Empowered by Innovation

NEC

Intelligence Adds Value, Added Value Generates Growth

Annual Report 2006

Year Ended March 31, 2006

NEC Networks & System Integration Corporation

PROFILE

NEC Networks & System Integration Corporation (“the Company”) was established in 1953 as a builder of communication network infrastructure. Today, the Company is working to expand its business realm and increase shareholder value as a system integrator with its principal business in network integration / support service and telecommunications engineering.

The NEC Networks & System Integration Group (“the Group”) is a core company in the network solutions business of the NEC Group. As such, the Group will work in unison to organically combine its strengths in sales, system integration (including telecommunications construction), and software development and maintenance to further reinforce its business capabilities in a rapidly changing operating environment.

NEC Networks & System Integration Group Corporate Philosophy

As a business partner to its customers, the NEC Networks & System Integration Group aims to build a bridge to a new era by:

- **Increasing customer value**
- **Helping create a more convenient and prosperous society**
- **Creating peace of mind through the establishment of reliable networks**

NEC Networks & System Integration Group Management Guidelines

- **Aim to increase the corporate value of our customers.**
- **Contribute to shareholders, customers and communities through sound management.**
- **Maintain a commitment to the highest levels of quality and safety.**
- **Act as a good, environmentally conscious corporate citizen**
- **Aim to create a workplace in which employees can fully exercise their capabilities.**

The Company Name

On October 1, 2005, the Company changed its name from NEC System Integration & Construction, Ltd. to NEC Networks & System Integration Corporation.

Since its founding, the Company has developed primarily as a builder of communication network infrastructure. In today’s communication network market, our business environment is changing rapidly, with diversification of customer needs and accelerating technological innovation driven by the shift of networks to Internet protocol (IP) and broadband and the development of ubiquitous networks. In this volatile business environment, the nature of our business is also changing significantly. Communication network infrastructure construction, traditionally our main business, now makes up less than 40 percent of sales, and network systems integration and support services has become our principal business.

To reflect this change in the nature of our business, and aiming to further develop and grow as a systems integrator in the network business, we changed the Company’s name to NEC Networks & System Integration Corporation.

CONTENTS

Cautionary Statement with Respect to Forward-Looking Statements

This annual report contains forward-looking statements concerning NEC Networks & System Integration Corporation and its consolidated subsidiaries’ current plans, projections, strategies and performance. These forward-looking statements are not historical facts. Rather, they represent the assumptions and beliefs of NEC Networks & System Integration Corporation management based on information currently available. NEC Networks & System Integration Corporation therefore wishes to caution readers that actual results may differ materially from expectations, and that forward-looking statements are subject to a number of risks or uncertainties.

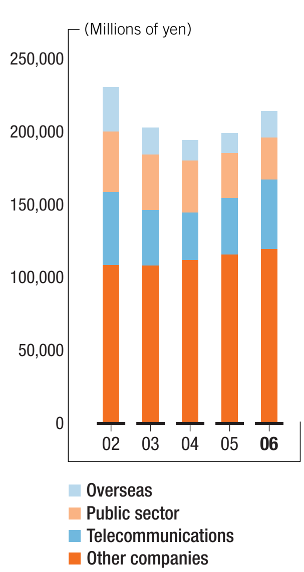
FINANCIAL HIGHLIGHTS

NEC Networks & System Integration Corporation and Consolidated Subsidiaries
Years ended March 31

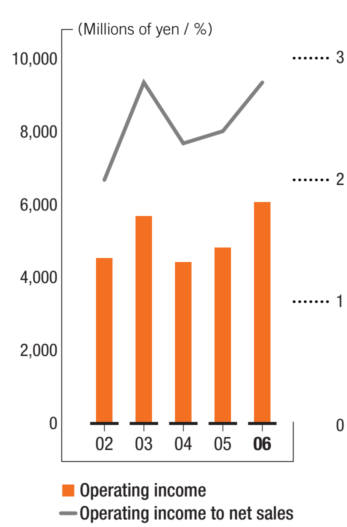
	Millions of yen (except per share amounts)			Thousands of U.S. dollars (except per share amounts)
	2006	2005	2004	**2006**
For the year:				
Net sales	**¥213,672**	¥198,625	¥194,012	**$1,818,950**
Operating income	**6,056**	4,812	4,419	**51,554**
Net income	**2,609**	1,222	500	**22,210**
At year-end:				
Total assets	**¥134,911**	¥123,935	¥118,416	**$1,148,472**
Shareholders' equity	**54,017**	51,704	50,971	**459,837**
Per share of common stock (yen and U.S. dollars):				
Net income	**¥ 60.56**	¥ 28.24	¥ 10.87	**$ 0.52**
Cash dividends applicable to the year	**14.00**	12.00	10.00	**0.12**
Ratios (%):				
Operating income to net sales	**2.8**	2.4	2.3	
Net income to net sales	**1.2**	0.6	0.3	
Return on shareholders' equity (ROE)	**4.9**	2.4	1.0	

Note: U.S. dollar amounts have been translated from yen, for convenience only, at the rate of ¥117.47 = U.S.$1.00, the approximate Tokyo foreign exchange market rate as of March 31, 2006.

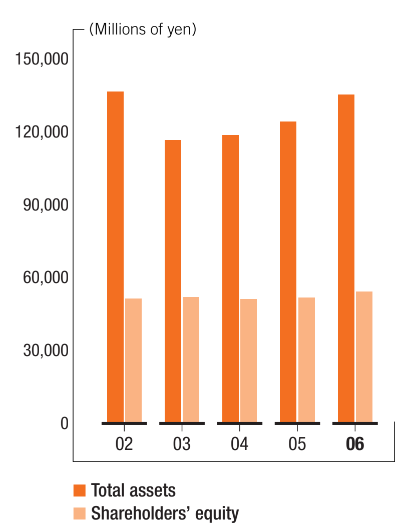
Net Sales by Customer



Operating Income and Operating Income to Net Sales



Total Assets and Shareholders' Equity



Thank you for your patronage of NEC Networks & System Integration Corporation.

The current network environment is evolving daily toward ever-greater convenience. At the same time, it is becoming a key factor in business success, as it transcends the boundaries of space and time in every business setting. The various network system configurations include voice, video and data, and many systems offer them in combination.

In addition to overall networks, we specialize in all systems that combine voice, video and data, and are enhancing our ability to respond to the Next Generation Network* (NGN), which will increase reliability, security and convenience.

In preparing for the NGN age, we are committed to increasing customer value, helping create a more convenient and prosperous society, and creating peace of mind through the establishment of reliable networks, as stated in our corporate philosophy. The entire NEC Networks & System Integration Group is committed to providing one-stop service, from proposal to construction and maintenance and operation services, to ensure that we can consistently deliver reliable and secure networks to our customers.

The Best Partner for Our Customers

As we look toward the coming NGN age, we will continue to serve our customers with leading-edge technologies and services. By doing so, we will increase our corporate value and meet the expectations of our shareholders, investors and other stakeholders.

All of us at NEC Networks & System Integration Corporation look forward to your continued patronage.

Masahiko Yamamoto
President

***Next Generation Network (NGN):**

The next-generation IP network will integrate the networks built by telecommunications carriers for services such as fixed-line telephone, mobile phone and Internet service by converting them to IP. This will enable the use of high-quality, highly reliable IP networks not only for telephones but also for other communications services such as the Internet and television broadcasting, without affecting access methods.

