April 27, 2012

Earnings Presentation QA for Fiscal Year Ended March 2012

Date/Time: April 27, 2012 19:00-20:00
Location: NEC Headquarters, Tokyo
Presenters: Nobuhiro Endo, President
Isamu Kawashima, Associate Senior Vice President and CFO

Questioner A

Q. How do you view your financial forecasts for the fiscal year ending March 31, 2013? IT Services segment is projecting a 4.7% year-on-year increase in sales. In what fields does the IT Services business expect sales to grow?

A. One field where sales growth is anticipated is large projects in Japan. As indicated on page 23 of the presentation, we expect strong demand for smartphone-related business and the renewal of systems due to realignment of the financial sector. Furthermore, we intend to grow public sector, including the National ID project, in addition to the earthquake recovery-related projects in the Tohoku region. And we anticipate growth of overseas business based on strong demand in the Asia-Pacific region for security area. NEC implemented an acquisition of Global View S.A. engaging video surveillance services in Latin America, which should also contribute to growth.

Q. I had expected the National ID project to start making a large contribution to business results in the fiscal year ending March 31, 2015. Do you now expect this project to be brought forward?

A. We expect major developments in regard to the National ID project to start taking effect next fiscal year and the fiscal year after that. However, in the fiscal year ending March 31, 2013, we will see preparations for the system get under way.

Q. In the Carrier Network segment, operating income is projected to increase only 4.9 billion yen in the fiscal year ending March 31, 2013, despite a projected year-on-year increase of 92 billion yen in sales. This means that earnings will effectively remain flat without the positive impact of 5 billion yen from restructuring. I also believe that the Carrier Network business will incur an increase in amortization of goodwill in relation to the acquisition of the BSS business of Convergys. Does this mean that your strategy is focused on sales expansion overseas?

A. There are several investments, including investment in manufacturing operations in India. Those factors have been deducted from the operating income forecast.

Q. Could you please provide breakdowns of sales and operating income in mobile terminals, and PCs and others, in the Personal Solutions segment? What were results for mobile terminal shipments in the fiscal year ended March 31, 2012, and what is the shipment forecast for the fiscal year ending March 31, 2013?

A. In the fiscal year ended March 31, 2012, the Personal Solutions segment recorded sales of 661 billion yen. This breaks down into mobile terminal sales of 301 billion yen and PCs and others sales of 360 billion yen. In terms of operating income, mobile terminals recorded an operating loss of 5 billion yen, whereas PCs and others recorded operating income of just over 5 billion yen. The Personal Solutions segment is forecasting sales of 610 billion yen in the fiscal year ending March 31, 2013. This forecast breaks down into projected sales of 296 billion yen in mobile terminals and 314 billion yen in PCs and others. In terms of the operating income forecast, mobile terminals is projecting operating income of 10 billion yen, while PCs and others is expected to break even.

In the fiscal year ended March 31, 2012, mobile terminal shipments results were 4.2 million units. In terms of regional breakdown, shipments in Japan in approximation accounted for just under 70% of the total, while overseas shipments accounted for just over 30%. The share of shipments of smartphones and featured phones was about 50% each. In the fiscal year ending March 31, 2013, domestic and overseas shipments are projected to account for around 60% and 40% of total shipments, respectively. The share of shipments of smartphones and featured phones is projected at just under 70% and just over 30%, respectively.

Q. How do overseas mobile terminal shipments break down by shipments to North America and other regions?

A. We expect to ship almost all of our overseas mobile terminals to North America.

Questioner B

Q. By reducing fixed costs by 30-40 billion yen through the headcount reduction of 10,000 and other measures, NEC should be able to generate operating income of 100 billion yen even without sales growth. However, considering the positive impact of sales increase, don't you think that the earnings forecast could be increased further? On the other hand, the sales forecast seems ambitious in certain respects. What is your view on these forecasts? Do you really expect to generate operating income of 100 billion yen even with flat sales? If sales fall short of forecast, will you then have trouble reaching the 100 billion yen operating income forecast?

A. We believe that operating income will finish the year at just under 100 billion yen assuming net sales of 3 trillion yen. Because we have pooled 20 billion yen for strategic investments, we actually have the ability to generate operating income of 120 billion yen on net sales of 3.15 trillion yen. In the event that sales are unlikely to reach our forecast, we have the option of not using half of the total strategic investments of 20 billion yen — the 10 billion yen in strategic investments pooled for the second half. Recently, there has been a growing necessity for investments spanning multiple businesses. We have pooled 20 billion yen for strategic investments that will not be allocated to any specific segment.

Q. How much restructuring benefits do you expect to reap monetarily in the first and second half of the fiscal year ending March 31, 2013?

