

Earnings Presentation Q&A for the Six Months of the Fiscal Year Ending March 2015

Date/Time: October 30, 2014 18:30-19:30 JST
Location: NEC Headquarters, Tokyo
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Questioner A

Q. Public business remains strong with good performance in Q1 and Q2. Will the momentum continue into Q3 and Q4? How long can Public business keep its high performance?

A. Public business has shown substantial growth in firefighting and disaster prevention areas. We expect that the strong momentum continues into next fiscal year. There are also elevated investments by local governments for “my number” or the national ID system. It is expected that ID cards are distributed to public in October 2015 and some services using the system will launch in January 2016. Additional systems related to “my number” should begin to operate from January 2017 and we expect a good amount of investments will be spent accordingly. In a few years, we anticipate active investments for ICT in transportation, safety, multi-lingual systems areas in preparation for Tokyo Olympics and Paralympics 2020. We expect solid investments in public sectors to continue into 2018 to 2019.

Q. Please comment on progress in Midterm Management Plan 2015. Which part of the plans is ahead of the schedule and which parts are getting behind?

A. The plans were formed based on investments by customers, which suggest that they are not likely to get ahead of the schedule. We focus on expanding Public business in the global market, particularly in Asia, Africa and the Middle East. NEC is working to provide solutions on a platform, which then can be fine-tuned to best suit our customers. This concept is what we call “One to Many”—one platform to serve many systems and solutions. By applying “One to Many” concept to solutions for public sectors, we expect many opportunities ahead. To further accelerate our global expansion, we began discussions at “matrix meetings,” where 50 members from global headquarters and 50 members in Japan put their heads together to analyze solutions and areas that are best suited to be offered as “One to Many” solutions. It may take several months to narrow down the list, but we are confident that these activities will lead to successful business in the global market.

Questioner B

Q. While there are no changes to the fiscal year outlook, the company mentioned that it aims to over-achieve the outlook. In which areas will the company outperform the target outcomes? Please refer to profits, expenses and tax.

A. By segment, Public continues to perform well while Telecom Carrier recovers from weak performance in 1H and attains target outlook for the fiscal year. The company outlook does not preset easy targets, but we are committed to achieving them.

Looking at profits, as mentioned at the beginning of the fiscal year, the company outlook does not include 5 billion yen decrease in depreciation of pension which may push up profits, while operating expenses are shrinking.

As for tax, the government is considering lowering corporate tax rates, in which case, the company will record valuation allowance for deferred tax assets. In this fiscal year, the company includes 10 billion yen of valuation allowance in its outlook for net income, which is an estimate amount the company records when corporate tax rates lower by 2%. In 1H, the company recorded 8 billion yen in minority income from consolidation of NEC Fielding as a fully owned subsidiary. This should offset the impact from changes in corporate tax rates.

Q. Please comment on sales, profits and depreciation of goodwill, and currency impact in NetCracker business. How is the business environment for TOMS?

A. We are enjoying a good business environment for NetCracker. Sales are increasing year on year, and while price competition is intensifying, we see strong needs for the TOMS solution.

Goodwill is depreciated by straight line. We expect that goodwill for NetCracker will be fully depreciated within a year, which leaves us with goodwill of Convergys. Currently, NetCracker is about to turn into black even with depreciation of goodwill.

Q. Is there any impact from appreciated Russian and Ukrainian currency?

A. We do not expect much impact from currency fluctuations.

Q. Enterprise business is improving but its margins are still low compared to other dedicated IT vendors. What are company plans with Enterprise business? NEC should obtain 20% or higher margins by leveraging its unique technologies.

A. In Enterprise, most of the projects are individually customized and require development costs. We are working to provide solutions on a platform and offer them as “One to Many” solutions. We expect Enterprise business to attain 5% as an initial step in improving its operating margins. We will also transform its business model into that of consulting. Ultimately, we will turn the business into

“One to Many” solution provider with added value of consulting.

Questioner C

Q. What is the expected share of SDN business?

A. Currently, we are working to secure a contract in this very new market for SDN. There are 20 projects underway, and we believe a successful commercialization of a project will catalyze the market. Competitors include network infrastructure vendors and IT solutions vendors. The competition is fierce but we concentrate in gaining an account from a global telecom carrier and we aim to attain 10% in market share going forward.

Q. Are those competitors providing field trials like NEC?

A. We believe they are. Our technology is well received by customers and we are often among 3 or 4 vendors invited for a business pitch.

Q. How long does it take to close an order?

A. It normally takes approximately six months or more. We believe Telefonica, Spain will become our first telecom carrier customer.

On the other hand, we are observing a strong momentum in implementing SDN to data centers, particularly for governments and enterprises. NEC already holds track record of more than 200 systems in Japan, and we believe that we can expand to enter the global market as well.

Q. Is “One to Many” a package solution?

A. Yes, it is. Currently, we spend development costs by each customer in delivering solutions, even when we have resembling solutions on our hands. In order to streamline overlapping development costs and technology assets, we will shift from “One to One” business to “One to Many.” In “One to One” business model, we deliver solutions which are customized to meet all the requirements by customers. In this business model, we can develop systems which deliver value that customers pay for. By contrast, in “One to Many” business model, we will apply a common platform to many customers as possible, while meeting their requirements. In this business model, we need to market the value of our solutions to customers by presenting how it will help their businesses. The concept has not been commonly practiced at NEC, particularly in IT related divisions, but we will alter our mindset in accelerating “One to Many” business. We will work on process to deliver “one platform” which can respond to diversifying needs of our customers.

Q. Many of the competitors are practicing similar concept. Does NEC have a strong branding power? Is there a strong platform lineup? What are expected margins?

A. To give an example of a strong platform, we offer *NeoFace*, a highly sophisticated, value-added solution for face recognition in safety business.

The target margins for these platforms are 10% and more. We will work on cost efficiency of these platforms by practicing “One to Many” business model sharpen their competitive edge in global market.

Questioner D

Q. There are markets arising for IoT and M2M. To what level will the standardization of M2M likely be set, and will NEC be involved in standardization process? What kind of business opportunities are related to wireless base stations for M2M?

A. We suspect that standardization of interface for M2M is not an easy task, but a transition to 5G network may be the key. Currently, sensors carry little amounts of information and the current network has enough capacity to deliver throughput. When sensors carry more information such as video files, the current network will not maintain enough capacity. The video files carry useful information and by processing and analyzing these data via software, they become valuable products.

We anticipate that business opportunities in M2M market will bloom in the 5G network era. NEC can offer its services in next generation network, and we are working on some solutions at the research center.

Q. When do we see an actual profit from the new market?

A. We believe that a progress in ICT, including in M2M, will be seen in 2020, the year of Tokyo Olympics and Paralympics.

Q. In considering currency fluctuations and increased costs in China, what is NEC’s view in shifting PC manufacturing to Japan? Also, please comment on in which segment sales and profits of PCs are recorded.

A. Please note that PCs are in Lenovo’s business domain, not NEC’s. NEC is in partnership with Lenovo for business PCs only, and Lenovo is responsible for manufacturing. Therefore, we cannot make any comment on the manufacturing strategy for business PCs. Sales and profits of business PCs are included in System Platform.

In general, manufacturing in Japan may be cost efficient today, considering that not so long ago, yen was appreciated at 80 yen per U.S. dollar. Ultimately, mass manufacturing of hardware will eventually shift to Vietnam or India. On the other hand, mother factories and manufacturing of highly sophisticated products such as space systems and satellites, should be kept in Japan to compete in the global market.