One service that will be made possible over the NGN is Fixed Mobile Convergence (FMC), which will allow a single telephone number and handset to be used for both fixed line and mobile telephone service, depending on the usage environment.

Overview of the Year Ended March 31, 2006

The Japanese economy moved toward a general recovery in the year ended March 31, 2006, despite a delay in the recovery of regional economies, as improvement in corporate earnings led to increased capital investment, and consumer spending and the employment environment also improved.

The business environment of the NEC Networks & System Integration Group ("the Group") was firm. Telecommunications companies expanded services to attract new subscribers, and capital investment in development of networks increased, particularly among mobile communications providers. However, there were completions of cycles and timing differences in large-scale investments by certain companies. Among other companies, despite some delays in the actualization of network-related investment of regional companies, network-related investment was solid overall, including investment in IP telephony to create advanced network environments and increase management efficiency. Moreover, in addition to the adoption of outsourcing services, the introduction of total security systems to prevent information leaks and protect personal information has been expanding in recent years.

In this business environment, the Group quickly and organically coordinated its strengths — a sales force covering the entire nation, expertise in system engineering, system integration and software development, and maintenance bases at 200 locations nationwide — to reinforce sales and proposal activities that meet customer needs. The Company has also been taking measures to enhance the earnings of the Group as a whole and expand and develop business. These included the start of operations of TOYO NETWORK SYSTEMS CO., LTD., which became a consolidated subsidiary on June 1, 2005, development of business in new fields, and sharing of markets.

As a result, in the year ended March 31, 2006, consolidated orders received totaled ¥223,383 million, a 7.7 percent increase year-on-year. Consolidated net sales were ¥213,672 million, a 7.6 percent increase, and consolidated operating income was ¥6,056 million, a 25.9 percent increase. Consolidated net income was ¥2,609 million, a 113.5 percent increase, but this was mainly because the five-year amortization of net retirement benefit obligation at transition (¥2,138 million), which had been recorded as an extraordinary loss in the previous fiscal year, was completed in the year ended March 2006.

Outlook for the Year Ending March 31, 2007

The Group will continue working to strengthen its market responsiveness and competitive power, and will aim to further develop business in the area of networks, which is expected to grow. To accomplish these goals, the Group will focus on (1) reinforcing its network businesses; (2) strengthening its ability to win orders; (3) promoting comprehensive cost reforms; and (4) niche businesses.

To reinforce its network businesses, in April 2006 the Company made a consolidated subsidiary of NEC Telenetworx, Ltd., which is mainly engaged in the business of maintenance and outsourcing services, including equipment maintenance and operation services for telecommunications companies and broadcasters, and network monitoring services for other private-sector companies. With the addition of this company as the core company in the NEC Group's network solutions business, the Group established a stronger business foundation. As a result, the Company will expand and strengthen its menu of services to meet customer needs while maximizing synergy throughout the Group to further strengthen its competitiveness in the network integration/support service business.

Profile of NEC Telenetworx, Ltd.

Wholly owned subsidiary as of April 1, 2006: Scheduled for integration in about one year.

Name:	NEC Telenetworx, Ltd.
Business scale:	Net sales ¥42.0 billion, operating income ¥1.2 billion, total assets ¥19.3 billion (year ended March 2006)
Number of employees:	1,347 (as of March 31, 2006)
Principal businesses:	The company provides the following services for conversion, carrier communication, wireless communication (micro and satellite), communication control, broadcast video and space related equipment and facilities:

- Maintenance services, etc.
  Maintenance, operations monitoring, repair and upgrading
- On-site adjustment
  System adjustment and evaluation on-site
- Technical support, etc.
  Technical support, project management and other contract services
- Supply sales, etc.
  Manufacture and sale of maintenance equipment (testers, etc.)

Approximately 90% of orders are from the NEC Group.

In the telecommunications engineering business, the Company will continue to promote cost reductions and will take measures to enhance its project responsiveness, including management capabilities, and further improve construction quality.

In addition, to respond to the fiercely competitive business environment, the Company will work to further strengthen its cost competitiveness by reinforcing overall cost reform measures and promoting improved personnel efficiency and greater efficiency in the use of expenses.

As a result of these measures, for the year ending March 31, 2007, the Company projects orders received of ¥266.5 billion (a 19.3% increase year-on-year), net sales ¥260.0 billion (a 21.7% increase year-on-year), operating income of ¥7.9 billion (a 30.4% increase year-on-year), and net income of ¥3.8 billion (a 45.6% increase year-on-year).

Medium-Term Management Strategy

In network-related business, the Company's main business area, private-sector companies are steadily adopting IP telephony and strengthening security measures to raise the sophistication of network environments and increase management efficiency. Telecommunications carriers are expanding investment in development of networks and upgrading of communications services as competition to obtain increases in new subscribers. Looking ahead, network-related investment, including the full-scale development of the NGN and expected investment in the services that will go into it, is forecast to continue on an expansion trend over the medium and long term.

Based on this business environment, the Company has set medium-term consolidated targets for fiscal 2009, the year ending March 31, 2010. Numerical targets for fiscal 2009 are net sales of ¥300.0 billion and operating income of ¥11.5 billion. To reach these targets, the Company will focus on expansion of its business areas and development of new markets to promote growth in its network integration / support service business.

Corporate Governance System

The Company believes that the cornerstone of corporate governance is ensuring management soundness and transparency by establishing a management system that enables quick decision-making to respond promptly to changes in the operating environment, and by practicing timely, appropriate disclosure.

The Company has adopted the form of a "company with corporate auditors" in order to build a proper corporate governance system, centered on the Board of Directors and corporate auditors.

The Company maintains the number of directors at an optimum level for quick decision-making. As of September 2006, the Board of Directors was composed of six directors, including one outside director. In addition, by reducing the terms of directors from two years to one year, the Company has clarified the management responsibility of directors and strengthened its management structure. The outside director attends meetings of the Board of Directors held regularly once a month and as necessary. As part of the Board of Directors, the outside director provides advice and makes decisions that add an external perspective to discussions on important matters concerning management and reports on the condition of business operations.

In addition, the Company has adopted an executive officer system to clearly separate oversight and business execution functions. Moving to enhance management functions, the Company also formed the Executive Committee, consisting of executive officers at the managing director level and higher and corporate auditors, to discuss policies pertaining to key management and operating issues, and the Business Execution Committee, which consists primarily of executive officers and division managers, to monitor the progress and report on significant matters concerning business execution.

As of September 2006, the Board of Corporate Auditors consisted of five corporate auditors, including four outside auditors. It decides audit policies and related matters, and reports on the status of audits performed by each auditor. Corporate auditors also attend Board of Directors meetings and other important meetings, examine significant documents related to final decisions, and listen to reports from directors and employees on performance of their duties, thus contributing to a robust system for scrutinizing directors' execution of their responsibilities.

The Audit Division, consisting of eight members, has been established to conduct internal audits. It examines whether business execution is being conducted legally and properly according to relevant laws, regulations and company rules. Corporate auditors and internal auditors cooperate with each other in various ways, including periodic exchanges of opinions as necessary through statutory audits.