A. For the full year, we are estimating restructuring benefits of 40 billion yen.

Because restructuring will be completed in the first half, much of the benefits will appear in the second half. Meanwhile, NEC has started implementing salary reductions from the first half of the current fiscal year. Accordingly, we anticipate restructuring benefits of 13 billion yen in the first half and 27 billion yen in the second half.

Questioner C

Q. What impact would a change of 1 yen in exchange rate assumptions for the fiscal year ending March 31, 2013 (1 U.S. dollar=75 yen, 1 euro=100 yen) have on operating *income?*

A. In terms of foreign exchange rate sensitivity, a change of 1 yen against the U.S. dollar would have an impact of around 0.5 billion yen on full-year operating income, while a change of 1 yen against the euro would have an impact of 0.4 billion yen.

Q. Eliminations/unclassifiable expenses were 51.4 billion yen in the fiscal year ended March 31, 2012, 18.2 billion yen higher than in the previous fiscal year. What was the main reason for this increase? Furthermore, NEC is forecasting eliminations/unclassifiable expenses of 70 billion yen in the fiscal year ending March 31, 2013, an increase of nearly 20 billion yen year on year. Can I assume that this increase corresponds to the strategic investment expenses of 20 billion yen?

A. One reason for the increase in the fiscal year ended March 31, 2012 was IT investment centered on SAP. Amortization costs due to the start of system operation, as well as expansion of the system to subsidiaries contributed 5 billion yen to the increase in these expenses. Next, NEC started incurring incubation costs for new businesses from the fiscal year ended March 31, 2012, which also contributed 5 billion yen to the increase in these expenses. Furthermore, there was an increase of around 1 billion yen in advertising costs, along with increases of around 4 billion yen from the elimination of unrealized income (loss) on fixed assets.

And, 20 billion yen year on year increase in these expenses in the fiscal year ending March 31, 2013 represents strategic investments for future growth.

Q. Does that mean that investment in IT and new businesses in the fiscal year ending March 31, 2013 will be largely unchanged from the previous fiscal year?

A. Basically, we expect these investments to remain mostly the same as in the fiscal year ended March 31, 2012.

Q. Assuming that sales for the fiscal year ending March 31, 2014 remain flat year on year, around how much operating income do you expect to generate? Some of the positive impact of salary reductions will end in December. How should we view the operating income forecast?

A. If sales remains flat, we would project exactly the same amount of operating income in the fiscal year ending March 31, 2014 as in the previous fiscal year. Basically, we must continuously execute strategic investments, and therefore we expect operating income to remain at 100 billion yen.

Although the benefits of urgent measures will eventually fade out, some of these benefits will appear for only six months in the fiscal year ending March 31, 2013. Since these benefits can be reaped year-round (for 12 months) in the fiscal year ending March 31, 2014, we also expect a positive impact of 40 billion yen in that fiscal year compared to fiscal year ending March 31.

Questioner D

Q. How should we view your outlook for a constant level of operating income, not just for the fiscal years ending March 31, 2013 and 2014? Does NEC believe that operating income of 100 billion yen is a level that can be attained comfortably without assuming any improvement in the business environment? Based on this assumption, does this mean that NEC will generate cash flow of around 50 billion yen a year?

A. We believe that the restructuring benefit of 40 billion yen will remain in place going forward. We also believe that operating income of around 100 billion yen is well within reach. We should also be able to generate cash flow of around 50 billion yen.

Q. NEC has cash in hand of around 250 billion yen. Considering the transition to IFRS, I don't believe that NEC has very much latitude in terms of its financial position. What kinds of financial strategies will NEC implement when executing large investments as part of the new Mid-term Growth Plan?

A. Managing cash flows will be a key priority for our financial strategies under the Mid-term Growth Plan. We will examine to what extent we can optimally balance debt with raising the efficiency of our own assets. We will consider financial strategies with the view to streamlining assets. In certain cases we will replace assets in the business portfolio to pave the way for the next round of investment.

Questioner E

Q. What is the nature of the strategic investment of 20 billion yen? Will the funds be invested in R&D, capital expenditures, M&As or other types of investment? Will these investments be allocated to business segments?

A. One key area of strategic investment will be OpenFlow technology. We have already conducted basic research in OpenFlow in the Carrier Network segment and Platform segment. However, we must combine the technologies of both segments in certain fields of business. The strategic investments will cover these sorts of outlays. Furthermore, we will use strategic investment expenses to recruit staff members in areas where we have yet to determine which business department will be responsible for various projects in new business domains, such as the smart city field.

