

July 31, 2019

Earnings Presentation Q&A for Q1 the Fiscal Year Ending March 31, 2020

Date/Time: July 31, 2019 17:15-18:10 JST

Location: NEC Headquarters, Tokyo

Presenters: Takayuki Morita, Senior Executive Vice President and CFO

Questioner A

Q. According to the company's forecast for the fiscal year ending March 2020, NEC expected to boost profits by about ¥10 billion excluding business structure improvement expenses and benefits. Yet, including the gains from business structure improvement, NEC has improved profits by ¥16 billion in Q1 alone. How much better were the results in Q1 than you expected? Also, why have you left full-year forecast unchanged?

A. Q1 performance was about ¥5 billion better than our plan. We left full-year forecast unchanged because it is only Q1 and we are only tracking ahead of our plan by a relatively small amount (¥5 billion). It looks at present that orders are staying as firm as last year, and there are no clouds on the horizon, so to speak. Yet there is still a lot of uncertainty about the prospects for the second half of the year, given the level of corporate profits and world economy. We do not expect such factors to have a direct impact on our business, but we are not adjusting full-year forecast at this stage due to a lack of visibility regarding investment trends among our customers.

Q. While there may not yet be any definite evidence of synergy between NEC and Japan Aviation Electronics (JAE), could you give us an update on JAE's positioning within the NEC Group?

A. We see JAE as one possible outlet for applying the technologies developed in our R&D facilities. There is also scope to create synergy with JAE's automotive operations. For example, NEC engineers working in the field of optical fiber are jointly developing optical connectors with JAE. In precision antennas, we have also begun building new prototype products using NEC technology and the production technology developed by JAE. There are several projects where we anticipate we could apply NEC technologies or research findings through JAE. We think there will be opportunities to create value as we identify these

promising areas, which is what we are doing at present.

Q. What are the factors behind the improved performance of the Network Services Business?

A. Although we had a specific unprofitable project in the previous fiscal year, which did not impact this fiscal year, one of the main contributing factors was the growth in fixed wired back bone network investment with an eye to the arrival of 5G, which was quite significant in value terms. Another factor was the growth from the IT domain, which includes Rakuten Mobile. I think each factor contributed roughly 50% of the increase in profit. Sales for mobile carriers decreased due to reduced investment in 4G mobile base stations and ahead of the 5G investment ramp-up.

Questioner B

Q. Which segments performed significantly better than expected?

A. Enterprise and System Platform businesses both outperformed by around ¥2 billion, while the corresponding figure for Network Services was about ¥1 billion.

Q. Whereas other companies have attributed improvements to lower material costs and other non-recurring factors, were the gains at NEC's System Platform Business mainly due to the benefit from business structure improvement? Is this improvement sustainable?

A. The outperformance of about ¥2 billion relative to the forecast is partly due to higher sales and improvement in the product mix, including one-time factors.

Q. Orders in Q1 for IT services were up 17% over the same period of the previous fiscal year. Can NEC handle the higher volume of orders? What is the situation from a resources perspective?

A. While we do not expect the same trend to persist throughout the year, the financial and government sectors were supporting extremely firm demand, and there are no signs of any impending slowdown at present. Resourcing this is an issue, and we recognize that, but we are working to ensure this does not lead to projects becoming unprofitable. We do not anticipate being unable to handle the backlog of orders.

Q. Could NEC still handle the order volume even if there were insufficient resources to allocate to stop projects losing money?

A. Yes. NEC can handle the order volume.

Q. Please tell us more about the scheduling and scale of the project in partnership with the Star Alliance.

A. Client confidentiality prevents us from disclosing any monetary amounts, but we can say that this is a major contract for NEC. Part of the database will be developed jointly. We understand individual airports and airlines will be bidding to introduce the platform. We have set internal goals for the project, but I cannot elaborate further. If you look at the countries, airlines, and major airports where Star Alliance member companies operate, you can see that it has a major scale and should be taken seriously.

Q. Is NEC looking to develop the IP through licensing and pay-as-you-go agreements?

A. The biometric database will employ NEC technology, and we will receive appropriate contractual reimbursement for supplying the technology. The development of the database by individual countries and airlines will be based on free competition. Our expertise in databases makes us confident that NEC will enjoy an edge in this marketplace.

Questioner C

Q. Amid strong orders, what trends do you see in sectors such as telecommunications and finance? Are major projects a factor that is pushing up orders? Are you concerned about a downturn in demand going forward?