The Company has an audit contract with Ernst & Young ShinNihon as its independent auditors to audit its accounts.

Executive Compensation

Details of executive compensation for the year ended March 31, 2006 are as follows.

1. Compensation paid to directors and corporate auditors
   - 7 directors: ¥81 million (including ¥0 million to 1 outside auditor)
   - 5 corporate auditors: ¥23 million (including ¥1 million to 2 outside corporate auditors)
2. Directors' and corporate auditors' bonuses paid by appropriation of profits
   - 5 directors: ¥29 million
   - 4 corporate auditors: ¥8 million
3. Special officers' retirement benefits paid by resolution of the general meeting of shareholders during the period
   - 1 director: ¥8 million
   - 1 corporate auditor: ¥4 million

Compliance

Gaining the trust of stakeholders is a fundamental item in the Group's management policies and the Group Corporate Behavior Charter. In addition, each officer and employee complies with and practices the Group Code of Corporate Behavior, which defines the points they should be conscious of in their business activities, thus working to ensure stakeholder-oriented management.

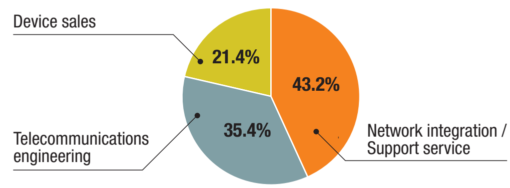
Environmental Preservation Activities

The Group aims to contribute to the environment by delivering to customers high-quality, secure and reliable products and services through its CS Quality Management Program and its Environmental Management Program, which are based on ISO9001 and ISO14001 standards.

Information Disclosure Policy

The Group understands that accurate, fair and timely disclosure of significant information concerning NEC Networks and System Integration Corporation and its subsidiaries and affiliates is an important responsibility. Accordingly, the Group makes timely disclosure based on the Rules for Timely Disclosure of Company Information of Issuers of Listed Securities set by the Tokyo Stock Exchange. Disclosure of information subject to the timely disclosure rules is made via the TDnet system provided by the Tokyo Stock Exchange, according to these same rules. Through press releases and its web site, the Company also voluntarily offers information not subject to the timely disclosure rules that concerns its business operations and is deemed significant and helps promote understanding of the Company. These measures exemplify the Company's proactive efforts to provide information to its stakeholders.

Composition of Net Sales by Business Segment
(Year ended March 31, 2006)



Network Integration / Support Service

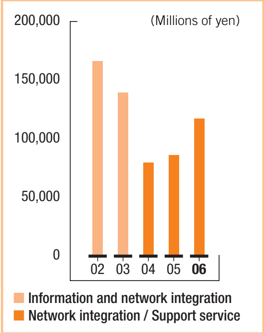
Overview of the Fiscal Year

For the year ended March 31, 2006, segment sales increased 36.4 percent, or ¥31,211 million, year-on-year to ¥116,997 million. The main factors behind the increase were solid orders for new network systems (including VoIP compatible systems) and improvement of existing systems for private-sector companies, as well as firm orders from domestic private-sector companies and telecommunications carriers in Japan and overseas for support services such as network operation and outsourcing. In addition, at TOYO NETWORK SYSTEMS CO., LTD., which became a consolidated subsidiary during the fiscal year, orders related to automated ticket machines were solid as demand continued for machines that accommodate redesigned currency notes, and orders for new products related to coin processing applications were strong.

Outlook

For the fiscal year ending March 31, 2007, the Group will work to strengthen its market responsiveness and competitiveness in the network integration / support service business, and will aim to further develop business in the area of networks, which is expected to grow. Specifically, the Group will aggressively develop its IP network related business, with a focus on the private-sector market. With the addition of TOYO NETWORK SYSTEMS CO., LTD. and NEC Telenetworx, Ltd. as consolidated subsidiaries, the Group will organically combine the expertise, technologies, markets and human resources of those companies with the strengths of the parent company: systems integration and software development capabilities, a nationwide sales force and nationwide maintenance coverage. In this way, the Group aims to further boost its competitiveness in the network integration / support service business, expand the earnings of the entire Group and promote the continued advancement of this business.

Segment Sales



Telecommunications Engineering

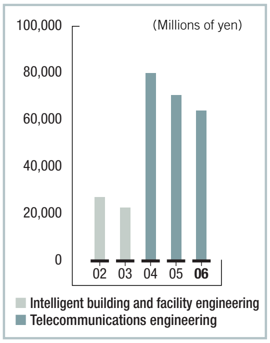
Overview of the Fiscal Year

Segment sales decreased 9.4 percent, or ¥6,639 million, year-on-year to ¥63,765 million. The main reason for the decrease was that despite increased orders for installation of base stations for mobile communications companies and construction of regional information networks for local governments, orders for construction of broadcast systems for broadcasters, including cable TV companies, as well as orders from overseas companies, decreased relative to the large-scale projects ordered in the previous fiscal year.

Outlook

Due to technological development and progress in shifting to IP, the decline in the construction field is continuing, although it is bottoming out. The Group will work to increase trust in the telecommunications engineering business by implementing additional cost-cutting measures to strengthen cost competitiveness and further improving construction quality.

Segment Sales

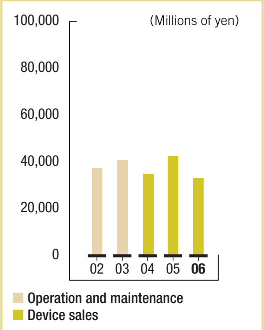


Device Sales

Overview of the Fiscal Year

Segment sales decreased 22.4 percent, or ¥9,525 million, year-on-year to ¥32,909 million. Among the main factors in the decrease, demand for information terminals and equipment for the financial industry to accommodate redesigned currency notes ran its course.

Segment Sales



SIX-YEAR SUMMARY OF SELECTED FINANCIAL DATA

NEC Networks & System Integration Corporation and Consolidated Subsidiaries
Years ended March 31

