

Earnings Presentation QA for Q3 (October-December) of
Fiscal Year Ending March 2012

Date/Time: January 26, 2012 18:00-19:10
Location: NEC Headquarters, Tokyo
Presenters: Nobuhiro Endo, President
Isamu Kawashima, Associate Vice President and CFO

Questioner A

Q. Could you please provide a breakdown of the headcount reduction of 10,000 employees as part of the current round of restructuring? Do the 3,000 overseas job cuts mainly involve factory jobs? Could you please go over the schedule and segment departments subject to the headcount reduction?

A. We have yet to finalize a detailed breakdown of the 10,000 job cuts. However, the job cuts will be split mostly evenly between permanent employees and contract employees. We are currently looking at the details, and will need some more time to make a final determination. We plan to execute the reduction in the first half of the fiscal year ending March 31, 2013 with a view to delivering effects in the second half. In the fiscal year ending March 2013, we are targeting an improvement of around 40 billion yen in operating income, half of which is expected to come from the headcount reduction. The other half will be derived from other initiatives.

Q. NEC announced a 20 billion yen reduction in R&D expenses compared to previous forecast. Do you plan to generate part of the 40 billion yen improvement in operating income from those cuts in R&D expenses?

A. Cost reductions will be directed at other expenses, not R&D expenses. In the fiscal year ending March 2014, we are targeting savings of few billion yen through initiatives other than the headcount reduction.

Q. In the mobile terminal business, NEC has reduced the mobile terminal shipment forecast again after lowering it at the 1H earnings announcement. How do you view these developments? Going forward, what is the break even point for mobile terminals in terms of shipment? What was the mobile terminal business' actual profitability in Q3, and what is its full-year forecast for profitability?

A. The reason for the most recent forecast revision was that smartphone shipments fell short of expectations. Smartphone shipments were progressing well until Q2, but started diverging from expectations in Q3. NEC brought several innovative models to market. However, consumer interest shifted from hardware to LTE compatibility, or the ability of mobile terminals to make use of networks. At present, LTE-compatible smartphones are attracting considerable consumer interest. NEC misread the markets by not launching an LTE terminal during Q3, and we must acknowledge this mistake. That said, although NEC is a latecomer to LTE terminals, I believe that we can catch up and regain lost ground.

It is difficult to put a figure on the number of mobile terminal shipments needed to break even, because this also depends on the product mix. However, we believe that one key

benchmark is 6 million units a year. Given that iPhone has made landfall in Japan, NEC must now move into overseas markets to increase shipment volume. Currently, NEC is supplying mobile terminals to Verizon of the United States, so our top priority is to expand business in the U.S. In other areas, we are also working to reach out to customers in Latin America and other regions.

The mobile terminal business made an operating loss of more than 6.0 billion yen in Q3 alone. On a full-year basis, we are projecting an operating loss of around 9.0 billion yen this year, factoring in the impact of the Q3 operating loss.

Q. How many development personnel work in the mobile terminal business? How many of these jobs will be cut?

A. We have yet to determine our personnel policies in this respect. However, we expect to reduce development personnel to a certain extent by utilizing Joint Design Manufacturers (JDM). That said, we must balance these sorts of job cuts with the need to actively allocate resources to certain areas in order to increase shipment volume. Collaboration with JDMs will be vital to make lean cost structure. JDMs have design capabilities that NEC does not possess, along with a sharp eye for selecting components. We aim to bolster our cost structure by taking full advantage of JDMs in these respects.

Questioner B

Q. Will restructuring expenses end in the current fiscal year or will NEC continue to book these expenses next fiscal year and beyond? You said that a detailed breakdown of the headcount reduction of 10,000 employees has yet to be determined. Net sales look likely to fall below 3 trillion yen. In this situation, will white-collar workers in NEC Headquarters also face job cuts? Is the latest round of headcount reductions just a trim around the edges, or does it represent a fundamental “reset” of NEC? How serious is NEC? Could you please comment on the company’s resolve in this regard?

A. In its mid-term growth plan, NEC established the targets of net sales of 4 trillion yen and an overseas sales ratio of 25%. However, we now believe that it will be virtually impossible for us to achieve these targets in next fiscal year. Therefore, we will build next fiscal year’s budget from net sales of 3 trillion yen. In order to ensure operating income, we will need to execute painful restructuring measures. One key priority is to move NEC closer to an operating income ratio of 5% by actively transforming our performance in difficult business domains.

