April 26, 2019

Earnings Presentation Q&A for the Fiscal Year Ended March 31, 2019

Date/Time: April 26, 2019 18:15-19:20 JST
Location: NEC Headquarters, Tokyo
Presenters: Takashi Niino, President and CEO
Takayuki Morita, Senior Executive Vice President and CFO

Questioner A

Q. From your perspectives as President and CEO and CFO, what is your assessment of the first fiscal year of Mid-term Management Plan 2020? Could you please comment separately on both your assessment of core businesses and business structure improvements?

A. In our core businesses, I believe that we have achieved our initial plan in terms of quantitative performance. However, I feel that we have achieved only around 70% of our plans as far as the transformation of our culture is concerned. Although we created various frameworks, at this stage we have not yet breathed life into these frameworks and put them into action. From the fiscal year ending March 31, 2020, we will bring these frameworks to life and put them into action.

Looking at business structure improvements, as we promised when we announced earnings for the nine months ended December 31, 2018, we rigorously examined business structure improvement measures and steadily implemented those measures that would effectively enhance business performance right up to the end of the fiscal year. As a result, I believe that we have factored in almost all of the business structure improvement measures that we could complete during the fiscal year ended March 31, 2019.

In our core businesses, we have spent our entire M&A budget of ¥200.0 billion. We believe that steady progress has been made on post-merger integration (PMI) at both Northgate Public Services Limited (NPS) and KMD Holding Aps. (KMD) Acquisitions to enable NPS to expand the value it delivers have also been carried out at appropriate prices and NPS is expected to contribute to profits in the fiscal year ending March 31, 2020. The PMI expertise we have developed through the acquisition of Netcracker Technology Corporation has been put to good use with KMD, and the company is steadily getting up and running. Existing businesses have performed firmly in Japan, with the Public and Enterprise businesses making solid contributions to earnings. With a steady accumulation of orders, we expect to continue delivering a stable performance in the fiscal year ending March 31, 2020.

Q. Do you expect any additional business structure improvements to emerge from the fiscal year ending March 31, 2020 onward?

A. At this time, we don’t expect anything in particular to emerge. However, a business is a living thing and is constantly changing. Therefore, we will continue to closely monitor each business from the fiscal year ending March 31, 2020 and implement necessary measures at the earliest opportunity.

Q. NEC has made changes to its performance evaluation and personnel systems. Have you already started operating the new systems?

A. These systems started in the previous fiscal year. In our performance evaluation system, supervisors and subordinates agree upon goals that should be achieved, and the evaluation is determined based on the degree of achievement of those goals. From April 2019, we have started, for the first time, to evaluate performance in the previous fiscal year based on the new system. With regard to the personnel system, all Corporate Officers provisionally resigned from their posts as of the end of March, and were brought back onboard by having them switch to one-year engagement agreements from April 2019.

Q. Could you please share your perspectives on dotData, Inc., specifically on the measures you will take and the future direction of this company?

A.dotData has already won several orders worth around several billion yen each. Its software is being used by more than 20 companies, including both trial and commercial deployments. Meanwhile, considering that competition is fierce in this field and continuous investment is needed to accelerate the business, dotData is currently operating in the red. That said, the corporate value of dotData has been rapidly increasing. With this in mind, we would like to implement various measures while balancing risk and business growth, including bringing in funding from third parties. We believe that we will have the opportunity to discuss progress of some sort on dotData within the fiscal year ending March 31, 2020.

Q. NEC noted that it will aim for a 5% profit margin within three years in the wireless solutions business (PASOLINK). What was the backdrop to your decision to continue this business? Does this mean that you will be satisfied if the wireless solutions business achieves a profit margin of 5% within three years?

A. The wireless solutions business achieved a breakeven result in Q4. Because this means that the business is on track to returning to profitability, we decided to continue the business. In addition, we believe that wireless technology will become increasingly important going forward, and we would like to effectively leverage this resource by putting it to good use in the next generation of technology. We see the profit margin of 5% within three years as the bare minimum target.