	Millions of yen (except per share figures)						Thousands of U.S. dollars (except per share figures)[1]
	2006	2005	2004	2003	2002	2001	**2005**
For the year:							
Orders	**¥223,383**	¥207,460	¥196,123	¥203,038	¥223,337	¥231,893	**$1,901,617**
Net sales	**213,672**	198,625	194,012	202,419	230,064	220,096	**1,818,950**
Network integration / Support service	**116,997**	85,786	79,285	—	—	—	**995,973**
Telecommunications engineering	**63,765**	70,404	79,853	—	—	—	**542,819**
Device sales	**32,909**	42,434	34,873	—	—	—	**280,148**
Information and network integration	**—**	—	126,617	138,997	165,557	156,873	**—**
Intelligent building and facility engineering	**—**	—	23,465	22,559	27,028	26,133	**—**
Operation and maintenance	**—**	—	43,929	40,863	37,478	37,089	**—**
Selling, general and administrative expenses	**20,502**	16,921	17,263	17,418	16,994	16,909	**174,530**
Operating income	**6,056**	4,812	4,419	5,675	4,526	8,745	**51,554**
Net income	**2,609**	1,222	500	1,512	617	3,018	**22,210**
Capital expenditures	**1,804**	2,829	1,120	755	1,506	686	**15,357**
Depreciation and amortization	**1,966**	1,712	1,455	1,464	1,099	1,033	**16,736**
Research and development costs	**455**	428	290	58	57	52	**3,873**
At year-end:							
Total assets	**¥134,911**	¥123,935	¥118,416	¥116,289	¥136,172	¥148,964	**$1,148,472**
Shareholders' equity	**54,017**	51,704	50,971	51,822	51,134	51,107	**459,837**
Per share of common stock (yen and U.S. dollars)[2]:							
Net income	**¥ 60.56**	¥ 28.24	¥ 10.87	¥ 33.93	¥ 14.33	¥ 70.40	**$ 0.52**
Net assets (BPS)	**1,285.92**	1,231.28	1,213.62	1,202.58	1,187.31	1,186.95	**10.95**
Cash flows (CFPS)	**108.2**	69.0	45.0	68.0	39.9	94.5	**0.95**
Cash dividends applicable to the year	**14.00**	12.00	10.00	10.00	12.50	12.50	**0.12**
Ratios and return indicators (%):							
Operating income to net sales	**2.8**	2.4	2.3	2.8	2.0	4.0	
Return on shareholders' equity (ROE)	**4.9**	2.4	1.0	2.9	1.2	6.1	
Return on assets (ROA)	**2.0**	1.0	0.4	1.2	0.4	2.2	
Shareholders' equity ratio	**40.0**	41.7	43.0	44.6	37.6	34.3	

Notes: 1. U.S. dollar amounts have been translated from yen, for convenience only, at the rate of ¥117.47 = U.S.$1.00, the approximate Tokyo foreign exchange market rate as of March 31, 2006.
2. A new accounting standard for amounts per share became effective April 1, 2002. See Note 13 of Notes to Consolidated Financial Statements (page 23) for details.

Review of Consolidated Operations

Changes in Scope of Consolidation

As of September 2006, the NEC Networks & System Integration Group consists of 13 consolidated subsidiaries with NEC Networks & System Integration Corporation as the core. In the fiscal year ended March 31, 2006, TOYO NETWORK SYSTEMS CO., LTD. became a consolidated subsidiary in June 2005. Two subsidiaries of this company, TOYO ALPHANET CO., LTD. and TNS Europe GmbH (established in Germany in October 2005) are also included in the scope of consolidation.

For the year ending March 31, 2007, NEC Telenetworx, Ltd., which became a Group company in April 2006, and Networks & System Integration Saudi Arabia Co., Ltd. (established in the Kingdom of Saudi Arabia in April 2006) are included in the scope of consolidation.

Sales and Income

Net Sales

Consolidated net sales for the period increased 7.6 percent, or ¥15,047 million, to ¥213,672 million. This was due to solid domestic private-sector demand in the network integration / support service business as well as the addition of TOYO NETWORK SYSTEMS CO., LTD. during the fiscal year.

By market, sales to telecommunications companies increased despite the completion of large-scale investments by some companies, due to expanded capital investment in base station equipment by mobile communications providers to improve voice quality and customer service. Among other private-sector companies, sales to regional companies were sluggish, but concerted sales and proposal efforts resulted in solid sales for renewal of networks and information systems, particularly in the financial and manufacturing sectors. Sales of maintenance and outsourcing services related to network system construction increased to both private-sector companies and telecommunications companies.

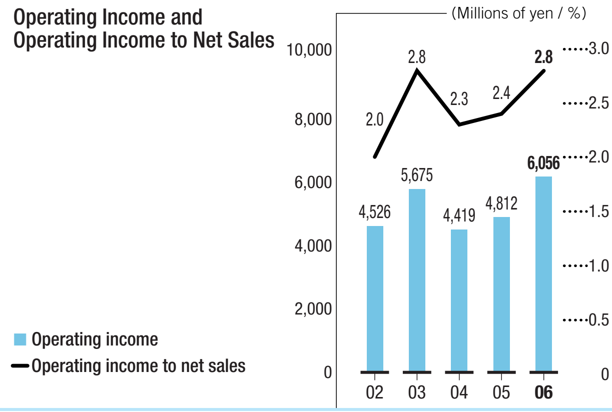
Cost of Sales and Gross Profit

Cost of sales increased 5.8 percent year-on-year to ¥187,113 million, but the ratio of cost of sales to net sales decreased from 89.1 percent to 87.6 percent, mainly due to the Company's promotion of cost-cutting activities. Gross profit increased 22.2 percent year-on-year to ¥26,559 million, and the gross margin improved 1.5 points from 10.9 percent to 12.4 percent.

Selling, General and Administrative Expenses and Operating Income

Selling, general and administrative (SG&A) expenses increased 21.2 percent year-on-year to ¥20,502 million due to factors including the addition of TOYO NETWORK SYSTEMS CO., LTD. As a result, despite the increase in SG&A expenses, operating income increased 25.9 percent, or ¥1,244 million, year-on-year to ¥6,056 million, reflecting the increases in net sales and gross profit. Research and development costs, which are included in SG&A expenses, were ¥455 million (in the previous fiscal year, research and development costs were included in SG&A expenses and manufacturing costs, and totaled ¥428 million).

Operating Income and Operating Income to Net Sales



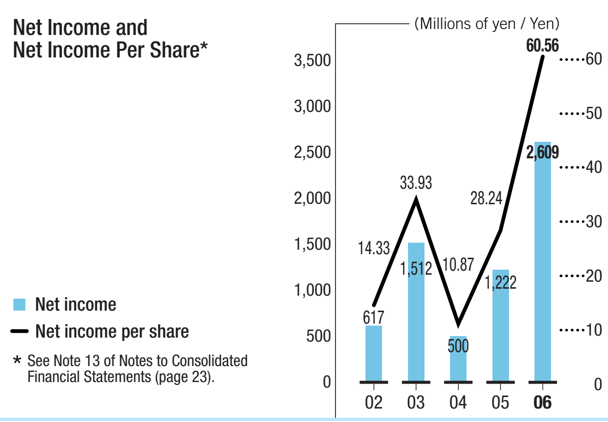
Other Income (Expenses)

Net other expenses decreased ¥1,723 million year-on-year to ¥525 million, due primarily to the absence of amortization of net retirement benefit obligation at transition recorded in the previous fiscal year. Major components of net other expenses included a loss of ¥154 million on sale of land, a ¥70 million impairment loss on investment securities, and one-time charges of ¥159 million for expenses for changing the Company's name and a ¥138 million loss on disposal of obsolete inventories.

Income before Income Taxes and Minority Interests, Net Income

As a result of the above, income before income taxes and minority interests increased 115.7 percent year-on-year to ¥5,530 million, and net income increased 113.5 percent year-on-year to ¥2,609 million.

Net Income and Net Income Per Share*



* See Note 13 of Notes to Consolidated Financial Statements (page 23).

Dividend Policy

The Company is working to raise its corporate value by strengthening its operating foundation, enhancing its financial structure and increasing its earnings capabilities. The Company considers increasing shareholder returns a management priority, and its policy is to meet the expectations of shareholders by distributing dividends that are appropriate in terms of overall consideration of consolidated performance, investment trends and other factors.

Based on this policy, the Company increased dividends for the year ended March 2006 to ¥14.00 per share from ¥12.00 per share for the previous fiscal year to return profits to the shareholders who have given the Company their support.

