

Q&A Session for Public Business Briefing Presentation

Date/Time: March 13, 2014 16:00-17:20

Location: Urbannet Otemachi, Tokyo

Presenter: Tomonori Nishimura, Executive Vice President, Public BU

Questioner A

Q. During the presentation, you explained that business results have been improving slightly and growth has been increasing in the fiscal year ending March 2014 (fiscal 2014). Can I correctly assume that business performance in fiscal 2015 will lie on the dotted line in the graph on page 13 of the presentation materials, between fiscal 2014 and fiscal 2016? If so, the forecasts for fiscal 2016 should be easily attainable. Does this mean that you are not projecting lower earnings on lower net sales in fiscal 2015?

A. We do not expect business results in fiscal 2015 to decrease from fiscal 2014. One of the features of the Public Business is that we conduct business directly with customers in the government, public and financial institution sectors, and we make projections based on their medium-term plans. In fact, in fiscal 2014, our business results have started to outperform the assumptions of NEC's Mid-term Management Plan 2015. Notably, there was a surge in demand in fiscal 2014 such as Field Communication Systems, partly special procurement from the government. We believe that the growth rate in the Public Business will return to a normal level from fiscal 2015 onward. That said, as we mentioned earlier, there are factors that will push investment higher than expected, such as investment in 2020 Tokyo Olympic/Paralympic games infrastructure and the national ID number system. For this reason, we seek to outperform our forecasts, factoring in supplemental budgets, while positioning current forecasts for fiscal 2016 as the bare minimum we must attain.

Q. I believe that upfront investment for the future will be crucial to building an overseas (non-Japan market) business framework. You noted that NEC has outstanding technologies. Could you please explain in a little more detail how big of an opportunity NEC has from an objective perspective, by elaborating on NEC's strengths and weaknesses, as well as its business opportunities and risks?

A. To give you a few examples of our technologies, there is no other company in the world that is working on disaster-tolerant ad-hoc network technology. Nor is there any other company in the world that can use invariant analysis technology to detect abnormalities in a facility 7 hours in advance. We hope that customers will get to know NEC through its breakthroughs in these fields. We also intend to use these breakthroughs to succeed in other businesses as well. We believe that we will eventually face competition from emerging players in each of these fields. Based on our outstanding technologies, we intend to prevail in niche fields where we are competitive, rather than plunge headfirst into fields embroiled in fierce price-based competition.

Questioner B

Q. How long is the preparation lead-time and what amount of personnel and resources are involved in a typical project in the Public Business? In cases where NEC has 3-5 years to prepare for a project, how many people make up the project team, including research laboratory, hardware, and software personnel, and how does NEC generate a profit? Outside Japan, project planning must be complicated by differences in the business customs and practices of government ministries and agencies. How will NEC address these challenges?

A. In Japan, we have a good understanding of the features of the project formation process, man-hours and lead-times, and other project aspects for each customer. For projects with long lead-times, we begin preparations several years in advance. Outside Japan, we have set up the Global Safety Division (GSD) in Singapore to explore effective marketing approaches in local markets, among other tasks. GSD is trying to make inroads into overseas markets by gathering information on business processes through global marketing activities and sharing information with us in Japan. In addition, NEC could win sales channels by teaming up with systems integrators and consulting firms. Through these activities, we see the fiscal 2014 to 2016 period of more than two years as a time to prepare for advancement to our next stage of growth.

Q. Could you please provide any specific examples of project man-hours and lead-times, and resources?

A. Air traffic control radar projects require several years to complete the design, manufacturing, evaluation and other stages. There are several engineers involved in each project. It took a couple of years to launch wireless equipment for disaster prevention purposes by applying Field Communication Systems. Our basic approach is to develop cutting-edge technologies mainly in Japan, and to appoint local groups of specialists as systems integrators to customize the technologies for local markets. GSD represents a major step forward in our efforts to transfer the initiative to locally led operations.

Q. Could you please discuss earnings of international business? If your international sales ratio reaches 15% by fiscal 2018, will you attain profitability? Is it conceivable that you may incur losses in fiscal 2016 and fiscal 2017 due to upfront investments?

A. We see the Mid-term Management Plan 2015 period from fiscal 2014 to fiscal 2016 as an investment period. During these years, we will improve our earnings capacity by 1% every year, while channeling this earnings growth to investment. The end result will be an operating margin of 8%. Investment is needed mainly in product development and human resources, which will serve as growth drivers in international markets.

