Question & Answer

Questioner 1

Q&A Session 1

Q: I would like you to break down the factors that are causing the high tax rate. Please also provide a roadmap to bring it down to a normal level in the future, say FY2025.

A: First, I will explain the three factors causing the tax burden ratio of over 40% for FY2023.

The first factor is that, as I have already explained, some of our overseas subsidiaries have incurred losses due to increased interest burden, and therefore deferred tax assets could not be recorded because future taxable income is not expected in such companies.

The second factor is the effect of the reversal of deferred tax assets. The recoverability of the future plan became a point of contention during an audit conducted for some overseas companies, and it was decided to reverse the deferred tax assets.

The third factor is the impact of taxation arising from transactions between overseas group companies, where the foreign tax credit could not be applied and the tax amount exceeded the amount of the credit.

Regarding the forecast for FY2024, we are planning the amount of taxes, taking into account the results of FY2023.

As you pointed out, we believe that the one-time negative impact we had in FY2023 will disappear to some extent. On the other hand, the gain from the data center sale posted in FY2023, for example, was a positive factor for tax expenses as we used deferred tax assets, but we are not expecting such sale in FY2024.

In addition, as we will continue the aggressive investment in the data center business, the increase in financial burden is expected to continue at some overseas subsidiaries. Therefore we expect the tax burden ratio will not improve significantly.

We are aware that reduction of the tax burden ratio is an issue we need to address, but it will take time to achieve a certain degree of alignment between income and loss within the Group. Therefore, the impact of the measures on FY2024 is expected to be limited, and thus we have planned the figures like this.

Q: Thank you. Regarding the first factor, the subsidiary that has incurred losses due to interest burden, is it NTT Ltd.?

A: Yes, that's right. These are subsidiaries within NTT Ltd.

Q: It was 41.5% in FY2023, up more than 10 percentage points from FY2022. If you break it down into the first factor, second factor, and third factor, how many percentage points of impact did each have?

A: I don't have an exact percentage, but the percentages are larger in the order I explained.

Q: In that sense, the negative impact of the increased interest burden at the subsidiaries, which is the largest factor, will expand further in FY2024 as the interest burden is expected to increase in FY2024, and as a result, the tax burden rate will remain unchanged, am I correct?

When you consider the final year of the medium-term management plan, is your anticipating scheme that the tax rate will be brought down to the normal level when the interest burden is reduced by debt reduction realized through securitization of data center assets?

A: Yes. We aim to generate a positive impact in FY2025.

Q&A Session 2

Q: As the gain from the data center sale is not planned for FY2024, I think it is natural to take it as a one-time gain for FY2023. If the gain from the sale is generated, will it be factored in the 10% EBITA margin of the medium-term management plan?

A: Some of the gain on the liquidation of the data center assets is also factored in the profit for FY2025. We are aiming to achieve the adjusted operating profit of 10%.

Questioner 2

Q&A Session 1

Q: I would like to ask you about the domestic situation. In the FY2024 plan of the Public & Social Infrastructure business, you expect a very strong growth in net sales, mainly for the public service, I think. Please tell me the details here.

In spite of that, the profit growth is planned to be weak in the Public & Social Infrastructure in FY2024. The FY2023 result was far above the plan, so I wonder if you are simply estimating it conservatively.

A: As for the strong sales expected in the Public & Social Infrastructure in FY2024, as you commented, the new orders received for public-sector projects progressed well in FY2023, so they are expected to boost net sales in FY2024.

With regard to the profit margin, as the characteristics of the projects, we control risks by accumulating a certain amount of risk expenses for each project. If those expenses are not used, the profit will increase. That's how they are structured. Therefore, our current plan is about the same level as FY2023, but it may change slightly depending on the difficulty level of each project and other factors.

Q: As to the timing of the increase in sales, is it going to become apparent from H1 of FY2024? Also, regarding the profitability, you have set the risk buffer as customary, and it's not that there are visible signs of decline in profitability due to some difficulty, am I correct?

A: I can't say exactly which period the growth will be recorded, but the public system usually starts its operation and generates sales at the end of the calendar year or fiscal year.

And in FY2024, we are not working on many more particularly difficult projects compared to previous years. We estimate costs and risk expenditures according to the difficulty of each project, and in that sense, I think the profit will be similar to previous years.