Just to add a few more points, we spoke about our collaboration with Ceragon Networks Ltd. in this field. We are also considering forming alliances of this kind with other partners. We believe that we can realize the benefits of joint development with Ceragon Networks within the fiscal year ending March 31, 2020. We will seek to secure a profit margin of 5% in the wireless solutions business, which will serve as a base, together with other alliances. We will then expand our initiatives to other areas, such as the Enterprise business.

Questioner B

Q. NEC has reported that its Mid-term Management Plan 2020 will be updated on a rolling basis. Has there been any change to your operating profit target of ¥150.0 billion for the fiscal year ending March 31, 2021? How will NEC achieve an increase in operating profit of ¥40.0 billion from its operating profit forecast of ¥110.0 billion for the fiscal year ending March 31, 2020 to its target of ¥150.0 billion for the fiscal year ending March 31, 2021?

A. If there is any change in our progress against our Mid-term Management Plan targets, we will revise our targets. However, the numbers do not need to be revised at this time, so we have not revised our target for the fiscal year ending March 31, 2021. We will need to increase operating income by ¥40.0 billion from ¥110.0 billion in the fiscal year ending March 31, 2020 to ¥150.0 billion in the fiscal year ending March 31, 2021. We believe that it will be too difficult to achieve this increase through business growth alone. Meanwhile, there is still more that we can do internally, including eliminating unprofitable projects, reducing the SG&A expense ratio and raising efficiency. We will assign managers to each target and set numerical targets within the current fiscal year, as we implement measures to ensure that we can reap the benefits in the fiscal year ending March 31, 2021.

Q. NEC implemented additional business structure improvements in Q4. Could you please go over the benefits of optimizing assets, the specific details of investments for the future and the expected benefits of those investments?

A. Almost all of the measures to optimize assets were recorded in the Global segment, with the largest items posted by NEC Australia Pty. Ltd. In the fiscal year ended March 31, 2018, NEC Australia had revenue of around ¥40.0 billion and broke even in terms of earnings. Approximately 70% of revenue was from managed services for the public sector, including telecommunications and IT. Given that major business opportunities had emerged as the public sector sought to adopt e-government technologies, NEC Australia made several upfront investments from the fiscal year ended March 31, 2018 to the fiscal year ended March 31, 2019. However, there were unforeseen events such as the cancellation of major projects. NEC Australia made allowance for these events by recording impairment on the fixed assets that it had made upfront investments in. Through these measures, we believe that NEC Australia has dispelled the main concerns for the future as it strives to restore sound earnings from the fiscal year ending March 31, 2020.

The investments for the future reflect the end of certain existing development projects and joint development investments in connection with the alliance with Ceragon Networks in wireless solutions. These investments are expected to generate benefits in terms of improved profitability in the future.

Q. In NEC's collaboration with Samsung Electronics Co., Ltd. in the 5G field, have the two companies already agreed on global business expansion initiatives? What kinds of activities and benefits do you expect from this collaboration? Could you please also discuss your initiatives in local 5G networks?

A. Together with Samsung, we are considering global business expansion initiatives, in addition to development activities. We are currently making preparations to submit joint bids for projects. Specifically, we are preparing to submit such bids for one project in Europe and one project in the Asia-Pacific region.

In the Public and Enterprise areas, we are considering initiatives in local 5G networks together with customers in conjunction with using resources in the Network area. We intend to accelerate these initiatives going forward.

Q. Will NEC participate in projects involving Samsung's existing customers?

A. We are also looking at such opportunities.

Questioner C

Q. Considering the business environment, it is inconceivable that revenue in the Enterprise business will not increase in the fiscal year ending March 31, 2020. Does your forecast of flat revenue indicate some sort of negative factor? Why is profit expected to increase against the flat revenue?

A. Based on firm orders, we don't expect revenue to decrease in the Enterprise business. We believe that this initial forecast marks the bottom of revenue. The reason for the increase in operating profit is that we have factored in the positive effect of voluntary early retirement centered on corporate staff, although the monetary amount is not as large as in other segments.

