July 29, 2016

# Earnings Presentation Q&A for Q1, the Fiscal Year Ending March 31, 2017

Date/Time: July 29, 2016 18:30-19:30 JST
Location: NEC Headquarters, Tokyo
Presenters: Isamu Kawashima, Executive Vice President and CFO

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**Questioner A**

*Q. Please describe the current state of IT investment sentiment in Japan.*

A. In Q1, the order trend for IT investment in Japan decreased 6% year on year. This reflected the rebound from strong order growth of 16% in the previous fiscal year, due to growth of retail and services area. Therefore I don't evaluate this as a significant drop.

*Q. Into which segment do you plan to consolidate Japan Aviation Electronics Industry, Limited? The company's sensors seem to offer prospects for synergies with the IoT field, but how about connectors?*

A. The segment has not yet been decided. We will consider which segment to consolidate the company into from the perspective of maximizing synergies, for example, in IoT solutions.

**Questioner B**

*Q. NEC noted that revenue and operating profit/loss came under pressure in Q1. How did NEC perform against its internal forecasts?*

A. Overall, revenue and operating profit/loss underperformed internal forecasts by around 40.0 billion yen and 10.0 billion yen, respectively.

By segment, revenue and operating profit/loss in the public business underperformed forecasts by around 10.0 billion yen and 3.0 billion yen, respectively. The main reasons were contracts falling behind schedule and customers' specifications not being finalized primarily in the social infrastructure area.

In the enterprise business, revenue and operating profit/loss were both largely in line with forecasts.

In the telecom carrier business, revenue and operating profit/loss underperformed forecasts by around 12.0 billion yen and 3.0 billion yen, respectively. With business in Japan largely in line with forecasts, it was the international business that underperformed. The international business did not perform as initially anticipated because of delays in the plans of international telecommunications carriers in regions such as Central and South America. Operating profit/loss also underperformed forecasts in line with the drop in revenue.

In the system platform business, revenue and operating profit/loss underperformed forecasts by around 8.0 billion yen and 3.0 billion yen, respectively. Hardware, including servers and storage, came under pressure. We had anticipated a year-on-year decline in certain quarters, but were unable to make up for the decline. Operating profit/loss reflected deterioration in hardware maintenance and services, in addition to the drop in revenue.

In the others business, revenue and operating profit/loss underperformed forecasts by around 10.0 billion yen and 1.0 billion yen, respectively. Revenue in the smart energy business and international business underperformed forecasts by around 4.0 billion yen each. The foreign exchange impact on the international business accounted for around 3.0 billion yen of this shortfall. Operating profit/loss underperformed forecast by 1.0 billion yen, as a shortfall of 2.0 billion yen in the smart energy business was partially offset by other businesses.

Adjustment was largely in line with our forecast.

*Q. I believe that the amount of the operating loss in Q1 was large. NEC is targeting operating profit of 100.0 billion yen on a full-year basis. Could you please tell us your outlook for each segment from Q2 onward?*

A. Although our financial results for 1H of the fiscal year ended March 31, 2016 have not yet been audited, current estimates put revenue at around 1,310.0 billion yen, and operating profit at around 19.0 billion yen.

By segment, the public business posted revenue of around 330.0 billion yen and operating profit of around 15.0 billion yen and the enterprise business posted revenue of around 150.0 billion yen and operating profit of around 10.0 billion yen. The telecom carrier business posted revenue of around 330.0 billion yen and operating profit of around 13.0 billion yen, and the system platform business posted revenue of around 350.0 billion yen and operating profit of around 9.0 billion yen. In the others business, revenue was around 150.0 billion yen, while operating profit/loss was a loss of around 3.0 billion yen. Adjustment was an operating loss of around 25.0 billion yen.

Looking at forecasts for 1H of the fiscal year ending March 31, 2017, Q1 revenue decreased by around 60.0 billion yen compared with the aforementioned results for Q1 of the previous fiscal year. This decrease is projected to carry over to our 1H results.

In Q1, operating profit/loss worsened by 22.4 billion yen year on year. We expect to regain lost ground in Q2, and are forecasting a certain amount of operating profit for 1H.