Q. Why did free cash flow in the fiscal year ended March 31, 2012 improve compared to forecast?

A. In the fiscal year ended March 31, 2012, NEC generated positive free cash flow of 34.2 billion yen, although we had expected mostly break even. The improvement was largely due to Company-wide efforts to accelerate cash conversion such as by collecting accounts receivable. In the fiscal year ending March 31, 2013, we are expecting to make payments of 50 billion yen related to restructuring. Taking these payments into account, we aim to break even in terms of free cash flow for the fiscal year. These cash outflows also include payment of just under 40 billion yen for the acquisition of the BSS business of Convergys.

Q. Are the strategic investments included in projected R&D expenses of 170 billion yen for the fiscal year ending March 31, 2013?

A. The strategic investments are not included in the projected R&D expenses.

Questioner F

Q. NEC reversed deferred tax assets at the 3Q. While I believe that there were other reasons for taking this action besides the tax rate reduction, what are your current assumptions for deferred tax assets? What specific time frame and level of earnings are you now assuming?

A. Our approach to deferred tax assets has not changed since 3Q. We have recorded a valuation allowance assuming a constant level of operating income of just under 100 billion yen. Even with some variability in earnings, we do not believe that there will be any problem regarding the realizability of deferred tax assets.

Q. I assume that the operating income forecast for the mobile terminal business of 10 billion yen for the fiscal year ending March 31, 2013 includes NEC Mobiling, Ltd.. In that the case, excluding NEC Mobiling, Ltd. the operating income forecast for the mobile terminal business itself would be a breakeven result. As far as management's current view on the mobile terminal business is concerned, does this mean that management is content as long as the mobile terminal business breaks even at the operating income level? I got the impression from your briefing at the 3Q earnings presentation that management would begin considering whether or not to continue this business if it were unprofitable. Under what conditions would management determine that the mobile terminal business can no longer be continued?

A. We believe that 5 million units is the breakeven point for the mobile terminal business. Our first goal is to reach this number of mobile terminal shipments. However, the domestic mobile phone market is almost matured, and we believe that a large number of providers will enter the Japanese market going forward. Accordingly, we will seek to expand into overseas markets. We are targeting a sales volume with a ratio of domestic to overseas sales of 50:50 or 60:40. Also, we believe that we will need to form a partnership of some kind in order to increase sales volume. Having said that, with mobile terminal shipments of 5 million units, we believe that we will constantly need to consider partnerships. However, it is not always possible to find good partners. Furthermore, we intend to retain mobile terminal technology within the company in order to develop end-to-end services and actively execute the cloud business overseas.

Q. Adopting IFRS may provide the opportunity for NEC to restore its fund-raising capabilities, such as re-registering in the U.S. How are IFRS considerations proceeding at this time?

A. We are preparing to adopt IFRS on a voluntary basis. However, we believe that we must carefully consider the timing of implementation given that the schedule for mandatory adoption in Japan has yet to be determined, new standards that were set to be issued by 2011 have not emerged, and the IFRS movement has toned down in the U.S. At present, we have no fixed schedule.

Questioner G

Q. For the fiscal year ending March 31, 2013, why is NEC forecasting net income of only 20 billion yen on operating income of 100 billion yen?

A. In the fiscal year ending March 31, 2013, NEC expects to book extraordinary income and an extraordinary loss, but they are projected to mostly cancel each other out. Net income is affected by minority interests in income, which is partly a reflection of the strong performance of NEC's listed subsidiaries. At present, net income is also subject to changes in the status of equity method affiliates.

Q. What were the sales results of the PASOLINK, submarine cable system and LTE businesses in the fiscal year ended March 31, 2012? What are your forecasts for these businesses?

A. The PASOLINK business posted sales of 77 billion yen in the fiscal year ended March 31, 2012, 8 billion yen below forecast. This was mainly due to the impact of weak investment in Europe. In the fiscal year ending March 31, 2013, the PASOLINK business is forecasting sales of 80 billion yen.

In the fiscal year ended March 31, 2012, the submarine cable system business reported sales of 39 billion yen, 6 billion yen below forecast. This was because the effective date of the agreement for the APG (Asia Pacific Gateway), a large-scale project, was carried over. In the fiscal year ending March 31, 2013, the submarine cable system business is forecasting sales of 60 billion yen.

In the fiscal year ended March 31, 2012, the LTE business posted sales of just over 30 billion yen. In the fiscal year ending March 31, 2013, the LTE business is targeting higher sales, but we cannot give specific figures at this time.

Q. What is the profitability of the PASOLINK and submarine cable system businesses?

A. In the fiscal year ended March 31, 2012, the PASOLINK business posted a small operating loss. In the fiscal year ending March 31, 2013, this business expects to almost break even. The submarine cable systems business posted solid earnings in the fiscal year ended March 31, 2012, and is projecting firm earnings in the fiscal year ending March 31, 2013.