The Company's fundamental policy for deploying internal capital reserves is to invest strategically in growth sectors, new businesses and enhancement of competitiveness based on careful assessment of developments in network-related markets.

Business Segment Information

Network Integration / Support Service

Segment sales were ¥116,997 million, a year-on-year increase of 36.4 percent, or ¥31,211 million. Principal factors behind the increase included integration of network systems for private-sector companies and the increase in related support services such as operation and maintenance, as well as the solid results of TOYO NETWORK SYSTEMS CO., LTD.

Telecommunications Engineering

Segment sales were ¥63,765 million, a year-on-year decrease of 9.4 percent, or ¥6,639 million. The main factor in the decrease was the reactive decline in large-scale telecommunications construction projects for cable TV companies ordered in the previous fiscal year, although, as was the case for orders, installation of mobile communication base stations increased.

Device Sales

Segment sales were ¥32,909 million, a year-on-year decrease of 22.4 percent, or ¥9,525 million. Main factors in the decrease included the fact that demand for information terminals and equipment for the financial sector to accommodate redesigned currency notes ran its course.

Note: Overseas sales information is omitted because overseas sales accounted for less than 10 percent of consolidated net sales.

Liquidity

Cash Flow

Cash and cash equivalents at the end of the fiscal year decreased by ¥299 million from the end of the previous fiscal year to ¥9,903 million. Although net cash provided by operating activities increased, net cash used in investing activities also increased and financing activities, which had provided cash in the previous fiscal year, used net cash in the fiscal year under review.

Free cash flow, the total of net cash provided by operating activities and net cash used in investing activities, was ¥619 million.

Cash Flow Highlights
(Millions of yen)

Years ended March 31	**2006**	2005	2004
Net cash provided by operating activities	**3,493**	1,032	2,785
Net cash used in investing activities	**(2,874)**	(2,394)	(952)
Net cash provided by (used in) financing activities	**(968)**	2,110	(1,218)

Funding Requirements

The Group uses working capital primarily for the purchase of materials and equipment for business development, and for outsourcing costs and SG&A expenses. The main components of SG&A expenses include personnel costs and real estate rental fees. During the fiscal year ended March 31, 2006, the Company also used funds to acquire the stock of subsidiaries for the purpose of strengthening its business.

Financial Position

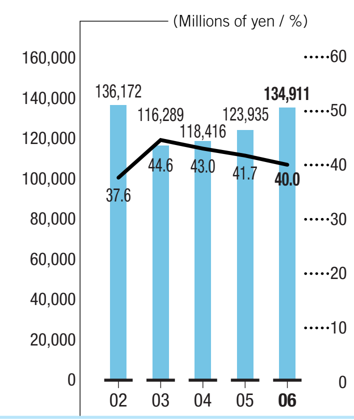
Assets

As of March 31, 2006, total assets were ¥134,911 million, an increase of 8.8 percent, or ¥10,976 million, from a year earlier. Return on average total assets (ROA) for the period was 2.0 percent, an increase of 1.0 percentage point from the previous fiscal year.

Current assets as of March 31, 2006 totaled ¥113,119 million, an increase of ¥10,582 million from a year earlier. The primary reason for the increase was an increase of ¥10,122 million in notes and accounts receivable compared to the previous fiscal year-end.

Property and equipment decreased ¥1,523 million from a year earlier to ¥7,760 million, primarily due to an increase in accumulated depreciation. Investments and other assets increased ¥1,916 million from a year earlier to ¥14,030 million.

Total Assets and Shareholders' Equity Ratio

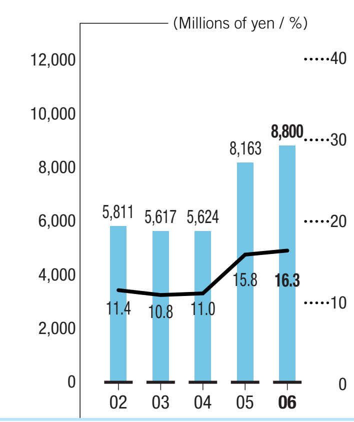


Liabilities

As of March 31, 2006, current liabilities were ¥60,760 million, an increase of ¥2,657 million from a year earlier. Although short-term bank loans decreased ¥4,363 million, notes and accounts payable increased ¥6,007 million.

Long-term liabilities increased ¥5,940 million from a year earlier to ¥19,524 million, primarily because of a ¥5,000 million increase in long-term debt.

Interest-Bearing Debt and Debt-to-Equity Ratio

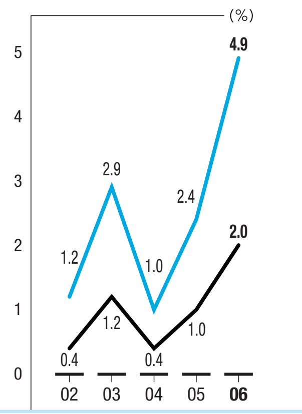


Shareholders' Equity

As of March 31, 2006, shareholders' equity totaled ¥54,017 million, an increase of ¥2,313 million from a year earlier. The increase was primarily the result of a ¥1,998 million increase in retained earnings resulting from net income of ¥2,609 million.

The ratio of shareholders' equity to total assets decreased 1.7 points from a year earlier to 40.0 percent. Return on average total shareholders' equity (ROE) increased 2.5 percentage points from a year earlier to 4.9 percent.

Return on Shareholders' Equity (ROE) and Return on Assets (ROA)



Capital Expenditures

Capital expenditures made by the Group during the fiscal year totaled ¥2,254 million. By segment, capital expenditures were ¥1,549 million in the network integration / support service segment and ¥30 million in the telecommunications engineering segment. Corporate capital expenditures totaled ¥675 million.

Research and Development Activities

The Group conducts ongoing research and development activities to respond to diversification of customer needs accompanying the rapid shift to IP and broadband in networks. As a result, research and development costs for the year ended March 31, 2006 totaled ¥455 million.

Outlook for the Fiscal Year Ending March 31, 2007

In the year ending March 31, 2007, there will be effects from delays in network-related investments by regional companies and the completion of a cycle of large-scale investments by certain telecommunications carriers, financial institutions, cable TV companies and other companies. However, growth is expected in the network integration / support service business, centered on domestic private-sector demand, and the addition of NEC Telenetworx, Ltd. as a consolidated subsidiary will increase revenues.

Given the above factors, the outlook for consolidated results for the year ending March 31, 2007 (announced April 26, 2006) is for orders received of ¥266.5 billion (a year-on-year increase of 19.3 percent), net sales of ¥260.0 billion (a year-on-year increase of 21.7 percent), operating income of ¥7.9 billion (a year-on-year increase of 30.4 percent) and net income of ¥3.8 billion (a year-on-year increase of 45.6 percent).

Risk Information

Matters that can be considered main risk factors in the Group's business operations are as follows. Note that the risks described herein do not cover all the risks related to investing in the Company's stock.

Security Management

As a system integrator, the NEC Networks & Systems Integration Group is engaged in the supply and maintenance of total systems with a focus on networks and related fields; network operation and monitoring services; and outsourcing services, and therefore possesses the information of a large number of customers. The Group has obtained ISMS certification, a system for evaluating the proper functioning of the information security management system (ISMS), and also acquired Privacy Mark certification in September 2005. In addition, the Group is also promoting ethics education for employees and education on measures to prevent information leaks.