Q&A Session 2

Q: Regarding the business combination cost, in FY2023, it seems that it was used as planned with a particular focus on Q4, but I would like to ask you about the progress of the PMI.

Also regarding the JPY30 billion planned for FY2024, which region are you going to focus on? Insights on quantitative or qualitative directions would also be helpful.

A: I would like to broaden the scope a bit and start from the explanation of the structural transformation on page 22 of the presentation material. We have been working on structural transformation in each region, and we believe we have taken all the steps necessary to achieve them, except for certain parts such as system integration.

We have examined the contents of the business combination cost, including IT integration, integration of bases, strengthening of sales force, and personnel optimization, and as a result, we have expected the cost to be about JPY30 billion in FY2024. We are planning to implement them as soon as possible to realize the benefits sooner.

If we expand the period to FY2025, we are expecting JPY10 billion to JPY20 billion. This has not yet been fully scrutinized, but we are thinking that we will peak the spending in FY2024 as much as possible and reduce it to a level within JPY20 billion.

Also, regarding the effects of the business combination, we are expecting JPY30 billion in benefits in FY2025, and we believe we are mostly on track so far.

Q: I think that the business combination cost has increased from the initial plan you made when you acquired NTT Ltd. You said you have scrutinized the contents, but what is the major reason for the increase, and which region is increasing? Also please tell me if there is any possibility that there will be one more increase.

A: We have been conducting enough scrutiny while working on it by establishing new leaders and structures since we announced the concept of new business units in FY2023, so we do not think we will be too far off the mark in terms of our estimates for FY2024 and the projections for the cost peaking in FY2025 and beyond. Especially when it comes to IT, we use a lot of ERPs, so we have found that IT integration entails significant expenditures.

As for the weight of each region, Europe has a larger number of companies as we have implemented numerous acquisitions and mergers, and there are still many areas of IT that need to be integrated, so I believe that Europe accounts for a large percentage of the total.

I would like to make one additional point. During the briefing on May 9, we said the business combination synergy for FY2025 will be JPY40 billion. This meant a positive synergy of JPY40 billion. Netting the business combination cost of JPY10 billion, the synergy for FY2025 will be JPY30 billion.

Questioner 3

Q&A Session 1

Q: I would like to ask about the performance trends of the data center business. Based on page 27 of the presentation material, please elaborate on the initiatives taken in FY2023 and the assumptions for the FY2024 plan.

A: In terms of results, revenue, EBITDA, and EBITDA margin have all been progressing better than the plan. The amount of investment in FY2023 was approximately USD2,700 million, equivalent to JPY390 billion, which is also on track. Margin in FY2023 was 45%, but there was a gain of JPY15.6 billion, or about USD100 million, from data center sale, so if we subtract that amount, the margin is about 39%.

Demand is very strong, and the demand from hyperscalers is strong in particular, so we are not too worried about orders or sales. Of course we have competition in the industry, so we aim to build a strong position and achieve figures that exceed the plan. In this sense, we think we are doing well for the most part.

Q: Please also explain your thoughts behind the FY2024 plan. There will be quite a bit of interest burden in FY2024 as well. Could you please briefly explain the background behind this?

A: Our plan for FY2024 is, as shown on page 27 of the presentation material, we will increase sales and profit by thoroughly fulfilling the orders we have already received. As for profit, EBITDA margin is expected to hover around 40%.

As for the amount of investment, we want to proceed so as not to lose out to competition, looking at demand trends. The target is set as similar level as FY2023 in a broad sense.

Regarding the interest burden you all are concerned about, as for investment in data centers, there is a growing demand in Japan, so we have been focusing on domestic investment even more, but overseas investment still accounts for a higher percentage overall, and in principle, funding is in US dollars for the US, euros for Europe, and Indian rupees for India. Because of this, financial expenses or interest burden are expected to increase by about 15 billion compared to FY2023.

The actual net profit for FY2023 was just under about JPY 134 billion, and the forecast for FY2024 is JPY137 billion, so some may say there is not much of an increase, but one reason for this is that since we are in a phase of rapidly launching the data center business, the financial expenses are outpacing sales and profits.

For the entire company, for FY2025, we revised the level of sales to be 4.7 trillion, and aim to raise the margin level substantially as well. As for net profit, the FY2024 figure may look like a slight increase, but in FY2025, we intend to raise the level of profit significantly as well.