Looking at our segment forecasts for 1H of the fiscal year ending March 31, 2017, revenue in the public business is projected to decrease by around 40.0 billion yen year on year. This outlook is based on the postponement of a satellite project which we had expected in Q2 to 2H of the fiscal year ending March 31, 2017, in addition to the revenue shortfall recorded in Q1. The additional impact of the postponed project is expected to push revenue down further in year-on-year terms. Operating profit is forecast to remain mostly unchanged year on year. This outlook is based on a reduction in front-loaded sales promotion expenses incurred in the social infrastructure area in Q1 and 1H of the previous fiscal year, in addition to an improvement in unprofitable projects.

The enterprise business is expected to remain mostly on par with 1H of the previous fiscal year.

In the telecom carrier business, revenue declined year on year in Q1, while the target is for Q2 revenue to remain flat year on year. Operating profit deteriorated by 4.5 billion yen in Q1, but we will work to regain lost ground in Q2, with the intention of offsetting the Q1 decrease as much as possible.

In the system platform business, revenue decreased by 10.0 billion yen year on year in Q1. Although this included display-related products of around 5.0 billion yen that could not be shipped due to the impact of the Kumamoto earthquake, we expect the full amount of the decline in Q1 revenue to carry over to 1H. Operating profit worsened by 8.9 billion year on year in Q1, but the decline is expected to contract in 1H.

In the others business, revenue is expected to increase by around 5.0 billion yen, based on higher revenue in the international business, although revenue in the smart energy business is expected to decline slightly year on year. Operating profit/loss is forecast to deteriorate in the smart energy business, but this decline should be offset by factors including improvement in staffing related companies such as NEC Management Partner, Ltd. Based on this, operating profit/loss is projected to improve by around 1.0 billion yen year on year.

Adjustment saw an increase in expenses of 3.9 billion yen year on year in Q1. With adjustment projected to remain mostly unchanged in Q2, we expect the increase in Q1 to carry over to the 1H result.

In total, we believe that our overall operating profit for 1H should amount to a profit of several billion yen in absolute terms.

*Q. I believe that the stronger yen is having a positive impact on NEC's operating profit. Could you please explain the impact of emerging-market currencies on operating profit?*

A. In Q1, the U.S. dollar and euro had a positive impact of around 1.0 billion yen on operating profit/loss in year-on-year terms. We have not changed our assumptions for other currencies as the Brazilian real, Argentine peso and so forth have remained stable.

**Questioner C**

*Q. Could you please share your outlook for IT investment in Japan?*

A. Looking ahead, we believe that NEC can win back some more orders. On a full-year basis, orders are forecast to be mostly unchanged from the previous fiscal year.

*Q. Japan Aviation Electronics Industry, Limited has revised its financial forecasts. Have these revisions been reflected in NEC's full-year financial forecasts?*

A. We have not reflected these revisions in NEC's financial forecasts because the timing of consolidation has not yet been determined. At the earliest, we expect to consolidate Japan

Aviation Electronics Industry in 2H of the fiscal year ending March 31, 2017. Therefore, we don't believe that the consolidation will have very much impact on NEC's consolidated financial results for the fiscal year ending March 31, 2017. There is some impact from factors such as reconsideration of tax expense. However, the consolidation of Japan Aviation Electronics Industry, including the aforementioned tax expense, have not been reflected in NEC's full-year financial forecasts.

*Q. Could you please discuss the status of progress on SDN (Software-Defined Networking), an area of focus, and the smart energy business, which presents an urgent issue for NEC?*

A. We are actively pushing ahead with SDN initiatives. Following the success of field trials in Brazil with Telefónica Brasil, S.A. using its commercial network, we will advance to the next stage. Our approach to SDN has not changed.

In the smart energy business, the international business booked a loss on impairment of goodwill of NEC Energy Solutions, Inc. in the fiscal year ended March 31, 2016. Although NEC Energy Solutions has not recently won any projects that would lead to orders or sales, cost has been controlled largely in line with expectations. Meanwhile, it is the smart energy business in Japan that has diverged from forecasts. Although we are proceeding with minimum operations in terms of costs, profitability has deteriorated more than initially anticipated in areas such as utility and residential energy storage systems. As we carefully assess the situation, we will consider additional measures as necessary.

**Questioner D**

*Q. NEC has transferred several businesses between segments. Have you retrospectively restated your past results to reflect these transfers?*

A. We have not retrospectively restated our past results. We have transferred the transportation and city infrastructure area under our public business to the international business under the others business. Revenue in Q1 was around 6.0 billion yen. We also transferred the mobile handset business under the others business to the system platform business. Revenue in Q1 was around 3.0 billion yen.