However, the occurrence of an information leak, in spite of measures the Group is implementing such as those described above, not only could cause harm to the Group, but would also be expected to be detrimental to operating activities due to loss of social trust, and therefore could potentially have an impact on the Group's business results.

Response to Complaints from Customers

The Group follows the principles of "Customers First" and "Customer Oriented," based on its policy of always taking the customer's perspective in its various points of contact with customers.

In particular, in the event that a complaint is received from a customer regarding the Group's systems and services, rules are established for communication and reporting systems at the companywide level according to the content of the complaint, and a system has been created to respond quickly. Also, because the Group's business areas of networks and network-related services are markets in which market environments are constantly changing due to rapid technological innovation and other factors, the Group systematically conducts technical training of its employees and the employees of partner companies to upgrade their skills on a regular basis. However, in spite of such measures as those described above, the occurrence of a shortcoming or dissatisfaction in regard to the Group's technologies or in the speed of its response to customer needs could have an adverse effect on the Group's business results.

Relationship with NEC Corporation

As a member of the NEC Group, the Group conducts its business based on cooperation with NEC Corporation, and primarily handles the products and equipment of NEC Corporation.

Consequently, any major change in the competitiveness or positioning of NEC Corporation's products and equipment in the market could have an adverse effect on the Group's business results.

Overseas Business Development

In executing its overseas business, the Group conducts business based on project management that leverages the know-how it has accumulated in regard to the various risks in each region.

In the event of system damage or the cancellation of projects due to events such as deterioration of political conditions or the occurrence of terrorist acts or war, or if the Group withdraws from a site due to an evacuation advisory from the government, the Group would incur additional costs and could be liable for compensation due to project delays. Such occurrences, or a sudden change in foreign exchange rates, could have an adverse effect on the Group's business results.

	Millions of yen		Thousands of U.S. dollars (Note 3)
Assets	**2006**	2005	**2006**
Current assets:			
Cash and cash equivalents	**¥ 9,903**	¥ 10,202	**$ 84,302**
Short-term investments (Note 4)	**6**	10	**51**
Notes and accounts receivable:	**82,656**	72,534	**703,635**
Less allowance for doubtful receivables	**(1,214)**	(1,186)	**(10,335)**
Inventories (Note 5)	**16,744**	16,239	**142,539**
Deferred income taxes (Note 7)	**3,045**	2,416	**25,922**
Other current assets	**1,977**	2,321	**16,830**
Total current assets	**113,119**	102,537	**962,961**
Property and equipment:			
Land	**2,422**	2,681	**20,618**
Buildings and structures	**6,922**	6,787	**58,926**
Machinery and vehicles	**345**	49	**2,937**
Furniture and fixtures	**6,757**	6,780	**57,521**
Construction in progress	**283**	271	**2,409**
Accumulated depreciation	**(8,971)**	(7,287)	**(76,368)**
Property and equipment, net	**7,760**	9,283	**66,059**
Investments and other assets:			
Investment securities (Note 4)	**1,164**	1,029	**9,909**
Intangibles, net of allowance for amortization	**3,226**	2,197	**27,462**
Deferred income taxes (Note 7)	**6,405**	5,713	**54,525**
Other assets	**3,233**	3,173	**27,522**
Total investments and other assets	**14,030**	12,114	**119,435**
Total assets	**¥134,911**	¥123,935	**$1,148,472**

Liabilities and shareholders' equity	Millions of yen 2006	2005	Thousands of U.S. dollars (Note 3) 2006
Current liabilities:			
Short-term bank loans (Note 6)	**¥ 3,800**	¥ 8,163	**$ 32,349**
Notes and accounts payable	**43,594**	37,587	**371,108**
Advances received	**4,156**	5,261	**35,379**
Accrued income taxes (Note 7)	**2,060**	1,235	**17,536**
Accrued losses on sales contracts	**24**	—	**204**
Other current liabilities	**7,123**	5,856	**60,637**
Total current liabilities	**60,760**	58,103	**517,238**
Long-term liabilities:			
Long-term debt	**5,000**	—	**42,564**
Accrued employees' retirement benefits (Note 8)	**14,353**	13,450	**122,184**
Accrued retirement benefits for directors and corporate auditors (Note 2 (k))	**130**	78	**1,107**
Other liabilities	**40**	55	**341**
Total long-term liabilities	**19,524**	13,584	**166,204**
Minority interests in consolidated subsidiaries	**608**	543	**5,176**
Shareholders' equity (Notes 9 and 17):			
Common stock, without par value:			
Authorized — 100,000,000 shares			
Issued — 43,069,207 shares	**13,122**	13,122	**111,705**
Capital surplus	**12,622**	12,622	**107,449**
Retained earnings	**29,413**	27,415	**250,387**
Unrealized holding gain on securities	**150**	88	**1,277**
Foreign currency translation adjustments	**(370)**	(635)	**(3,150)**
	54,937	52,613	**467,673**
Treasury stock, at cost	**(920)**	(909)	**(7,832)**
Shareholders' equity, net	**54,017**	51,704	**459,837**
Commitments and contingent liabilities (Note 10)			
Total liabilities and shareholders' equity	**¥134,911**	¥123,935	**$1,148,472**

See accompanying notes to consolidated financial statements.

NEC Networks & System Integration Corporation and Consolidated Subsidiaries
Years ended March 31, 2006 and 2005

	Millions of yen		Thousands of U.S. dollars (Note 3)
	2006	2005	**2006**
Net sales (Note 15)	**¥213,672**	¥198,625	**$1,818,950**
Cost of sales (Note 12)	**187,113**	176,891	**1,592,858**
Gross profit	**26,559**	21,733	**226,092**
Selling, general and administrative expenses (Note 12)	**20,502**	16,921	**174,530**
Operating income	**6,056**	4,812	**51,554**
Other income (expenses):			
Interest and dividend income	**108**	123	**919**
Interest expense	**(93)**	(92)	**(792)**
Provision for doubtful receivables	**(62)**	(66)	**(528)**
Amortization of net retirement benefit obligation at transition	**—**	(2,138)	**—**
Gain on sale of investment securities	**82**	98	**698**
Loss on sale of land	**(154)**	—	**(1,311)**
Exchange loss	**(126)**	(71)	**(1,073)**
Provision for retirement benefits for directors and corporate auditors (Note 2 (k))	**—**	(49)	**—**
Loss on investments in partnerships	**—**	(52)	**—**
Impairment loss on investment securities	**(70)**	—	**(596)**
Expense for a change in company's name	**(159)**	—	**(1,354)**
Loss on disposal of obsolete inventories	**(138)**	—	**(1,175)**
Other, net	**87**	(0)	**741**
	(525)	(2,248)	**(4,469)**
Income before income taxes and minority interests	**5,530**	2,563	**47,076**
Income taxes (Note 7)**:**			
Current	**2,804**	1,868	**23,870**
Deferred	**66**	(573)	**562**
	2,871	1,294	**24,440**
Minority interests	**50**	46	**426**
Net income (Note 13)	**¥ 2,609**	¥ 1,222	**$ 22,210**

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

NEC Networks & System Integration Corporation and Consolidated Subsidiaries
Years ended March 31, 2006 and 2005

