

Mid-term Management Plan 2018 Progress and Formulation of Next Mid-term Management Plan

Review of Mid-term Management Plan 2018

In fiscal 2017, we reluctantly lowered our revenue and profit forecasts in response to multiple factors, including delivery delays that pushed back substantial revenue beyond the fiscal year-end, failure to land expected orders, sluggish growth in overseas operations and a falloff in hardware sales. Revenue and profits ended up falling short of our initial forecasts.

Below I review our challenges and accomplishments in fiscal 2017 in terms of our Mid-term Management Plan 2018 and explain our intentions in terms of formulating our next mid-term management plan.

Challenges

Fiscal 2017 proved to be a challenging year that exposed NEC's shortcomings in bold relief. Our fiscal 2017 operating performance fell far short of our initial forecasts, which we revised downward in January 2017. In my assessment, the biggest factor behind the shortfall were deficiencies in management execution capabilities in terms of responding to changes in market environments and customer trends.

Our Mid-term Management Plan 2018 was initially predicated on predominately overseas revenue growth in the aforementioned three key businesses and flat revenue in our predominantly domestic existing businesses. However, the existing businesses missed their targets and we

encountered delays, mostly overseas, in ramping up the three key businesses. Consequently we had failed to achieve revenue growth.

Operating profit fell sharply from the previous fiscal year, largely as a result of earnings deterioration in the Telecom Carrier and Smart Energy businesses, and unprofitable social infrastructure projects.

Additionally, we provisioned reserves for contingent losses after being found in violation of the Antimonopoly Act, as well as ordered to cease and desist and fined by the Japan Fair Trade Commission in fiscal 2017 in connection with three matters for which we had been under JFTC investigation.

Looking Back at the 1st Year of the Mid-term Plan - Challenges

Lack of execution by management team responding to changes in market environments and customer movements

Financial targets for existing businesses not achieved, while results for new businesses delayed

- Could not execute growth strategy well enough in 3 focus business areas, mainly in the international market

Profitability deteriorated in certain business areas

- Dip in Telecom Carrier business : Need to flexibly allocate resources to focus business areas for optimization, accelerate development of 5G technology targeting the shipment of commercial prototypes in FY19/3
- Slow recovery in the energy business : Loss from operations (excluding one-time costs) decreased. Expect sales growth and profitability improvements, mainly in the large ESS and electrode business
- Booked new unprofitable projects : Accelerate deployment of project management know-how from system integration/ services throughout the company during FY18/3

Governance, Compliance

Received the cease and desist orders and the orders for payment of surcharge

- Booked provision for contingent loss (FY17/3), Anticipate an influence from the nomination suspension (FY18/3)

Accomplishments

While fiscal 2017 left us with much to reflect upon, we also started to make progress on certain fronts. Fiscal 2017 being our Mid-term Management Plan 2018's initial year, we focused on implementing the plan's two management policies: reorganization of profit structure and getting back on the track to growth.

First, reorganization of profit structure, we (1) took remedial action toward underperforming businesses and unprofitable projects, (2) implemented the business process optimization project and (3) worked on optimizing development and manufacturing functions in the aim of realizing a 5% operating margin. Of these three initiatives, the business process optimization project has progressed as planned. In fiscal 2017, it yielded some ¥14 billion in year-over-year cost savings, largely from improvement in operational and IT-cost efficiency. Meanwhile, we made steady progress toward realizing ¥10 billion of fiscal 2019 cost savings from optimization of our development and manufacturing functions by reorganizing and merging our domestic hardware development and production subsidiaries and also our domestic software development subsidiaries effective April 1, 2017.

To getting back on the track to growth, we focused on growing our safety, global carrier network and retail IT service

businesses, all of which we have designated as key businesses, in the aim of globalizing our Solutions for Society.

In the safety business, our video face recognition technology was ranked first in a benchmark performance test conducted by the U.S. National Institute of Standards and Technology (NIST). Including previous benchmark tests of still-image face recognition, NEC has won four consecutive top rankings in NIST benchmark tests of face recognition technologies. We believe we have firmly established a competitive advantage in the face recognition field. The global carrier network business landed 10 contracts for commercial SDN/NFV projects from major telecom carriers in Europe, the Near/Middle East and North America. Our pipeline of network projects under negotiation also has been steadily growing. We intend to parlay telecom carriers' growing push to upgrade their networks into expansion of our network business. In the retail IT service business, we were awarded an order and maintenance contract from 7-Eleven, Inc., for a POS system for around 8,600 stores in the US and Canada.

Lastly, we proactively pursued alliances and collaborations with other companies and academic institutions in pursuit of future business expansion in the AI and IoT realms, both of which are crucial for diversifying our Solutions for Society.

Next Mid-term Management Plan

In 2013, we decided to focus on Solutions for Society with the aim of becoming a social value innovator that solves social issues through information and communication technologies. This goal remains unchanged today, underscoring the significance of NEC's continued existence and growth within society.

To realize this goal, however, we ourselves must personally continue to change faster than the rapidly evolving markets. In preparing our next mid-term management plan, we intend to first revise our mid-term and annual planning processes with the aim of expediting the transition from strategy formulation to execution. Additionally, to upgrade corporate functions, we will accelerate decision-making by progressively delegating authority to C-suite officers and clearly delineating their roles, responsibilities and authority.

Our primary focus in terms of management policy is reforming underperforming domestic operations and otherwise improving domestic profitability while devising specific measures to accelerate overseas growth in our three key businesses. As our primary management objective, we will focus on establishing a profit structure that ensures a 5% operating margin through disciplined management of a well-diversified portfolio of businesses.

We are currently in the process of formulating specific quantitative targets for our next mid-term management plan. Suffice it to say for now that we intend to set responsibly attainable targets that are credible to various stakeholders.

Looking Back at the 1st Year of the Mid-term Plan - Achievements

Stable progress in the business process optimization project

Reorganization of Profit Structure

- Business process optimization project : Improved efficiency of back-office operations and reduced expenses/IT-related costs by approximately ¥14.0 billion YoY (in line with expectations)
- Optimization of development and manufacturing functions : Integrated subsidiaries of hardware development and production as well as software development

Getting Back on the Track to Growth

- Safety : Ranked as #1 at face in video evaluation (4th consecutive win including previous benchmark tests of still image face authentication technologies)
- SDN/NFV : Acquired 10 commercial deployment orders from major operators in Europe, the Middle East, North America, etc. Pipeline expanded 1.6x in half a year, as sales to grow 1.5x YoY in FY18/3
- Retail IT Service : Selected by 7-Eleven, Inc. to provide and maintain POS system
- AI & IoT : Enhanced partnership with academic institutions and commercial partners

Key Management Agenda

Discuss new mid-term management plan during 2017

Accelerate management speed	Change the process of mid-term and annual plan formulation Enhance corporate functions ■ Empower Chief Officers under clear definition of roles, authorities and responsibilities
Management policy	Improve profitability of business in Japan, including transformation of underperforming businesses Pursue further opportunities in addition to the 3 focus areas, while fundamental policy of international growth unchanged
Set new financial target	Establish structure to generate 5% operating profit margin ■ Portfolio management with discipline