

October 29, 2020

Earnings Presentation Q&A for Q2 of the Fiscal Year Ending March 31, 2021

Date/Time: October 29, 2020 16:30-17:20 JST

Location: Live audio streamed from NEC Headquarters, Tokyo

Presenters: Takashi Niino, President and CEO

Takayuki Morita, Representative Director, Senior Executive
Vice President and CFO

Questioner A

Q. You have explained a shortfall between the Company's internal plan and the actual result. Could you tell us how much of a shortfall occurred in the second quarter (three-month period)?

A. The shortfall was around ¥30.0 billion for revenue and ¥10.0 billion for adjusted operating profit.

Q Regarding fluctuations in orders in the Public Infrastructure and Network Services segments, could you explain the main factors behind the sharp increase during Q2?

A. In Network Services segment, NEC Networks & System Integration Corporation, a subsidiary of NEC Corporation, was the main recipient of an increase in demand associated with the "new normal," such as expansion of corporate networks. In the Public Infrastructure segment, results were driven by the receipt of orders for the GIGA School project, mainly centered on demand from central government. We initially expected a certain amount of orders for the GIGA School project, but these have progressed steadily and surpassed the plan.

Q. Will the increase in orders in the Public Infrastructure and Network

Services segments contribute to revenue for this fiscal year?

A. It will contribute to revenue for this fiscal year. We think it will also continue contributing next fiscal year as well.

Questioner B

Q. The hurdle for achieving the second-half earnings target seems high. What kind of projects and fields will contribute to revenue and operating profit in Q3 and Q4?

A. To achieve the annual forecasts, we need to add around ¥10.0 billion in adjusted operating profit. Apart from this, I think we are on track to meeting the targets.

Our first task for achieving the forecasts is to expand and ramp-up deliveries of 5G base stations from the end of Q3 onward. Our ability to do this as planned will have a significant influence on our result.

The second is the GIGA School project. Orders have been firm, but there are some issues with material supplies, and this may have some impact, mainly on revenues. The key here is whether we can firmly deliver on projects. Together with this GIGA School project, there is also some demand from telecommunications equipment and routers, which may prove to be a positive factor.

The third point is projects associated with the government's supplementary budget. I believe we will see some of these come through as orders during this fiscal year, but their impact on revenue and operating profit may be limited for this fiscal year. I think some of them may be shifted through to the next fiscal year.

These make up the ¥10.0 billion that has not been added.

Q. You talked about recording gains on sales of assets, such as sales of subsidiaries' shares. Aside from Showa Optronics Co., Ltd.'s shares and transfer of the land at NEC's Sagamihara Plant, are there any other assets that may be sold as a contingency?

A. At this time, the main asset sales that will have an impact on operating profit are the sale of Showa Optronics Co., Ltd.'s shares and the transfer of land at the Sagamihara Plant. No other asset sales are planned. Separately from these, we will continue to look at items that will affect cash, including cross shareholdings. We will continue to proceed with these in the next fiscal year as well, while monitoring the market conditions.

Q. Could you tell us the growth rate in revenues in the Public Solutions and Enterprise segments from the first half through the second half? The Public Solutions segment recorded a 15% year-on-year decrease in revenue for the first half, but your plan is for a recovery in the second half to around the same level as the previous year. What is the reason for this improvement? Looking at orders received in Q2, I am concerned about whether the second half revenue target will be achieved.

Furthermore, in the Enterprise segment, first half revenues were down 17% year on year. The plan for the second half shows a significant increase of 23%. How is the outlook on this?

A. Both the Public Solutions and Enterprise segments had projects delayed due to the impact of the spread of COVID-19. From Q2, the delayed projects have gradually started to make progress. We believe that both the Public Solutions and Enterprise segments will make progress and contribute positively.

On the other hand, with regard to revenue, we do see a certain level of risk with our current forecasts. With regard to the impact of a deterioration in market conditions, we see a risk to companywide sales

of around ¥180.0 billion and we will prepare recovery countermeasures for the operating profit side.

Questioner C

Q. Recently, the U.K. government announced cooperation with NEC regarding the deployment of 5G in the United Kingdom. What kind of support are you going to receive from the U.K. government, specifically? Do you think this will lead to upgrading telecommunications network and base stations? Also, if you were to build up the accomplishments of 5G projects in the United Kingdom, what would be the impact on the overseas 5G business overall?

