

**Earnings Presentation Q&A for 1H (April-September) of Fiscal Year Ending March 2014**

Date/Time: October 30, 2013 18:00-19:00

Location: NEC Headquarters, Tokyo

Presenters: Nobuhiro Endo, President

Isamu Kawashima, Senior Vice President and CFO

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**Questioner A**

*Q. Could you please go over the domestic Telecom Carrier business? Did first-half net sales increase or decrease year on year? Also, do you expect growth in traffic to generate new demand going forward?*

A. Sales from the domestic fixed-line network business increased year on year, but sales from the mobile network business decreased. In the first half of the fiscal year ended March 31, 2013 (fiscal 2013), one of our customers decided to move forward a major investment that had been originally planned in the second half of the fiscal year. This had the effect of proportionally reducing first-half sales in fiscal 2014 in year-on-year terms. In the second half of fiscal 2014, however, we do not expect the change to be as pronounced as in the first half. In terms of our future direction, we anticipate that new areas such as Software-Defined Networking (SDN) could expand, whereas investment by telecom carriers in hardware equipment is projected to decrease. Overseas telecom carriers are showing an even stronger interest in SDN, which provides a means of boosting efficiency, than we had originally anticipated. In fact, we are being requested to introduce SDN as early as possible. Furthermore, we should see an increase in the need for SDN and Telecom Operations & Management Solutions (TOMS) in Japan over the next 3 years. Therefore, we expect to offset the decline in hardware sales with SDN and TOMS sales. In the LTE area, we expect demand to continue to arise to because of expansion in coverage areas, and growth in traffic, among other factors.

*Q. To what extent has NEC benefited from Japan's economic recovery?*

A. Considering that NEC is primarily engaged in the infrastructure business, we believe that NEC will be slower to benefit from the economic recovery compared with improving business sentiment in areas encompassing consumer fields. That said, in the Public business, NEC has seen greater infrastructure investment than initially anticipated, and this has pushed up orders received. In the Enterprise business, we have seen strong sales to the retail and service industries along with infrastructure investment, but sales to the manufacturing industry have edged down. However, considering that the economic recovery will be slower to filter through to the manufacturing industry than to consumer spending, we expect demand to emerge in the manufacturing industry from the second half. We believe that the economic recovery in Japan will have a positive impact on both of these businesses, and we have factored this into our full-year forecasts. In the System Platform business, we are projecting expansion in IT-related investment such as business PCs, driven by demand to update Windows XP.

*Q. Do your latest financial forecasts reflect the positive impact of the economic recovery?*

A. Yes.

*Q. Could you please discuss NEC's progress on restructuring? Will NEC reshape its business portfolio further? What kind of portfolio would be ideal? Also, how will the number of employees and divisions change going forward?*

A. NEC reaped benefits of 40 billion yen from restructuring carried out in fiscal 2013. We believe that we have produced results with respect to the number of employees, this will continue to contribute positively to earnings. Turning to business restructuring, NEC announced revisions to its mobile handset business strategy in July 2013. The semiconductor, PC and mobile handset businesses had been destabilizing factors, but we have now set a clear direction for them, although this took 3 years. We finished the first half of fiscal 2014 with an overall operating income of 0.4 billion yen due to losses in the mobile handset business. However, there should be no more negative impact in terms of operating profit from the mobile handset business from the second half of the fiscal year. We have yet to produce tangible results along with overall course for growth, so we will strive to successfully implement our growth strategies by increasing orders.

## Questioner B

*Q. Could you please give forecasts for full-year operating income and net income of NEC CASIO Mobile Communications, Inc.? Do you now expect to break even in terms of operating profit after having taken various actions, including the use of NEC Saitama, Ltd.?*

A. In the first half, the mobile handset business posted an operating loss of about 17.0 billion yen, and an extraordinary loss of about 11.0 billion yen. In total, this business reported loss before income taxes of about 29.0 billion yen. The net loss was around the same amount. In the second half, we plan to break even in terms of operating profit, including NEC Saitama, Ltd. Looking ahead, we need to identify the one-time losses incurred by the related companies, including those overseas. All in all, we could incur a one-time loss of around several billion yen. However, we intend to offset this loss by taking countermeasures throughout the entire company.

*Q. Could you please explain the extraordinary loss booked in the first half in a little more detail?*

A. The bulk of the extraordinary loss was related to the write-off of smartphone inventories. Having booked this loss, we have now completed the necessary write-offs. In other areas, we booked costs relating to maintenance activities.

*Q. The Public and Enterprise businesses appear to slow down in the second half. Do your full-year forecasts reflect the new orders received in the first half? Although there were loss-making projects, I believe that your earnings targets could be set a little higher. Is there any reason why you haven't raised your forecasts?*

A. In the first half, there were a few loss-making projects, particularly in the Public business. Earnings growth was therefore offset by the impact of these projects. In the Enterprise business, we recorded a negative impact of about 1 billion yen due to project lineup changes, in addition to some upfront investments. In the second half, although we know of no loss-making projects that will definitely emerge at this time, we have come up with a conservative forecasts. Therefore, if less loss-making projects emerge than in the first half, there will be upside potential in the second half.