Q. I believe that NEC is constantly struggling because of the lack of top-line growth, along with low cost effectiveness. Is the latest round of headcount reductions just another attempt to balance the books as before? Or will the job cuts completely streamline the organization and show that NEC has made a clear turnaround?

A. I believe that the headcount reductions will be closer to the latter—a clear turnaround. We consider the restructuring expenses of 40 billion yen to be an investment. It is imperative that we establish a robust cost structure to maintain business viability with net sales of 3 trillion yen.

Q. What is the breakdown of your full-year mobile terminal shipment forecast of 5 million units in Japan and overseas? Also, could you please sum up the reasons why growth in the overseas mobile terminal business has fallen short of target?

A. We expect to ship 35% of mobile terminals overseas.

The overseas mobile terminal business has not grown as much as expected because

our initial estimates reflected ambitious targets. In light of strong expectations for LTE services in the U.S., NEC has received requests for LTE terminals from its customers. Initially, we were planning to supply 3G smartphone models, but we had to drastically change our plans. In Japan, NEC will rapidly launch an LTE-compatible smartphone in February 2012. Overseas, we aim to make inroads into the LTE smartphone market early next fiscal year.

Q. *Could a lack of investment in mobile terminals explain why the mobile terminal business has continued to underperform forecasts?*

A. We misread the mobile terminal development roadmap to a certain extent. We thought that February 2012 would be the right time to launch an LTE terminal.

Questioner C

Q. *What portion of the anticipated cost reduction of 40 billion yen do you expect to achieve irrespective of net sales? If sales increase, won't the projected cost savings of 40 billion yen get smaller?*

A. We expect to achieve all of the cost savings irrespective of any increase in sales.

Q. *In the event that the mobile terminal business does not improve with the latest management reforms, do you have a plan to take more drastic measures? Can we expect to see a continuous series of management reforms, in addition to current measures?*

A. We must press on with continuous restructuring. However, we don't believe that headcount reductions should be continued indefinitely. We will continuously strive to transform ourselves, but we hope that the current round of personnel measures will be enough to deliver results.

Q. *Will NEC face any financial problems as a result of its most recent net loss forecast of 100 billion yen, such as a breach of financial covenants or the need for an injection of capital?*

A. In regard to our financial position, NEC had an equity ratio of 29% at the beginning of this fiscal year. As a result of the projected net loss of 100 billion yen, we expect the equity ratio to decrease by around 3 percentage points to 26%. We believe that this level of equity does not represent a large impact on our financial position. We do not believe this will have a negative impact on fund procurement, as we are not subject to any restrictions such as financial covenants.

Q. *Won't there be an impact if pension obligation shortfalls are moved on to the balance sheet?*

A. Assuming that pension obligation shortfalls were moved on to the balance sheet, we estimate that this would reduce net assets by 140 billion yen. We have been steadily addressing pension obligation shortfalls for some time, and do not believe that they present an issue.

Q. *Page 14 of the presentation materials states that NEC will focus on the IT Services, Carrier Network, Social Infrastructure and Energy businesses. These businesses together represent around 2 trillion yen in net sales. How will NEC address the remaining 1 trillion yen of business, such as the mobile terminal business? What exactly do you mean by "focus"? Will you concentrate investment in these key businesses?*

A. We aim to transform the four key businesses into strong earnings drivers. By

contributing positively to customers, we intend to generate profits in each of these business fields.

In the mobile terminal business, we believe that having a user interface is essential for NEC's business execution. We believe that ownership of this technology is necessary.

- Q. *NEC has reduced R&D expenses and depreciation by a combined 25.0 billion yen. Therefore, is it correct to assume that NEC expects earnings from actual business operations to fall 45.0 billion yen below the initial plan?*
- A. NEC has reduced R&D expenses in line with the decrease in mobile terminal sales. Therefore, rather than viewing R&D expenses and depreciation as negative factors in their own right, we would like you to consider the net decrease in earnings after adjusting for these factors.
- Q. *Could NEC divest assets or take similar actions going forward? In businesses outside of your areas of focus, will you consider such actions as divesting operations to external partners? Or will NEC maintain its current business portfolio?*
- A. In businesses outside of NEC's core strengths, we will review our tie-ups with external partners as a matter of course. For example, NEC TOKIN is currently focused on capacitors and related businesses. Because it excels at developing materials, I expect NEC TOKIN to continue developing innovative materials. Taking into account such factors, we will consider all actions from a comprehensive viewpoint.

