North America, which decreased by about USD50 million YoY over the past six months. This reduction is mainly due to cuts in labor costs, so we expect to see continued effects in the full-year as well.

As for structural transformation costs, approximately JPY13.5 billion was spent in H1 of FY2023, but this is absent this fiscal year. As for business transformation costs, we have incurred JPY5.5 billion in FY2024, which is an increase of about JPY2 billion YoY. Netting these resulted in a reduction of about JPY11 billion in SG&A expenses.

In H2, on the other hand, we expect JPY24.5 billion in business transformation costs, which is an increase of about JPY8 billion YoY, while again, the structural transformation costs of about JPY13 billion recorded in the previous fiscal year will be absent, so netting these is expected to result in a reduction of about JPY5 billion in SG&A expenses.

Questioner 5

Q&A Session 1

Q: Could you once again share an overview of your management policies you have in mind as president?

A: Thank you. The business combination with NTT Ltd. took place two years ago, and in FY2023, we were able to finally present the financial results that incorporate the NTT Ltd. results for the full year.

While we're still in the middle of the business transformation process, I believe how we make use of the two axes we gained from this: scale and a broad business portfolio, are crucial elements for us moving forward.

The scale has been very beneficial in strengthening our relationships with partners and in engaging more closely with clients. I see the business combination as essential to gain the broad business portfolio, offer a full-stack service unmatched by others, and fully harnessing these assets to reap the rewards. I believe we are now finally on equal footing to compete directly with our top global competitors.

In addition, as a global IT company headquartered in Japan, we aim to fully leverage the strengths we've developed in Japan, while integrating agility and a challenge-oriented mindset, traits that are prominent in Western companies. This will help us establish a one-of-a-kind position as a global IT service provider.

I believe that increasing the value we provide to our clients is paramount. By maximizing this value, we aim to increase our profit levels.

Q&A Session 2

Q: Considering the progress made up to Q2, could you share your current outlook on achieving the full-year targets, as well as the targets for FY2025, the final-year of the medium-term management plan?

A: We believe our Q2 results are very positive. As for full-year outlook, we have a mostly solid outlook for achieving the net sales target. On the other hand, for operating profit, we recorded a profit of around JPY15 billion from the sale of data centers in H2 of FY2023, so this will be a factor contributing to YoY profit decline in the second half.

The H1 results were the outcome of a mixture of strong performance from profitable regions and areas, and weak performance from areas facing some challenges. In H2, by focusing on these two aspects: maximizing profit from strong-performing areas and accelerating recovery efforts in weaker areas, we aim to meet our full-year target for operating profit as well.

In FY2025, we'll complete most of the business transformation, so I believe it will be the year when we begin to realize the synergy between NTT Ltd. and the former NTT DATA that we initially envisioned.

The addition of the data center business has enabled us to tap into the new business domain of offering data center services with added value. The rise of generative AI has also provided tailwinds for this business, which we aim to leverage. We will continue working toward our planned targets for the final year of the medium-term management plan as well.

Q&A Session 3

Q: There was a media report that a REIT listing for some data centers is planned for the Singapore market in June 2025. If you're able to comment on the timing or the market choice at this stage, we would appreciate it.

A: I'm unable to provide a clear answer at this time. Thank you for your understanding.

Q: Understood.

Questioner 6

Q&A Session 1

Q: Regarding the data center order backlog, could you provide an approximate ratio of built-to-suit projects? If in the future, new technologies such as liquid cooling will emerge, is there a possibility that they will cause any changes to contract terms or amounts, etc.?

A: We are not providing a specific ratio of built-to-suit orders. We believe about 80% of our orders are from hyperscalers, so it would the around that level. As such, a certain portion of the order backlog also consists of built-to-suit projects for hyperscalers.

Any design modifications would be addressed through negotiations with the client as needed. We don't expect these changes to have a positive or negative impact.

Q&A Session 2

Q: I believe you currently have just under 200,000 employees across the entire Group. If you aim to be in the top three in each country, I believe this headcount is not sufficient. I think while increasing the investments in data centers, it is essential to invest in securing talent. I would appreciate any insights you can share about how you might prioritize or allocate investment funds.

A: As we are currently around sixth in the IT services industry, we are aiming to reach the top five, and also to provide high quality services.

Against this backdrop, we believe talent is indeed critical, and we are actively conducting training and investments. Regarding generative AI engineers in particular, as we explained in the briefing, we will train all of our 200,000 employees so they are equipped to use AI. We will implement a training program with a staged structure.

While we recognize the need to increase our headcount beyond 200,000, considering that each region has different employment customs, we are working to become an attractive company that is chosen by the labor market, ensuring that any increase in numbers is accompanied by quality.

Q: Would it primarily be through organic growth and hiring, rather than acquisitions?

A: We aren't aiming to suddenly increase by hundreds of thousands to match our competitors. We plan to grow organically through hiring as well as through M&A. However, as the increase needs to involve quality, we aim to pursue M&A that is aligned with our strategy to grow both in quality and quantity.