

Earnings Presentation Q&A for 3Q (October-December) of
Fiscal Year Ending March 2013

Date/Time: January 31, 2013 18:15-19:10
Location: NEC Headquarters, Tokyo
Presenter: Isamu Kawashima, Associate Senior Vice President and CFO

Questioner A

Q. By how much did actual results in each segment exceed your budget?

A. Looking at operating income in the third quarter, the IT Solutions segment exceeded its operating income budget by about 2 billion yen. IT Services was above target, while Platform was in line. In the Carrier Network segment, operating income exceeded the budget by around 8 billion yen, including one-time gains on intellectual property transactions of several billion yen. In the Social Infrastructure segment, operating income was around 3 billion yen above target, thanks to strong sales. In the Personal Solutions segment, operating income was in line with the budget, despite lower-than-expected mobile handset shipments. This mostly reflected cost reductions and a higher-than-anticipated performance in PCs and Others. The Others segment was mostly on target.

Q. Adding up the segment results, does this mean that operating income exceeded your budget by around 13 billion yen on a Company-wide basis?

A. That is largely correct.

Q. Operating income was much higher than your budget for the first half and third quarter. Assuming no change in this trend, operating income should continue to increase in the March quarter. At this rate, operating income for the full year could reach 150-160 billion yen. Could you please explain any specific factors that could prevent this from happening, such as temporary costs or additional upfront investments?

A. We still expect to generate 30% of annual sales in the March quarter. We will need to remain vigilant as the outlook is still uncertain. Our explanations do not assume any major positive or negative factors.

During the current fiscal year, we are budgeting for strategic investments of 20 billion yen. We used around 6.5 billion yen of this budget during 9 months. We have approved strategic investments worth around 17 billion yen against the 20 billion yen budget. However, we have yet to allocate the remaining 3 billion yen. We will consider whether or not to use this budget in the March quarter. In the March quarter, we expect to execute strategic investments of 10 billion yen or more.

In regard to whether the portion of operating income that exceeded our forecast through 9 months will remain in the March quarter, this operating income included earnings that were brought forward from the March quarter. Factoring this into the equation, we must watch carefully to see whether we can generate earnings in the March quarter as in past years.

- Q. *NEC won an order for the next core banking system of Sumitomo Mitsui Banking Corporation. I have the impression that this project will primarily involve replacement of hardware. Will this project also involve software? Can I correctly assume that this project will impact business performance for the next two years or so?*
- A. Considering our relationship with the customer, among other factors, we cannot comment on details. Given that the system upgrade is scheduled for completion in fiscal 2015, we believe that the impact will last for around two years.

Questioner B

- Q. *Could you please explain your sensitivity to exchange rates? Which businesses will benefit, and which businesses will be negatively impacted?*
- A. For every depreciation of 1 yen there will be a positive impact of around 0.5 billion yen on operating income for the full year. That said, the impact in the March quarter alone will be limited and not very large. There will be a large positive impact on the Carrier Network segment, which has a lot of business overseas. We also expect the Personal Solutions segment to be positively impacted.
- Q. *I believe that the mobile handset business has more-or-less returned to operating profitability in the second half. Meanwhile, NEC has noted that it will explore strategic partnerships in this business. Now that the business is profitable, what is NEC's approach to the partnership strategy? Will you revise this strategy?*
- A. Volume is crucial to the mobile handset business. Accordingly, we have not revised our approach of keeping all options on the table, including partnerships.
- Q. *Considering non-consolidated earnings, dividends and so forth from the standpoint of Japan's tax code, are you planning to take any specific actions to change your internal structure in regard to non-consolidated earnings?*
- A. We are not currently considering any specific actions in this regard.
- Q. *In the Social Infrastructure segment, NEC has noted that sales should remain at a high level, albeit flat. Since the change in Japan's government administration, I believe that there are heightened expectations for this business. What are your expectations for changes in this business in the current fiscal year and heading into next fiscal year?*
- A. In the Social Infrastructure segment, we have received orders for large projects in the current fiscal year. Some projects cover a long period and will continue into next fiscal year. Since this business is based on orders, not mass-market sales, we believe that sales should continue to increase going forward.
- Q. *You said that sales in the Social Infrastructure segment should continue to increase based on orders received in the past. I am interested in future projects in this segment. Could you please explain what areas these projects will fall under and your outlook for them?*
- A. Let me illustrate with an example. The Japanese government has planned a supplementary budget of around 10 trillion yen for the current fiscal year. NEC has access to fields related to post-quake recovery and Big Data, among others. We believe that these fields represent around 20% of the overall budget. Our future course will be determined by how many of these projects we can win.

Questioner C

Q. *What exactly do you mean by “gains on intellectual property transactions” in the Carrier Network segment? Specifically, what kind of amount are you envisaging when you say several billion yen? In the first half, NEC sold LCD patents to Hon Hai Precision Industry Co., Ltd. Did this transaction happen by chance or was it part of NEC’s intellectual property strategy?*

A. We cannot disclose details on the temporary gains on intellectual property transactions due to counterparty issues. We have always invested in intellectual property. These assets comprise both intellectual property used in business and intellectual property that is effectively utilized through sale to third parties and others. These transactions are not necessarily unique to the current fiscal year. This year’s transactions of intellectual property just happened to involve large sums of money.