	Number of shares of common stock	Millions of yen					
		Common stock	Capital surplus	Retained earnings	Unrealized holding gain on securities	Foreign currency translation adjustment	Treasury stock
Balance at March 31, 2004	43,069,207	¥13,122	¥12,622	¥26,691	¥ 81	¥(643)	¥(902)
Net gains on sales of treasury stock	—	—	0	—	—	—	—
Bonuses to directors and statutory auditors	—	—	—	(37)	—	—	—
Cash dividends paid	—	—	—	(419)	—	—	—
Net income for the year ended March 31, 2005	—	—	—	1,222	—	—	—
Decrease of consolidated subsidiaries	—	—	—	(41)	—	—	—
Unrealized holding gain on securities	—	—	—	—	7	—	—
Foreign currency translation adjustments	—	—	—	—	—	8	—
Treasury stock	—	—	—	—	—	—	(7)
Balance at March 31, 2005	43,069,207	¥13,122	¥12,622	¥27,415	¥ 88	¥(635)	¥(909)
Net gains on sales of treasury stock	**—**	**—**	**0**	**—**	**—**	**—**	**—**
Bonuses to directors and statutory auditors	**—**	**—**	**—**	**(37)**	**—**	**—**	**—**
Cash dividends paid	**—**	**—**	**—**	**(587)**	**—**	**—**	**—**
Net income for the year ended March 31, 2006	**—**	**—**	**—**	**2,609**	**—**	**—**	**—**
An adjustment to record deferred tax assets at a consolidated subsidiary	**—**	**—**	**—**	**12**	**—**	**—**	**—**
Unrealized holding gain on securities	**—**	**—**	**—**	**—**	**62**	**—**	**—**
Foreign currency translation adjustments	**—**	**—**	**—**	**—**	**—**	**265**	**—**
Treasury stock	**—**	**—**	**—**	**—**	**—**	**—**	**(11)**
Balance at March 31, 2006	**43,069,207**	**¥13,122**	**¥12,622**	**¥29,413**	**¥150**	**¥(370)**	**¥(920)**

	Thousands of U.S. dollars (Note 3)					
	Common stock	Capital surplus	Retained earnings	Unrealized holding gain on securities	Foreign currency translation adjustment	Treasury stock
Balance at March 31, 2005	$111,705	$107,449	$233,379	$ 749	$(5,406)	$(7,738)
Net gains on sales of treasury stock	**—**	**0**	**—**	**—**	**—**	**—**
Bonuses to directors and statutory auditors	**—**	**—**	**(315)**	**—**	**—**	**—**
Cash dividends paid	**—**	**—**	**(4,997)**	**—**	**—**	**—**
Net income for the year ended March 31, 2006	**—**	**—**	**22,210**	**—**	**—**	**—**
An adjustment to record deferred tax assets at a consolidated subsidiary	**—**	**—**	**102**	**—**	**—**	**—**
Unrealized holding gain on securities	**—**	**—**	**—**	**528**	**—**	**—**
Foreign currency translation adjustments	**—**	**—**	**—**	**—**	**2,256**	**—**
Treasury stock	**—**	**—**	**—**	**—**	**—**	**(94)**
Balance at March 31, 2006	**$111,705**	**$107,449**	**$250,387**	**$1,277**	**$(3,150)**	**$(7,832)**

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

NEC Networks & System Integration Corporation and Consolidated Subsidiaries
Years ended March 31, 2006 and 2005

	Millions of yen		Thousands of U.S. dollars (Note 3)
	2006	2005	2006
Operating activities			
Income before income taxes and minority interests	¥ 5,530	¥ 2,563	$ 47,076
Depreciation and amortization	1,966	1,712	16,736
Amortization of excess of costs over net assets acquired	53	(6)	451
Provision for doubtful receivables	(18)	(55)	(153)
Provision for accrued employees' retirement benefits	(885)	1,090	(7,534)
Provision for retirement benefits for directors and corporate auditors	52	78	443
Provision for accrued losses on sales contracts	24	—	204
Impairment loss on investment securities	70	—	596
Interest and dividend income	(38)	(63)	(323)
Interest expense	93	92	792
Gain on sales of investment securities	(82)	(98)	(698)
Gain on sales of property and equipment	(12)	(8)	(102)
Loss on sale of property and equipment	154	—	1,311
Trade notes and accounts receivable	(5,701)	(9,592)	(48,532)
Inventories	4,095	2,859	34,860
Trade notes and accounts payable	679	3,849	5,780
Other	(365)	435	(3,107)
	5,616	2,858	47,808
Interest and dividends received	38	63	323
Interest paid	(89)	(92)	(758)
Income taxes paid	(2,072)	(1,796)	(17,639)
Net cash provided by operating activities	3,493	1,032	29,735
Investing activities			
Purchases of property and equipment	(1,506)	(2,132)	(12,820)
Sales of property and equipment	129	22	1,098
Purchases of intangibles, net of allowance for amortization	(738)	(695)	(6,282)
Purchases of investment securities	(113)	(26)	(962)
Sales of investment securities	94	154	800
Loans receivable made	(22)	(42)	(187)
Collection of loans receivable	19	39	162
Purchase of common stocks of newly consolidated subsidiaries	(748)	—	(6,368)
Other	11	285	94
Net cash used in investing activities	(2,874)	(2,394)	(24,466)
Financing activities			
Net increase in short-term bank loans	(5,366)	2,546	(45,680)
Proceeds from long-term debt	5,000	—	42,564
Purchases of treasury stock, net	(11)	(7)	(94)
Proceeds from sales of treasury stock	1	1	9
Cash dividends paid	(585)	(418)	(4,980)
Other	(6)	(12)	(51)
Net cash provided by (used in) financing activities	(968)	2,110	(8,240)
Effect of exchange rate changes on cash and cash equivalents	51	(6)	434
Net (decrease) increase in cash and cash equivalents	(298)	741	(2,537)
Cash and cash equivalents at beginning of the year	10,202	9,463	86,848
Decrease due to the exclusion of subsidiaries from consolidation	—	(3)	—
Cash and cash equivalents at end of the year	¥ 9,903	¥10,202	$ 84,302

See accompanying notes to consolidated financial statements.

1. BASIS OF PREPARATION

NEC Networks & System Integration Corporation (the "Company") and its domestic subsidiaries maintain their books of account in conformity with the financial accounting standards of Japan, and its foreign subsidiaries maintain their books of account in conformity with those of their countries of domicile.

The accompanying consolidated financial statements have been compiled from the consolidated financial statements prepared by the Company as required under the Securities and Exchange Law of Japan and, have been prepared in accordance with accounting principles generally accepted in Japan, which are different in certain respects as to the application and disclosure requirements of International Financial Reporting Standards.

As permitted by the Securities and Exchange Law of Japan, amounts of less than one million yen have been omitted. As a result, the totals shown in the accompanying consolidated financial statements (both in yen and U.S. dollars) do not necessarily agree with the sum of the individual amounts.

Certain amounts in the prior year's financial statements have been reclassified to conform to the current year's presentation.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of consolidation and accounting for investments in unconsolidated subsidiaries and affiliates

The accompanying consolidated financial statements include the accounts of the Company and the significant companies controlled directly or indirectly by the Company. All significant intercompany balances and transactions have been eliminated in consolidation.