Q&A Session 2

Q: You talked about the topic of optimizing or strengthening the balance sheet a year ago. From an external perspective, it looks like you are behind the initial plan, but is that just due to the effect of the exchange rate?

Is the capital investment progressing as planned, or are there delays? Are you going to continue to do it yourself for the foreseeable future because it is hard to find a third-party due to the high interest rates?

Based on this, you said that you would move forward with REIT in FY2025, but please tell me the likely area and scale. Also, as you are using REIT, should we expect that asset sales will not happen in FY2024?

A: Regarding financial soundness, as shown in the right-hand side of page 28 of our presentation material, our progress as of FY2023 was mostly on track to the level we had initially expected.

In FY2024, we do not expect sale of data centers and we are putting more focus on considering REIT, so our plan is set like this and the level of net debt/EBITDA ratio is higher than originally projected.

As for REIT, we are still considering various options, but as to how much we will sell ultimately, we would like to make a final decision by assessing the balance between the return we will get from holding the assets and the benefits we will get from selling them, so we cannot tell you the scale of the monetary amount at this point. We are of course making a list, and in terms of the areas, the United States and Europe are among the candidates.

From the beginning we had planned to implement an asset-light strategy to reduce assets by about JPY500 billion during the period from FY2022 to FY2025. So far we have reduced by about a little less than JPY100 billion, so we have JPY400 billion to go. For this, we will of course implement the sale of the data centers, but we will also consider streamlining other assets we have. But as a result of various decisions we will make considering the whole picture, if the reduction resulting from data center sale amounts to only about half of the JPY400 billion, there is a good chance that Net Debt/EBITDA ratio will land at above 2x.

However, we have set this target of 2x because we still believe that we should proceed with a certain degree of discipline. We will naturally have to decide what is the best to increase the total value of the entire Company with an eye to the future, so on those and other matters, we will listen to your opinions and ultimately control them.

Q: I understand very well.

Questioner 4

Q&A Session 1

Q: As for REIT, I have imagined listed ones, but shouldn't I imagine large ones as you are starting on a trial basis first? Also, regarding the final target of the data center business, if you don't have a clear future vision of how much return you want to achieve and in how many years, I get very concerned about how long a business that will not contribute to your net profit will last, so I would like you to show us the vision as early as possible.

A: As for your question about the details of REIT, at this stage, I would like to refrain from giving a specific answer to the question. To do something sizable, I think listing may be necessary, but we will make a final decision on the monetary scale and what form to take after further consideration.

As for the targets of data center business, we said the medium-term target is USD1.4 billion as profits for FY2027. Of course we aim to keep the EBITDA margin as high as the current margin, so if you divide this by 0.4, you will get the scale of sales. In the medium- to long-term, our major direction is that the increase in profits will gradually catch up with the increase in financial expenses.

Q: I understand. Both NTT Corporation and your company set an EBITDA target, but I wonder if it is possible to set a target for profit attributable to shareholders such as EPS. Only net profit is attributable to shareholders, so as a message to the stock market, I would like you to show us a net profit target as well in the future.

A: We received similar comments on this point at the NTT Corporation's analyst meeting held on May 10, and as we responded at that time, we will deliberate on it going forward.

Q&A Session 2

Q: I think the big advantage of your company in the data center business compared to your competitors is that you are based in Japan and you can use financial capacity in Japan. I am not sure what other advantages you have.

The CFO of NTT Corporation announced the use of yen carry trade, but in reality, there has been almost no yen carry trade implemented. How should I interpret this?

A: We took some measures to reduce financial expenses in FY2023. But maybe, from the level you are expecting, it was not enough. We reduced financial expenses by about JPY1 billion by switching from variable-rate to fixed-rate borrowings, and about JPY2.5 billion by implementing yen carry trades for half a year.

However, we also need to consider an ALM perspective. Borrowing in yen may reduce financial expenses on P&L, but we will have to take exchange rate risks at the same time because if the yen appreciates, we will incur a foreign exchange loss. This means that the foreign currency translation adjustments on the balance sheet will also be impaired, which will have an impact on the net assets. But of course, there is the issue of cash flow. We also have to assess the risk magnitude and the recent exchange rate situation and other factors. Therefore we have an impression that it is difficult at this moment to go that far where we drastically reduce financial expenses through individual measures.

Q&A Session 3

Q: I think the payout ratio is very low. Before, you said that there would be room for improvement. What is your current thinking about dividends?

