

July 31, 2018

**Earnings Presentation Q&A for Q1, the Fiscal Year Ending March 31, 2019**

Date/Time: July 31, 2018 17:30-18:20 JST

Location: NEC Headquarters, Tokyo

Presenters: Takayuki Morita, Senior Executive Vice President and CFO

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**Questioner A**

*Q. Could you please describe how your Q1 business results performed against your internal targets?*

A. Operating profit was approximately ¥4.0 billion above our internal target. The Public business and Others contributed ¥3.0 billion and ¥1.0 billion, respectively, to this result.

*Q. Could you please provide an update on any subsequent developments pertaining to the sale of the electrode business?*

A. We are currently continuing negotiations on the sale of the electrode business in earnest. We believe the sale can be realized during the current fiscal year as initially planned. Accordingly, we have not revised our financial forecasts.

*Q. Could you please go over the factors behind the ¥5.0 billion improvement in operating profit/loss in the Others?*

A. There was an improvement of approximately ¥2.0 billion due to the reallocation of development expenses for the IoT services platform that had been carried by the Others to each business unit, profit in the electrode business of approximately ¥1.0 billion and an improvement of approximately ¥2.0 billion due to the withdrawal from the small energy storage systems business and the streamlining of administrative staff costs. These improvements totaled ¥5.0 billion.

*Q. Why did the System Platform business post a decline in earnings, despite mostly flat sales?*

A. Earnings in the System Platform business declined because it strategically selected orders. This impact is expected to be offset in Q2 onward.

*Q. As NEC's newly appointed CFO (Chief Financial Officer), could you (Takayuki Morita, Senior Executive Vice President) please share your perspectives on the main issues facing NEC, and discuss your commitments?*

A. For the management team, including the President, our greatest objective is to ensure that we achieve an operating margin of 5% in the fiscal year ending March 31, 2021, as set forth in the Mid-term Management Plan. In my view, one pressing issue facing NEC is that it has outstanding technologies, but it is not very good at monetizing and commercializing those technologies. Currently, NEC's R&D expenses have fallen below 4% of revenue. I would like to enable NEC to allocate 5% of revenue to R&D expenses, while maintaining an operating margin of 5%.

Moreover, as CFO, I would like to conduct management with a focus on long-term earnings. If a project will lead to sustainable earnings growth, I would like to consider it as an option even if a decision to approve such a project may lead to fluctuations in profits in the short term.

## **Questioner B**

*Q. I have learned that the sale of the electrode business has been cancelled, and NEC is now looking for a new buyer. Meanwhile, I believe that the electrode business has been improving recently. If NEC is unable to find a buyer, what impact will this have on the ¥10.0 billion gain on sale of the business that is forecast as part of operating profit for the current fiscal year? Although I doubt that it will make very much difference, could you please also discuss what the impact would be if NEC were to continue operating the electrode business as it is now?*

A. I cannot speak with complete certainty on this matter as it will happen in the future. However, the management team is committed to doing what it has promised. Therefore, we would like to get this done and explain the outcome within the current fiscal year.

*Q. How does the electrode business stand?*

A. In Q1, the electrode business posted operating profit of ¥1.0 billion on revenue of ¥10.0 billion. It is not imposing any short-term burden on management as a business. However,

we don't see any valid reason for NEC to retain ownership of this business over the long term. Therefore, we plan to divest this business.

*Q. NEC reported that IT services orders increased by 7% in Q1. Could you please go over this growth rate by industry sector?*

A. In our view, the IT services market is basically strong. Orders increased by 14% in the financial sector, 15% in the manufacturing sector, and 5% in the retail sector.

*Q. NEC has renamed the Telecom Carrier business as the Network Services business, and will expand 5G to customers other than telecom carriers. What kinds of areas do you find promising?*

A. Capital investment in 5G itself and capital investment in network infrastructure hardware are expected to contract as a whole. That said, capital investment in the service platform and application components is expected to increase. In addition, we foresee demand for virtualization and the emergence of initiatives to generate earnings from new services in real time by linking 5G to operations support systems (OSS) and business support systems (BSS), wherein lie NEC's strengths. We would like to focus on these sorts of areas.

### **Questioner C**

*Q. Can we assume that the 5G-related service platform business will mainly involve equipment and integration, without too much emphasis on service type businesses?*

A. We believe that SI, managed services, and operation and maintenance will make up the core of this business in the near term. Meanwhile, we also believe that service businesses in fields requiring a high level of security will also fall under the scope of this business. In this sense, we do not rule out the possibility of service type businesses.