*Q. The presentation covered progress on Mid-term Management Plan 2015. I believe that the plan puts emphasis on Asia, which hasn't been touched upon yet. I have the impression that NEC lacks a compelling track record in expanding business overseas. Looking at recent projects, NEC has teamed up with the Japan Bank for International Cooperation (JBIC), the Japan International Cooperation Agency (JICA) and other such organizations. Has NEC shifted gears from its activities in years past? Although none of these projects are very large individually, I believe that some of them hold promise for the future. Please explain a little more about how these projects differ from overseas business expansion in the past, and your current approach.*

A. Before I became president, NEC primarily developed overseas business by marketing network products abroad. There have been no major changes to this approach today. However, considering domestic IT market conditions, I believe that it will be imperative for NEC to expand both the IT and network businesses overseas in the years ahead. Over the past 3 years, we have endeavored to expand by establishing regional headquarters, or by launching technological competence centers overseas. However, I deeply regret that these initiatives have been slow to get up and running. To make certain that our direction is to develop business projects overseas and to increase our sensitivity to local needs and speed business development, we established the Global Safety Department (GSD) in Singapore. As a result, we are more strongly aware that our direction is to venture out overseas in both IT and networks. NEC is now able to go out and win ODA projects related to networks together with the Japanese government. Prime Minister Abe and other government officials have made a considerable number of trips to Asia. Although ODA projects have so far been centered on water and road projects, the government now understands the importance of communications infrastructure. Therefore, we can now proactively go out and win projects. Furthermore, in Vietnam, satellite projects are starting to be treated as ODA projects. NEC would like to proactively lobby for projects to which it can make a contribution.

*Q. Renesas Electronics has increased its capital, and the shares it issued have become NEC's investment securities. If the shares can be sold after a 2-year lock-up period, I believe that NEC will have the opportunity to utilize the past valuation losses for tax purposes. Am I correct in assuming that you are actively preparing to make use of those securities? Or will you continue to hold the Renesas Electronics shares for business reasons?*

A. The Renesas Electronics shares will be treated as ordinary investment securities from the second half. We will then decide on our future policy on these shares. We have yet to decide whether or not to continue holding the shares. In any case, we will be looking at this issue very carefully.

#### **Questioner C**

*Q. NEC's first-half operating income was 10 billion yen below its forecast. How does this shortfall breakdown by segment?*

A. The Public business performed in line with forecast, while the Enterprise business fell short by around 1.0 billion yen. The Telecom Carrier business met its forecast, while the System Platform business was about 2.0 billion yen below forecast. In the Others business, the mobile handset business and smart energy business underperformed forecasts by 2.0 billion yen and 3.0 billion yen, respectively.

*Q. What is your free cash flow forecast for fiscal 2014?*

A. That should be discussed in the context about what we will be spending our cash on. Besides our ordinary cash outflows, we acquired trust beneficiary rights set to land and buildings of the NEC Group's Tamagawa business facilities in fiscal 2014. Factoring in this acquisition, we expect to break even in terms of free cash flows. If we carry out an M&A, for example, this will result in a commensurate negative free cash flow.

*Q. NEC will need to generate operating income of 100.0 billion yen in the second half to attain its full-year forecast. What is the likelihood of achieving your target, and what measures will be taken in the second half to make up for lost ground?*

A. Based on our initial internal assumptions, we were forecasting operating income of 10.0 billion yen in the first half, and 90.0 billion yen in the second half. These forecasts assumed a projected deterioration in the mobile handset business, and the absence of a patent sale recorded in the first half of fiscal 2013, which had a positive impact on operating income. We believe that we can make up for the underperformance in the first half mainly in the Public, Enterprise and System Platform businesses, where SI-related orders are increasing. In the second half of fiscal 2013, NEC posted operating income of around 67.0 billion yen on net sales of 1,600.0 billion yen. In the second half of fiscal 2014, we expect to generate operating income of around 70.0 billion yen, as net sales are projected to be mostly unchanged from the same period last year. In addition, we expect to break even in the mobile handset business, from a loss of around 14.0 billion yen in the second half of fiscal 2013. We also expect an improvement of around 17.0 billion yen in SI-related fields. With these two factors combined, we should be able to increase earnings by around 30.0 billion yen in the second half. Accordingly, we have not revised our full-year forecasts. For fiscal 2014, we are still projecting net sales of 3,000.0 billion yen, operating income of 100.0 billion yen, and net income of 20.0 billion yen.

**Questioner D**

*Q. I believe that the second-half improvement of 10.0 billion yen against the initial forecast will be mainly based on contributions of several billion yen each from the Public and Enterprise businesses. Could you please give your image of the breakdown? The smart energy business underperformed in the first half. Will it be able to make up for lost ground in the second half? Please also comment on the status of the PASOLINK and submarine cable systems businesses.*

A. We fielded a greater number of inquiries in the Public and Enterprise businesses than we had anticipated. Extrapolating from this trend, we expect the Enterprise business to post strong sales to the manufacturing industry from the second half, in addition to continuing strong sales to the retail industry. In the smart energy business, we believe that electric power companies pared back investment in the first half more drastically than we had expected. In the PASOLINK business, we are hoping for a recovery in demand in India. However, progress has not been made because of the radio frequency issue. That said, the new PASOLINK models we have developed are succeeding in slowly penetrating the market. Therefore, we expect to start producing results in the second half particularly in Russia and Asia. In the submarine cable systems business, NEC won an order in Indonesia in the first half. In addition to our current projects, the new project in Indonesia will begin later this fiscal year. In terms of our image of the projected 10.0 billion yen increase in the second half, we see the Public business as offering the greatest potential. We believe that SI-related demand will increase, followed by demand in the System Platform business, such as servers, and the Enterprise business. In the smart energy business, we significantly increased development expenses in the first half, and this caused the business to fall short of forecast. We will work to achieve our full-year net sales targets of 75.0 billion yen in the PASOLINK business and 50.0 billion yen in the submarine cable systems business.