A. In the financial sector, the demand was strong for general system overhauls. In the telecommunications sector, we received orders for billing and operational support systems such as OSS and BSS. Looking ahead, we do not expect any major downturn in demand. While there are some variable factors, the scale of demand is not as large as in other businesses such as social infrastructure and undersea cable systems. Even excluding more than ¥10 billion in orders for large-scale intermediate server projects, NEC recorded double-digit year-on-year growth in consolidated orders in Q1.

Q. Gains from business structure improvement in Q1 include a figure of ¥2.9 billion for

other measures. To which segments did this apply?

A. Efficiency improvements at overseas sites were booked by Global Business. System Platform Business claimed gains from optimization of production facilities. Others / Adjustments included the optimization of office floor space.

Questioner D

Q. What was the effect of the consolidation of KMD?

A. The sales contribution in Q1 was around ¥23 billion.

Questioner E

Q. Was improved profitability with business PCs and IA servers part of the reason behind growth in profits in System Platform business? My understanding was that business PCs procured from Lenovo does not affect the profitability for NEC significantly, but has the situation changed?

A. Business PCs were making some contribution, but they were not a major factor in the Q1 result. This was due mainly to mix improvements from strong sales of hardware products that generate strong margins.

Q. What were the contributions of KMD and NPS to the improvement seen in adjusted operating profit within the Global Business?

A. There was an adjusted operating profit of roughly ¥2.0 billion in the Safer Cities domain, with both companies contributing positively. We broke even in the existing business excluding KMD and NPS.

Q. Will NEC be booking a loss following the conclusion of the tender offer for Nippon Avionics? Also, is there any significance to NEC continuing to own preferred stock in the company?

A. The loss is immaterial. With the preferred stock, the understanding is that we could redeem these shares once there is a sufficient earned surplus.

Questioner F

Q. President Niino has talked at previous briefings about the need to change the earnings models. Can NEC employ a recurring income model with the Star Alliance project?

A. In our view, we have tackled the heart of the matter and made a breakthrough where we have acquired the essential elements to build a business model. It is important for us to leverage this going forward. Developing the technology for airlines and airports, and for outside of airports, is where we now need to focus more effort.

Q. In Global Business, could you please provide a little more explanation regarding the risks in Display and Energy? What is the outlook for these operations in value terms?

A. In Display, our use of an asset-light EMS model lowers the risks of asset write-downs. However, profits are volume-dependent, and there is a downside risk in the billions of yen. We will continue to monitor the progress of the business and manage the situation. In the Energy, where we built up an order book worth ¥26 billion in the previous fiscal year, we are focusing this year on translating that into sales. This approach assumes relatively low expectations in terms of contributing to higher profits, however. Sales and material cost reductions have not so far proceeded as planned, and we expect this domain to record a loss of ¥3 billion in this fiscal year. That is slightly worse than our original forecast at this time.

Q. The expectation is that NEC is likely to exceed its forecast for the fiscal year ending March 2020. As in the previous fiscal year, does NEC intend to use any surplus relative to the forecast to fund business structure improvement or other initiatives to address various issues?

A. We have no specific plans in sight, but we will consider addressing any issues that arise. Naturally, management will consider any measures we think are needed to increase the chances of achieving the targets set out in the Mid-term Management Plan 2020 (adjusted operating profit of ¥165 billion).

Questioner G

Q. My understanding is that NEC supplies Rakuten Mobile with OSS/BSS as well as radio units for 5G base stations. Do you see this business generating recurring revenue in the future?

A. Both sides have their own expectations and approaches, but normally with this type of business we would expect some level of recurring demand from maintenance and upgrade services, as well as the upselling of additional modular functions. With some customers, there is an opportunity to adopt a business process outsourcing (BPO) model. This is an emerging international trend, and our feeling is that it is especially strong with non-Japanese companies.

Q. Rakuten Mobile is also using other software vendors. How would this co-exist alongside NEC?

A. NEC is the sole OSS/BSS supplier. We understand that various software vendors are supplying Rakuten Mobile, including the subsystems.

Questioner H

Q. With the Star Alliance project, is NEC's aim to follow the example shown by the demonstration at Nanki-Shirahama Airport in Japan? In the future, will there be a world where you can travel empty-handed and make all payments through an NEC database? A. That would be great, but first we need to ensure the safety and security of procedures from check-in to boarding. Next would be systems within airports. After that, we would look to develop outside of airport applications. We realize there are differing national regulatory approaches, but our approach is to develop the technology for widespread adoption.