A: We recognize that there are calls for an increase in dividends.

As shown on page 29 of the presentation material, the payout ratios for FY2023 and FY2024 have been slightly increased from 24.1% to 25.6%, although you may think this is not enough.

As for dividends, naturally our policy is to increase our operating profit and then the net profit as the whole Group, and distribute it in the form of dividends. Therefore we intend to fully pay back the increase in overall profit in the form of dividends. The actual amount of dividends is increasing at a trend similar to the trend in FY2023 and FY2024. As I have just explained, we believe there is ample room to increase the absolute dividend amount by raising the level of net profit, therefore we expect to increase the ordinary dividend by 2 yen in the FY2024 forecast.

As for the dividend payout ratio itself, we do not have a fixed target, but from the viewpoint of maintaining the dividend payout ratio over the medium term, 25% is our guideline. Going forward, we will make our decision based on the opinions of our shareholders and investors.

Q: Thank you. I understand.

Questioner 5

Q&A Session 1

Q: It says NTT Ltd. recorded net sales of JPY1,241 billion in FY2023, of which JPY282.7 billion was from the data center business. What is the current status of other businesses?

A: We can divide NTT Ltd.'s business into three main categories: data center business, telecommunications terminal and network equipment business, and other IT infrastructure business.

As for the telecommunications terminal and network equipment, comparing between FY2022 and FY2023, sales have increased by about JPY20 billion, but excluding the positive impact of foreign exchange rates of about JPY39 billion, sales would have actually decreased.

However, the supply chain issues have been mostly addressed and are moving towards improvement, and since FY2023, we've been working to improve the gross profit margin by not only selling telecommunications terminal equipment but also adding value when selling it to clients.

As for the IT infrastructure business other than data center business, net sales declined YoY by about JPY8 billion. Again there was a positive impact of foreign exchange rates of about JPY19 billion, so if we exclude that, it was actually a decline of about JPY27 billion. It declined because the figure includes withdrawn businesses such as the teleconferencing system business, but in the managed services business, we are receiving many inquiries from clients, and sales increased YoY even excluding the effect of exchange rate fluctuations. We intend to continue to strengthen this business.

Q&A Session 2

Q: I would like to ask about the difference in operating profit between the total of the three businesses in Japan and the Japan Segment in the FY2024 forecast on page 20 of the presentation material. The difference expanded from negative JPY28.4 billion in FY2023 to negative JPY44 billion in FY2024, and this will result in a YoY decrease of operating profit, so I would like to know the breakdown.

A: The negative difference expands by JPY15.6 billion from FY2023 to FY2024. The majority of this is due to the increase in amortization as well as maintenance and operation costs of the new internal system released in FY2024 for domestic companies.

Besides that, there are incremental costs for strategic investments, as well as for security countermeasures undertaken by the entire group, which are not allocated to each business individually.

Q: If it is the amortization burden, it is a very transparent and almost definite figure, is it?

A: Yes, that's right.

Q: I see.

Questioner 6

Q&A Session 1

Q: I would like to ask whether JASTEC is factored in the FY2024 plan. And if it is, to what extent?

A: We have already announced about JASTEC in the form of takeover bid. Although only to a certain extent, we are expecting a certain impact on our performance, assuming that it will be successful.

Q&A Session 2

Q: When competing with other companies in the data center business, in what ways do you win or lose? I think it could be power induction, floor space, land for expansion, or many other things. I would appreciate it if you could remind me what the competition points are.

A: Regarding the competitive element in the data center business, each region has its own characteristics, but generally speaking, demand for data centers has been very strong, and there have been a significant number of inquiries from hyperscalers, so the huge bottleneck when building a data center is power source at the moment.

Therefore, the speed of building a data center with secured power source is very important, and we will take care not to fall behind in speed through land banking or by securing power source ahead of time.

Q: Is it possible to lose due to an insufficient amount of power supply?

A: What I just said was about where to get the power from, and at the moment we are not losing because of insufficient power capacity in the data center itself. What you are probably worried about is whether the current data centers will be sufficient to run a huge number of GPUs after the spread of generative AI. The ones we will build in the future will be designed and built so that they can integrate those GPUs, so I don't think we will generally be in trouble in that sense. There have actually been more cases of installing a large number of GPUs in a data center and offering services to clients, but no such problem has manifested.

Q: I understand.