Q. NEC is forecasting a large increase in earnings in the Global business in the fiscal year ending March 31, 2020. Earnings are expected to increase by ¥19.0 billion, excluding one-time costs of ¥20.0 billion recorded in the fiscal year ended March 31, 2019, such as business structure improvement expenses and the impairment of assets. Does this mean that the business has exceeded its breakeven point and is starting to generate increased profits on higher revenue?

A. We can reliably expect an increase in earnings of ¥8.0 billion in safety based on large contributions to profit from NPS and KMD, which we have acquired. In wireless solutions, the business has maintained its breakeven performance in Q4 of the fiscal year ended March 31, 2019 and we have already made the necessary investments. Therefore, we expect earnings to increase by around ¥2.0 to ¥3.0 billion. In software & services for service providers, we faced issues including those concerning ODA projects for optical IP in the fiscal year ended March 31, 2019, but things are expected to improve in the fiscal year ending March 31, 2020. In the Global business as a whole, around 70% of the operational improvements are already on a sound footing at this time.

Q. NEC reported that the Network Services business has started collaborating with other business units on local 5G networks. Which business unit is trying to develop applications based on the technologies of the Network Services business?

A. Local 5G networks are being looked at closely in the transportation area of the Enterprise business.

Q. It is generally believed that 5G will not be rolled out in earnest until after the Tokyo Olympics in 2020. When do you believe that 5G will get up and running? What are your views on the timing for the rollout of local 5G networks?

A. We believe that standalone 5G networks will not be realized until 2022 or 2023. Because local 5G is a closed network, we believe that local 5G networks will emerge at a relatively early stage if the investment returns and economic benefits become apparent.

Questioner D

Q. What amount of one-time costs were included in the Global segment's earnings in Q4 of the fiscal year ended March 31, 2019?

A. We implemented measures to optimize assets and additional business structure improvements in Q4. Therefore, almost all of the one-time costs of ¥20.0 billion were recorded in Q4.

Q. In the Global segment, NEC expects operational improvements of ¥14.0 billion in the fiscal year ending March 31, 2020. This partly reflects a large contribution from the safety field. What are conditions like in the other SBUs?

A. We expect software & services for service providers to return to profitability, as there are no factors that could cause losses. Wireless solutions are expected to achieve a breakeven result based on the current level of revenue. Submarine cable systems faced factors that led to low profitability in the fiscal year ended March 31, 2019. However, in the fiscal year ending March 31, 2020, it has returned to full capacity utilization at this time and the profit ratio can be expected to improve to 5-10%. Our greatest challenge lies in the energy business, where we are forecasting a loss of ¥3.0 billion. We face risks in this business.

Questioner E

Q. Revenue in the Public business is forecast to decrease in the fiscal year ending March 31, 2020. Could you please go over the level of orders in the Public business?

A. Orders for local governments increased 16% year on year, whereas orders for the national government declined by 7% year on year. For NEC as a whole, orders increased by around 4%.

Q. Does NEC have any projects other than satellite projects for which a decrease from a rebound from the previous year should be expected in the fiscal year ending March 31, 2020?

A. We expect projects other than satellites to remain flat or to show positive growth.

Q. I'd like to confirm something about the backdrop to the segment revision. It appears that consolidated subsidiaries are being transferred from the Public to the Others. Which companies are being transferred? What does the transfer of these companies signify?

A. The company being transferred is NEC Facilities, Ltd. NEC Facilities has a water purification business, and we had believed that there was potential for synergies with the Public business. However, since most of NEC Facilities' business is for the NEC Group, we decided to transfer this company to the Others.

Q. For the fiscal year ending March 31, 2020, adjustment is forecast to increase by ¥17.9 billion compared with the fiscal year ended March 31, 2019. Of this amount, I believe that ¥10.0 billion is for an increase in funds for employees' bonuses. What is the remaining ¥7.9 billion for? Do you have anything specific in mind?

A. There is no particular significance to the remaining amount.

Q. I'd like to ask about the significance of the increase in funds for employees' bonuses. Is NEC increasing these funds because employees in Japan are getting worn down, or is it to strengthen the Global business?

A. The purpose of this increase is to align the remuneration standards for human resources hired from outside the Company in a competitive recruitment environment, and the

Company's internal standards. In particular, it is to ensure that NEC retains talented human resources.