Q. How fast is new orders received growing?

A. At present, new orders received are growing faster than net sales. For example, with the inclusion of large projects such as quasi-zenith satellite systems, new orders received are trending favorably.

Questioner C

Q. I believe that the entire national ID number business is worth around 250.0 to 270.0 billion yen in scale. What share of this business do you think you can capture?

A. We are anticipating a business worth around several hundred billion yen in scale. Some of our customers include municipalities that have already installed NEC systems. We see national ID number systems as a part of the systems we will provide mainly to these customers. We see the national ID number business as an integral part of systems upgrade and replacement work on the systems we have delivered to date. We are strongly determined to win orders for projects from customers who are existing users of NEC systems. We are at the stage where the tendering and bidding process of projects for central government ministries and agencies are about to begin. We estimate a business scale of around several 10 billion yen from these customers at this stage. We believe that the scale of business for projects at the municipality level will be even greater.

Q. For quasi-zenith satellite systems, I believe that the satellites themselves are manufactured by third parties. You noted that NEC is involved in satellite operations. What kind of business is this?

A. There are two kinds of quasi-zenith satellite system businesses. The first business involves becoming the operator of a satellite system on behalf of the government. In this area, NEC is conducting the representative role of Special Purpose Company (SPC) that has received a comprehensive order from the government to deliver maintenance and operational services for ground systems. We have been tasked with the mission of operating satellite systems such as management of navigation signals through 2025. The satellites themselves are separate from this operation business. NEC has taken on some mission systems duties related to navigation, which is separate from the examples explained today. Furthermore, there are application businesses using navigation satellites.

Q. In fiscal 2014, net sales are projected at 745.0 billion yen and operating income 57.0 billion yen. In fiscal 2016, net sales are projected at 780.0 billion yen. Based on an operating margin of 8%, operating income would amount to 62.4 billion yen. This would imply operating income is projected to increase by only 5.0 billion yen. Is this because of the impact of development expenses?

A. Development expenses represent around 2-3% of net sales. In fiscal 2018, we will target an operating margin of 10%.

Questioner D

Q. Please illustrate the changes in net sales through fiscal 2016 in the Public Business' priority domains under Mid-term Management Plan 2015: administrative services, defense, public safety, transportation, water, and media. Also, could you please identify the high-margin domains and the low-margin ones?

A. The current share of net sales is as follows: public safety accounts for 30%, administrative services 20%, defense 10-20% and transportation, water and media a combined 10-20%. As for changes in net sales, we do not anticipate sizable growth from administrative services due in part to a proposal by the Japanese government Chief Information Officer (CIO) to streamline investment, although growth is expected from the national ID number system. We hold the highest hopes for the public safety and transportation and water domains, followed by the defense domain. There are no major differences in projected profitability, although profit margins will vary yearly. We are targeting a combined operating margin of around 8-10%.

Questioner E

Q. How many employees does the Public Business have at present? Could you please provide a breakdown of employees in Japan and outside Japan, and illustrate any anticipated changes in the workforce from fiscal 2016 to fiscal 2018?

A. Public Business currently has around 14,000 employees. Employees outside Japan are not counted as part of the Public Business segment. However, we intend to increase the employees outside Japan's headcount by around several hundred employees going forward.

Q. It appears that you are putting emphasis on introducing systems, including hardware, in the course of expanding business overseas. Will you entrust systems operation and maintenance work to local partners, without proactively pursuing these activities on your own? As for geographic expansion, in which regional markets will you focus on expanding business globally?

A. We cannot significantly break free of our traditional business scale by relying on equipment sales alone. That is why we intend to enter the systems operation domain. Local systems integrators will be crucial to this task. Naturally, we will collaborate with local partners, although we may have to shift to locally led efforts. With regard to geographic expansion, we will collaborate with GSD, which we established in Singapore, to vigorously push ahead with activities in the transportation, disaster prevention and other network infrastructure domains centered on the ASEAN region.

Q. Will the workforce increase by several hundred employees every year?

A. We seek to increase headcount by around several hundred employees for international markets in fiscal 2015 and 2016. We have not set clear numerical targets for subsequent years. However, we believe that there will be a need to increase personnel on an even greater scale in those years.

Q. Will your local partners capture the added-value portions of the systems operation and maintenance businesses?

A. Although we will collaborate with partner companies, unless we take part in the actual operations, we will be unable to contribute to infrastructure safety and security in the big data and cyber security fields. We will participate in systems operation and maintenance services together with local enterprises.