*Q. Could you please comment on the status of unprofitable projects in Q1? Did any unprofitable projects arise in the telecom carrier business?*

A. In Q1, unprofitable projects of around 0.5 billion yen arose with respect to IT-related projects in the public business. However, this marks an improvement in unprofitable projects of around 2.0 billion yen compared with Q1 of previous fiscal year ended March 31, 2016. No unprofitable projects arose in the telecom carrier business in Q1 of the fiscal year ending March 31, 2017.

*Q. The telecom carrier business underperformed its forecasts in Q1. However, its revenue and profit are projected to increase year on year on a full-year basis. From Q2 onward, do you expect the international business to outperform its forecasts? Or do you plan to regain lost ground through the business in Japan?*

A. The international business under the telecom carrier business underperformed in Q1 due to delays attributable to customers' circumstances. Our forecasts assume that we can book these projects at some point.

**Questioner E**

*Q. NEC has not revised its full-year operating profit forecast of 100.0 billion yen, given that the major factor at play was the postponement of projects in Q1. I believe that NEC will have to make up for nearly 100.0 billion yen in 2H. Have there been any changes in the business environment or earnings structure? Operating profit decreased to the 100.0 billion yen level in the fiscal year ended March 31, 2016. In the fiscal year ending March 31, 2017, operating profit could decrease even further. Is NEC's cost structure suited to the Company? What is NEC's view on additional structural reforms?*

A. In Q1, operating profit/loss decreased by around 20.0 billion yen year on year, and underperformed the forecast by around 10.0 billion yen. We had anticipated that operating profit/loss would worsen by around 10.0 billion yen year on year, mainly based on fewer highly profitable large projects in the system platform business, and a decline in capital investment by telecom carriers in Japan in the telecom carrier business. Meanwhile, we decided at the beginning of the fiscal year to make use of corporate expenses that had been put on hold in the fiscal year ended March 31, 2016. The shortfall against our forecast was attributable to the postponement of projects. In the public business, social infrastructure-related projects were postponed. In the telecom carrier business, projects were postponed due to the circumstances of our international customers. In the smart energy business, revenue dropped further than initially anticipated. Although we will need to carefully assess whether these projects will return, none of these projects represent large changes. We will pay close attention to the projects that have been pushed back. We must also carefully control costs at all times.

**Questioner F**

*Q. Could you please tell us a little more about the specific reasons for the postponement of projects?*

A. In the public business, the postponement of projects involved satellite-, broadcasting-, and local government security-related projects. We had expected to record security-related projects in Q1, but the final contracts were pushed back to Q2 and beyond. Despite the delays, we expect to be able to recognize sales within the fiscal year ending March 31, 2017. There were two major satellite-related projects. One project that was initially expected to be recorded in Q2 will be postponed. The other project was initially expected to be recorded in 2H.

*Q. Are the overseas projects postponed in the telecom carrier business the unprofitable projects that arose in the fiscal year ended March 31, 2016? Or are the projects related to PASOLINK, SDN or suchlike?*

A. The postponed projects are not the unprofitable projects that arose in the previous fiscal year. Neither are they related to SDN. They are related to PASOLINK and optical networks.

*Q. What were your assumptions for Q1 for the telecom carrier business in Japan?*

A. We had expected to see a decline in the number of major projects we had in the fiscal year ended March 31, 2016, including fixed-line business. We had also anticipated a decline in mobile business.

*Q. What is the difference between the conditions that prompted the downward revisions to forecasts since the Q3 earnings announcement of the fiscal year ended March 31, 2016, and conditions in Q1 of the fiscal year ending March 31, 2017? Could it be that events faced by business units are not being properly reported to headquarters?*

A. Timing differences in even one major project has a significant impact. There are no differences between business units and headquarters in the timing for recognizing orders and sales. However, timing differences can arise when the desire to avoid the postponement of a project is at odds with the actual conditions. When several of these timing differences happen at once, it can be impossible to regain lost ground and forecasts must be revised down. That has been the situation so far.

**Questioner G**

*Q. In the system platform business, the size of the year-on-year decrease in revenue and operating profit/loss in Q1 is almost the same. I believe NEC anticipated the decrease in major hardware projects. However, what led to the deterioration in the profitability of the maintenance and services business? What measures will NEC implement to address this deterioration?*

A. The decline in hardware projects is the main factor that led to the deterioration in the profitability of the maintenance and services business. We will carefully assess future shipment conditions, including small SI projects. If the situation worsens, we will implement measures including cost structure enhancements.