Q. *NEC noted at the previous earnings presentation (10/26) that NTT’s investment in mobile network infrastructure had peaked at that time. What is the current situation? Have approaches to infrastructure investment changed since the new LDP administration took over?*

A. We cannot comment on a specific customer’s investment trends, but data traffic continues to increase at this time. That said, we expect lower infrastructure investment in the March quarter than in the third quarter.

Q. *I suspect that conditions in the PASOLINK business should change when the yen weakens. Could you please go over the current situation regarding market share and earnings for PASOLINK?*

A. In the PASOLINK business, we had expected customer investment sentiment to recover, but conditions have proven difficult. PASOLINK is still one of the top 3 in terms of market share, but it is currently in third place. We have regained some market share compared with before.

Q. *Free cash flow doesn’t seem to have improved. Was the free cash flow result of negative 60 billion yen for the third quarter better than your forecast? Assuming that NEC posts operating income of more than 100 billion yen for the full year, by how much will free cash flow exceed your target of breaking even in the current fiscal year?*

A. As you said, we aim to break even in terms of free cash flow for the full year. To this end, we are enhancing our activities to shorten the cash conversion cycle (CCC). We finished the first nine months of the fiscal year with an extremely strong number. This free cash flow result is after the use of 100 billion yen in cash, comprising 40 billion yen for retirement costs associated with structural reforms and 60 billion yen for the acquisition of two companies. We believe that we are on the right track, and that positive free cash flow for the full year is now within reach.

Q. *Did you include M&As in your initial target of breaking even in terms of free cash flow for the full year? If operating income is higher than the forecast, will free cash flow also exceed the forecast by the same amount?*

A. We are currently looking closely at how much free cash flow we can generate in excess of the forecast. Since one of the M&As was decided after the initial forecast was issued, it was not included in the initial forecast.

- Q. *Did any transactions related to intellectual property in the Carrier Network segment involve communications technology? The transaction with Hon Hai Precision was in a non-core business field. However, assuming that core technologies in the Carrier Network segment were sold, will everything be okay?*
- A. The transaction with Hon Hai Precision consisted of the sale of patents. However, considering the customer relationship, we cannot disclose details on the transaction.

Questioner D

- Q. *In the mobile handset business, NEC CASIO Mobile Communications, Ltd. has achieved profitability. Can I correctly assume that the company has established an earnings structure that can break even at mobile handset shipments of around 800 thousand units? In terms of the impact of foreign exchange fluctuations, will the yen's depreciation have a negative impact on earnings in this business?*
- A. In the third quarter, we conducted cost cutting and other measures. Quarterly mobile handset shipments of 800 thousand units equate to 3.2 million units on an annual basis. However, we need to look closely at whether or not we can break even at this volume. Because we use Joint Design Manufacturers (JDM) overseas, foreign exchange fluctuations can have a negative impact on earnings in some respects. However, since we also procure some components from overseas, foreign exchange fluctuations do not necessarily have a straightforward impact on earnings.
- Q. *I have a question about personnel costs for the current fiscal year. I believe that employees participating in the early retirement program retired on October 31, 2012. Can I correctly assume then that this will have a positive impact for two months in the third quarter and three months in the March quarter?*
- A. As part of the early retirement program, approximately 2,400 employees retired in the end of September 2012. Therefore, there was a positive impact for three months in the third quarter. For the full fiscal year, there will be a positive impact of six months.
- Q. *Naturally, I assume there will be positive impact for 12 months next fiscal year. On the other hand, would I be correct in assuming that the immediate pay cuts implemented in the current fiscal year will be reversed next fiscal year? What is your outlook for overall personnel costs, taking into account the headcount reductions and cuts in personnel costs?*
- A. Next fiscal year, we expect to reverse the pay cuts implemented in the current fiscal year. At this time, we have already reversed the pay cuts of union members, and we also expect to reverse those of management level employees going forward. Even after reversal of these pay cuts, we expect the positive impact of the early retirement program next fiscal year to be twice as large as the structural reform benefits of 40 billion yen recorded in the current fiscal year. In the current fiscal year, we implemented immediate cost reductions from the first half because the early retirement program was only to produce savings for six months. However, even without savings from the immediate cost reductions next fiscal year, we still expect to generate a positive impact of 40 billion yen as a result of year-round savings from the early retirement program as well as reduction of external resources.

- Q. In the Carrier Network segment, earnings were generated in the third quarter of the previous fiscal year, mainly from 3G-related business. In the current fiscal year, did earnings in this segment surpass the forecast because gains on intellectual property-related transactions were added to roughly the same level of earnings as in the third quarter of the previous fiscal year?*
- A. Operating income in the third quarter of the current fiscal year increased from the corresponding period of the previous fiscal year due to a boost from gains on intellectual property-related transactions as well as structural reform benefits.
- Q. In the third quarter of the current fiscal year, I believe that the Carrier Network segment recorded lower earnings from 3G-related business and higher earnings from LTE-related business, compared with the third quarter last year. I suspect that the segment is still generating earnings from investment by telecom carriers. How long do you think this situation will continue?*
- A. In the third quarter of the current fiscal year, we believe that telecom carriers continued to make a considerable amount of investment to address growing data traffic. We will be looking a little more closely at trends in the Marchquarter. Although we cannot be absolutely certain since investment is up to customers, we don't expect investment in this field to decrease sharply.