

July 16, 2019

NEC IR Day 2019 (Global Business) Q&A

Date/Time: July 16, 2019 14:50-15:40 JST

Location: NEC Headquarters, Tokyo

Presenters: Akihiko Kumagai, Senior Executive Vice President

Questioner A

Q. Could you please go over the impact of Huawei on NEC's businesses? NEC's wireless solutions and 5G business fields could be impacted by Huawei. In these businesses, have there been any changes in demand or customer inquiries over the past one or two months?

A. There have been no major changes over the past few months. We are now looking closely at the impact on future opportunities. However, regardless of whether such opportunities materialize or not, we believe that it is crucial for us to focus on realizing our strategies.

Q. I understand that NEC acts an integrator in the energy business. However, considering this role, it's difficult to see why NEC has posted a loss in this business. Could you discuss the fundamental reasons why the energy business has posted a loss? Are your competitors also in the red? Or is this a business where investments are unprofitable at first but are recovered over the long term? Were targets set improperly?

A. We believe that our competitors face the same situation. In terms of the background to this business, we first adopted a start-up mentality and gave priority to winning projects based on the opportunities in the market. That said, this business is no longer a start-up, so we have shifted to a policy of putting emphasis on profitability from the previous fiscal year. In the process, we still believe that we need a certain scale of business. With this in mind, we built up our order book in the previous fiscal year and have established a sufficient business scale to take us through the current fiscal year and beyond. In the current fiscal year, we will do what we can to improve profitability within this context. NEC has continued this business in the belief that there will be opportunities to apply AI-driven software. Everyone recognizes that this market offers substantial growth potential. However, when considering how to generate profits, systems integration (SI) alone is not

enough to make money in this business. In AI and software technologies, NEC has competitive advantages that other companies do not possess. By making the most of these advantages, we intend to convert this business into a profitable growth business. To do so, we seek to complete the initiatives discussed earlier within this year. By the end of the current fiscal year, we would like to confidently expect to restore this business to profitability next fiscal year.

Questioner B

Q. The organic areas of the safety business will drive progress toward the achievement of an adjusted operating margin of 5% in the future. Meanwhile, the top-line struggled to grow in the previous fiscal year. Could you please go over the reasons why revenue declined in a growing market and what kinds of strategies you will employ to increase sales?

A. The organic areas of the safety business certainly did not grow in the previous fiscal year. However, we believe that this was due to cyclical reasons. In the long run, we believe that these markets will definitely grow. In the current fiscal year, we are forecasting growth of 20% or more with a high degree of certainty. Notably, there is considerable demand in the Airport ID business and by working relentlessly to win orders in this business, we aim to pave the way for growth. Lying beyond this is our India strategy. We have a large software & services center at NEC India and Netcracker Technology Corporation. Combined with Northgate Public Services, we have a workforce of around 6,000 employees. While we have not yet entered the Indian market in earnest, this only underscores the tremendous opportunity that awaits us in the country. In the current fiscal year, we expect orders to triple and sales to increase six-fold year on year in the Indian business of Safer Cities. We believe these forecasts are well within reach.

Q. I believe that a large loss was recorded in the SDN business in Service Provider solutions. Development costs have run their course and orders were received for large projects in Europe in the previous fiscal year. I believe that these and other developments will contribute to improved earnings in the current fiscal year. Could you please go over the extent of the improvement you foresee in each of these areas?

A. Since the previous fiscal year, we have not divided this business into the traditional

categories of Software Defined-Networking (SDN) and Telecom Operations and Management Solutions (TOMS) (Operation Support System/ Business Support System (OSS/BSS)). OSS/BSS is in the process of shifting to cloud computing. Since the shift to cloud computing signifies a shift to SDN, we now see both areas as a single business. In this sense, Netcracker Technology Corporation has achieved substantial growth. One of the major drivers of this growth is the shift to cloud computing. Synergies have been created between OSS/BSS and SDN, meaning that there is no longer any need to manage ROI for SDN on a standalone basis. That said, when we do the actual calculations, we find that the combined returns of OSS/BSS and SDN relative to the investment in SDN to date will turn positive in the next fiscal year.

Questioner C

Q. In your partnership with Samsung Electronics Co., Ltd., I believe that NEC has agreed to supply certain Samsung products to NTT DOCOMO, INC. in Japan. Could you please describe the status of the agreement outside Japan? For example, I believe that Samsung has accounts in advanced markets such as the U.S. and South Korea. Is it possible for NEC products to make inroads into those accounts?

A. The agreement does not clearly delineate the supply of products. Since it is a partnership, both partners are committed to do their utmost to create synergies. In the near term, we believe that both companies will repeat the process of consulting one another on the respective roles they can fulfill for each individual account. Existing telecom carriers in the U.S., South Korea, and other countries already have Samsung and other suppliers, so we believe that it will be difficult for NEC to suddenly make inroads into those accounts. Initially, we expect to start business by offering Samsung 5G base stations in areas where Samsung does not have a well-developed presence, with a focus on accounts and countries where we can maximize NEC's strengths. For the near term, we expect to target accounts in Europe and Asia Pacific, where we can enter relatively easily. Thereafter, we believe that possibilities will emerge not only with telecom carriers, but also with cable TV operators, IoT-related closed networks and other areas.

Q. In the 5G environment, I believe that the need for PASOLINK has been increasing slightly. Could you please share your perspectives on the situation? Will the need for PASOLINK increase? If so, does NEC have the preparations and systems in place to respond effectively?

A. We believe that there is ample potential and that NEC's wireless technologies can be put to good use in 5G applications. In this sense, we are pleased that NEC has kept its wireless business. We finally managed to restore profitability to the wireless business after working on this priority for a full year since the previous fiscal year. Therefore, we seek to make further improvements and remain engaged in the wireless business over the long term, thereby laying the groundwork for actively winning 5G business.

Questioner D

Q. Will management conduct valuation of M&A deals based on adjusted profit? Or will M&A deals be valued based on profit based on GAAP? If an acquisition is valued based on adjusted profit, wouldn't it receive a positive valuation even if the acquisition value is high, provided that the profits are high?

A. From the current fiscal year, acquisitions will be valued based on adjusted operating profit as a common policy for all business units. Meanwhile, the most important factor for making a decision on an acquisition is whether the deal is consonant with NEC's global strategy. Acquisitions will not be conducted based solely on valuations based on adjusted profit. We see no problem with a positive valuation resulting from the use of adjusted profit.

Q. Could you please go over the factors that will increase profit from the fiscal year 2019 to fiscal 2020, as you seek to achieve an adjusted operating margin of 5% in fiscal 2020?

A. The main factors will be profit growth in line with increased sales primarily from the Safer Cities business, Netcracker Technology Corporation, and the Submarine Network business. In addition, improving profits in the Energy business will also help to improve operating profit for fiscal 2020.

Questioner E

Q. I see that there are opportunities in the Safer Cities business in the near term. Could you please share your perspectives on the longer-term outlook? In the high-end market where NEC can leverage its strengths, how large do you expect the market to grow in five years and what level of market share will NEC seek to capture at that time?

A. For example, the public safety market is currently estimated to be worth around ¥570.0 billion. NEC currently holds a share of just over 10% of this market. In areas where we can leverage NEC's strengths, we seek to capture a market share of around 20%. Whether other markets will join the public safety area will depend on future developments. We believe that the Safer Cities area is where we can put NEC's strengths to the greatest use, and it is the greatest driver of the Global business.