Questioner D

- Q. *NEC has posted a valuation allowance for deferred tax assets for reasons other than the change in Japan's corporate tax rate. Is this because of a change in earnings for tax planning purposes? Or does this reflect a change in the standard number of years for realizing deferred tax assets? How are these figures viewed internally? Is there any similar risk from next fiscal year onward?*
- A. Our plan for collection of deferred tax assets was previously based applying stress to earnings targets in the "V2012" mid-term growth plan. Following the revisions to our business forecasts, we have withdrawn deferred tax assets on the basis of the application of further stress to our revised earnings targets. We have recorded a valuation allowance assuming a very conservative estimation of future earnings.
- Q. *How did you decide on the figure of 10,000 employees for the headcount reduction? Is it because cutting 10,000 jobs will make a noticeable difference in terms of transforming production, development and sales three months and half a year down the road? How will NEC look after the restructuring?*
- A. The figure of 10,000 employees was chosen because that is the number of job cuts necessary to improve operating income by 40 billion yen. It wasn't chosen on the basis of numbers alone. NEC must generate operating income of around 100 billion yen even with net sales of around 3 trillion yen. We have therefore adopted a restructuring plan that will have a positive impact of 40 billion yen on earnings. The objective of the current round of restructuring is to produce the positive effect of improving earnings by 40 billion yen.
- Q. *Telecom carriers have recently experienced technical issues. Has there been any impact on NEC's infrastructure equipment business in Japan?*
- A. Capex is determined by our customers. NEC's policy is to contribute to the fullest extent possible to those investments. Our customers cannot easily upgrade their network

infrastructure all at once, so I assume that they plan to phase in upgrades over time. I suspect that an unanticipated surge in data traffic and “keep alive” functions unique to smartphones might have stretched their network capacity. We believe that NEC must enhance its ability to address the data traffic problem so that it can contribute to its customers.

Questioner E

Q. Can I correctly assume that the main target of the current round of restructuring is the mobile terminal business? Alternatively, would I be correct to assume that NEC, as a network infrastructure provider, has no intention of exiting the mobile terminal business? Or, do you intend to maintain the NEC brand while minimizing risk? What is your current approach?

A. Our first step is to strengthen the structure of the current mobile terminal business. We must utilize JDMs to strengthen the business. It is absolutely essential that we remain cognizant of user interfaces as we execute the cloud business. For that reason, NEC needs to retain mobile terminal technology within the company. However, owning technology and running a business are not necessarily the same.

Therefore, after strengthening the current business, if we find that the mobile terminal business will grow stronger through a partnership, we will be open to such an option.

Q. Do you mean that NEC could own the mobile terminal business in different ways than now?

A. If we have an option that will definitely make the mobile terminal business stronger, including partnerships, then we would consider taking it. We believe we should treat such a decision as NEC’s strategic alliance with Lenovo on PCs.

Questioner F

Q. You said that NEC will execute structural reforms in the mobile terminal business. What are NEC’s assumptions for market conditions? Are you assuming that NTT DOCOMO will start selling iPhone? You said that NEC will break even at 6 million units. How does sales volume break down in Japan and overseas markets?

A. It is difficult to be certain about the future, but we cannot completely rule out the possibility that NTT DOCOMO will start carrying iPhone. Above all, we believe that it is crucial for NEC to increase mobile phone shipments to the 6 million-unit, including overseas markets.

Q. Fujitsu has announced that it will reassign 30,000 SEs in IT services to different job categories. Is NEC addressing the situation with the same urgency? Could Fujitsu streamline its operations before NEC, compelling NEC to follow in its footsteps with further restructuring in IT services?

A. With the current round of restructuring, we are looking at how to develop a robust earnings structure in each business unit, including IT services. At present, the systems integration (SI) business accounts for the bulk of the IT business. However, I believe that one key priority is to increase service business. We will remain mindful of the need to foster service-oriented personnel, including personnel at affiliated companies, as we strive to increase service business.