*Q. Earlier, you discussed the reallocation of AI and IoT-related expenses with respect to the Others. What was your AI and IoT-related development expenses in the previous fiscal year on a Company-wide basis?*

A. In the previous fiscal year, we recorded expenses of ¥8.0 billion for the full year, and ¥2.0 billion for Q1. We expect to record mostly the same amount of expenses in the current

fiscal year.

*Q. In the statements of financial position in your earnings release (Consolidated Financial Results for the First Quarter of the Fiscal Year Ending March 31, 2019), "contract assets" and "contract liabilities" are shown under current assets and current liabilities, respectively. Could you please discuss the content of these line items?*

A. These line items have been introduced as a result of a change in accounting standards. Previously, receivables related to the percentage of completion method were recorded as "receivables from contractees for construction work" in "trade and other receivables." These receivables have been reclassified and presented separately as "contract assets."

#### **Questioner D**

*Q. In Q1, the Enterprise business posted an increase in revenue of around ¥8.0 billion year on year and IT services orders in Japan rose firmly by 7% year on year. However, the full-year revenue forecast for the Enterprise business is mostly flat year on year. Do you expect any factors to emerge in Q2 onward that would offset the revenue growth in Q1, such as a revenue decline from a large project recorded in the previous year?*

A. If conditions in Q1 remain in place, including the business environment, we believe that full-year revenue will surpass the forecast. We are still at the Q1 stage, so I would like to carefully assess the situation based on conditions in H1 and the revenue recognition timing for orders.

*Q. Could you please go over your progress on the business structure improvements announced in January 2018?*

A. As we have already announced in a press release, we have reached an agreement with the labor union on business structure improvements. Under the format of a call for early retirement based on the voluntary wishes of individual employees, we believe that we will be able to finalize the relevant costs by the end of Q3.

*Q. What progress are you making on the theme of reviewing businesses that have an operating margin of less than 5%?*

A. To address businesses that do not expect to achieve an operating margin of 5%, we plan

to consider measures such as withdrawing from those businesses, setting up joint ventures, selling those businesses, and transforming their business models. One of those businesses is the PASOLINK business. We are currently implementing improvement measures to address this business, with a view to determining the future course of this business within the fiscal year ending March 31, 2019.

*Q. In some cases, I believe that you will need to review large businesses. Will you be able to implement these measures thoroughly at the frontlines?*

A. I believe that the measures will be thoroughly implemented at the frontlines through diligent execution by the management team.

### **Questioner E**

*Q. My question concerns the automotive battery-related business. Judging from how NEC has disclosed information and factored it into its numerical forecasts in the past, I find it surprising that NEC has maintained the gain on sales of the battery business in its forecast. Is this because you already have a Plan B and Plan C in place? Could you please share any details that you may be permitted to discuss at this time?*

A. Considering the intellectual property and quality of the battery business, we believe that the battery business possesses adequate enterprise value even when taking into consideration current conditions and competition from an objective point of view. Although it may be a matter of time, I'm confident that we can steadily achieve our goal. I have personally been involved in this business since the establishment of the automotive battery joint venture. I will take full responsibility for executing what I have said I will do.

*Q. Could you please go over the trend in unprofitable projects for Q1?*

A. In the previous fiscal year, unprofitable projects amounted to around ¥11.0 billion on a full year basis. In the current fiscal year, we plan to reduce this amount by ¥5.0 billion to ¥6.0 billion for the full year. Of this ¥6.0 billion, no unprofitable projects were realized in Q1. Therefore, we believe that the trend in unprofitable projects is proceeding according to plan.

*Q. Could you please go over the quantitative results for orders in the Public business, including the IT as well as public infrastructure-related businesses? I believe that NEC's*

*performance was weak until the previous fiscal year compared with trends in the market, including business targeting small and medium-sized enterprises. Has a different trend now emerged?*

A. In the public infrastructure area of the Public business, orders increased by more than 15% year on year. Even amid extremely favorable conditions overall, business targeting small and medium-sized enterprises has not attained this level of growth. That said, I would like to monitor trends in this sector for a little while longer. With regard to your question about whether there has been any kind of a fundamental change, we have put all of our branch offices into the Public Solutions Business Unit as part of efforts to unify sales and SI in the public solutions area. We have been able to foster stronger collaboration between branch offices and business units than before. I believe this collaboration has started to work positively in our favor. I would like to support the relevant business unit leaders to ensure that we deliver a solid performance trend in Q2 onward.