A. To promote the 5G business globally, primarily in Europe and the United States, we need to obtain various technical verifications in each region. We are working on preparing facilities to conduct this evaluation in the United Kingdom. Through this work, if we are able to achieve a certain level of results in the United Kingdom, then we may be able to expand our business with telecommunications carriers there. So, the first step is to conduct the technical verification. If our base stations are adopted in the United Kingdom, then we expect that this will propel the global expansion of our 5G business. As the move towards open telecommunication networks progresses, we are seeing inquiries about verification from various telecommunication carriers, not only in the United Kingdom, and we will respond to these in earnest.

Questioner D

Q. How has your outlook for the full year changed between the Q1 financial results announcement and now? Could you tell us how the impacts of the spread of COVID-19 and special countermeasures have changed?

A. To put it simply, the initially anticipated impact of COVID-19 has now

become clear. Initially, we estimated the negative impact of market deterioration at around ¥50.0 billion. We expected to cover half of that by controlling expenses, and the remaining half we expected to recover by capturing new demand under the “new normal.” With expense control we have now reached a stage where we can expect with some confidence an improvement of around ¥22.0 billion, which is close to our initially anticipated level. On the other hand, the “new normal” recovery is proceeding rapidly with a full range of products and services. NEC Networks & System Integration Corporation’s network expansion and other initiatives are moving forward, but at this point, we have mainly comparatively small projects, while the GIGA School project’s contribution to profits is relatively modest, and is expected to make a confirmed addition of around ¥6.0 billion over the full year. To recover the shortfall, in the current fiscal year we have moved forward with converting assets to cash as a contingency to make a profit. As a result, at our current stage of progress if we can add the remaining ¥10.0 billion, we can expect to achieve the forecasts.

Q. Regarding orders received, excluding the global segment’s orders and looking only at orders in Japan, could you tell us what kind of year on year growth you have achieved?

A. Orders received in Japan, excluding the global segment, were down by 15% year on year for Q1, and up 6% for Q2.

Questioner E

Q. The impact of deterioration in market conditions due to COVID-19 is estimated at ¥65.0 billion over the full year. You are expecting the impact for the second half to be about the same level as the first half. How do you expect the impact of deterioration in market conditions to trend in each of Q3 and Q4? Also, I imagine that the impact will play out differently in Japan and overseas. How do you expect the impact to occur in each case?

A. I am not able to present detailed figures for Q3 and Q4, but there has been a recovery from Q1 to Q2, and October also appears to show a gradual recovery. We are hopeful that the conditions will gradually recover in the second half from Q3 to Q4. However, in terms of business management, we have formulated countermeasures assuming the same level of impact as the first half. Moreover, out of the impact of ¥33.0 billion in the first half, ¥8.0 billion was attributable to the Global segment. In addition to the deconsolidation of the display business, which was most heavily affected by international markets, we expect the impact of worsening the Global segment in the second half to be significantly reduced.

Q. The decrease in orders received in the Enterprise segment appears to have shrunk in Q2. Looking at each industry, which fields are recovering and what is your outlook for the second half?

A. The general opinion on impact by industry is that transportation-related and retail industries are weak, and manufacturing-related industries also continue to be in a weak condition. On the other hand, finance and related industries are seen to be relatively solid.

Questioner F

Q. NIPPON TELEGRAPH AND TELEPHONE CORPORATION (NTT) has announced that it will make NTT DOCOMO, INC. a wholly owned subsidiary. What kind of impact will this have on the partnership between NEC and NTT? Do you expect the partnership to be strengthened?

A. Our partnership with NTT envisages NTT DOCOMO as a customer for our jointly developed base stations, so I think that NTT's making NTT DOCOMO a wholly owned subsidiary has simplified things. In terms of promoting R&D also, we can expect stronger links with the entire NTT

Group, and this move to make NTT DOCOMO a wholly owned subsidiary is expected to accelerate the speed of our cooperation.

Questioner G

Q. Regarding the Enterprise segment, could you tell how orders received and revenues have performed year on year excluding PCs?

A. I'm afraid I cannot answer that as we do not disclose figures on a hardware-excluded basis.

Q. Regarding the situation with ABeam Consulting Ltd., have you seen an improvement in orders received in relation to digital transformation under the "new normal?"

A. Since it is a consulting business, even under these conditions, it performs solidly. Overall, however, it is down from last year by several percentage points. We expect the composition of projects to change, partly due to inquiries regarding workstyle reforms and digital transformation.