The excess of costs over underlying net assets at fair value at the respective dates of acquisition is amortized by the straight-line method over a period, up to twenty years, in which the future benefit of each investment is expected to continue.

(b) Foreign currency translation

Monetary assets and liabilities denominated in foreign currencies are translated into yen at the exchange rates prevailing at the balance sheet dates, except for assets and liabilities hedged by forward foreign exchange contracts. All other assets and liabilities denominated in foreign currencies are translated at their historical rates.

All revenues and expenses associated with foreign currencies are translated at the rates of exchange prevailing when such transactions were made. The resulting exchange gain or loss is credited or charged to income.

The revenue and expense accounts of the foreign subsidiaries are translated into yen at the average exchange rates prevailing during the year, and, except for the components of shareholders' equity, the balance sheet accounts are translated at the rates of exchange in effect at the balance sheet date. The components of shareholders' equity are translated at their historical exchange rates. Translation adjustments are presented as a component of shareholders' equity and minority interests in the accompanying consolidated financial statements.

(c) Cash equivalents

All highly liquid investments with a maturity of three months or less when purchased are considered cash equivalents.

(d) Investment securities

Investment securities other than those in subsidiaries and affiliates are classified into three categories: trading, held-to-maturity or other securities. Trading securities are measured at fair value and held-to-maturity securities are carried at amortized cost. Marketable securities classified as other securities are measured at fair value with any changes in unrealized holding gain or loss, net of the applicable income taxes, included directly in shareholders' equity. Non-marketable securities classified as other securities are carried at cost except for investments in limited partnerships that are accounted for by the equity method. Investment securities classified as other securities are reviewed annually for impairment. An impairment loss is recognized when such impairment is considered other than temporary. Cost of securities sold is determined by the moving-average method.

(e) Inventories

Work in process is stated at cost determined on a specific project basis. Purchased goods, materials and supplies are stated at cost determined primarily by the moving-average method.

(f) Depreciation and amortization

Depreciation of property and equipment is principally computed by the declining-balance method, except for certain leased assets of the Company and property and equipment of certain foreign subsidiaries on which depreciation is computed by the straight-line method, based on the estimated useful lives of the respective assets. Significant renewals and improvements are capitalized. Maintenance and repair costs are charged to income.

The useful lives of property and equipment are summarized as follows:

Buildings and structures	2 to 47 years
Machinery and vehicles	4 to 10 years
Furniture and fixtures	2 to 20 years

Intangible assets are amortized by the straight-line method over their estimated useful lives.

(g) Allowance for doubtful receivables

The allowance for doubtful receivables is provided at an amount determined based on the historical experience of bad debt with respect to ordinary receivables, plus an estimate of uncollectible amounts determined by reference to specific doubtful receivables from customers which are experiencing financial difficulties.

(h) An accrual of losses on sales contracts

Allowance for losses on sales contracts is provided for at the amount of estimated losses for work in progress at the balance sheet date. Among sales orders of the Company on hand at balance sheet date, for projects in which the estimated cost is expected to exceed the amount of the sales order, such excess costs on sales contracts are accrued.

(i) Leases

Non-cancellable lease transactions are accounted for as operating leases (whether such leases are classified as operating or finance leases) except that lease agreements which stipulate the transfer of ownership of the leased assets to the lessee are accounted for as finance leases.

(j) Research and development costs

Research and development costs are charged to income as incurred.

(k) Retirement benefits

Accrued employees' retirement benefits are provided mainly at an amount calculated based on the retirement benefit obligation and the fair value of the pension plan assets at the balance sheet dates, as adjusted for the unrecognized net retirement benefit obligation at transition, unrecognized actuarial gain or loss and unrecognized prior service cost. The retirement benefit obligation is attributed to each period by the straight-line method over the estimated years of service of the eligible employees. Actuarial gain or loss is being amortized in the year following the year in which the gain or loss is recognized primarily by the straight-line method over the average remaining years of service of the employees. Prior service cost is being amortized as incurred by the straight-line method over the average remaining years of service of the employees.

In addition, directors and corporate auditors are entitled, in most circumstances, to lump-sum severance payments based on current rates of pay, length of service and certain other factors. Provision for retirement benefits for these directors and corporate auditors are made at estimated amounts based on their internal rules.

(l) Change in accounting method for the impairment of fixed assets

Effective April 1, 2005, the Company has adopted "Opinion Concerning Establishment of Accounting Standards for Impairment of Fixed Assets" (issued by the Business Accounting Deliberation Council on August 9, 2002) and the Financial Accounting Standard Implementation Guidance No. 6, "Implementation Guidance on Accounting Standards for Impairment of Fixed Assets" (issued by the Accounting Standards Board of Japan on October 31, 2003). There was no effect from the adoption of the pronouncement.

(m) Income taxes

Deferred tax assets and liabilities are determined based on the differences between financial reporting and the tax bases of the assets and liabilities and are measured using the enacted tax rates and laws which will be in effect when the differences are expected to reverse.

(n) Appropriation of retained earnings

Under the Commercial Code of Japan, the appropriation of retained earnings with respect to a given financial period is made by resolution of the shareholders at a general meeting held subsequent to the close of such financial period and, therefore, the accounts for the period do not reflect such appropriations. See Note 17.

(o) Derivative financial instruments

Derivatives are recorded at their fair value with any changes in unrealized gain or loss charged or credited to income, except for those which meet the criteria for deferral hedge accounting under which unrealized gain or loss is deferred as an asset or a liability. Receivables and payables hedged by qualified forward foreign exchange contracts are translated at the corresponding foreign exchange contract rates.

(p) Revenue recognition

Revenues from construction contracts of the Company and the domestic consolidated subsidiaries are recognized by the completed-contract method except for those from construction work with contracted amounts exceeding ¥100 million, which are recognized by the percentage-of-completion method. Revenues from construction work of the foreign consolidated subsidiaries are generally recognized by the percentage-of-completion method.

3. U.S. DOLLAR AMOUNTS

The translation of yen amounts into U.S. dollar amounts is included solely for the convenience of readers outside Japan and has been made, as a matter of arithmetic computation only, at ¥117.47 = U.S.$1.00, the approximate rate of exchange on March 31, 2006. The translation should not be construed as a representation that yen have been, could have been, or could in the future be, converted into U.S. dollars at that or any other rate.

4. INVESTMENT SECURITIES

a) The components of unrealized gain or loss on marketable securities classified as other securities at March 31, 2006 and 2005 were summarized as follows:

	Millions of yen			Thousands of U.S. dollars		
March 31, 2006	Acquisition cost	Carrying value	Unrealized gain or loss	Acquisition cost	Carrying value	Unrealized gain or loss
Securities whose carrying value exceeds their acquisition cost:						
Equity securities	**¥136**	**¥412**	**¥275**	**$1,158**	**$3,507**	**$2,341**
Debt securities	**—**	**—**	**—**	**—**	**—**	**—**
Other	**—**	**—**	**—**	**—**	**—**	**—**
Subtotal	**136**	**412**	**275**	**1,158**	**3,507**	**2,341**
Securities whose acquisition cost exceeds their carrying value:						
Equity securities	**—**	**—**	**—**	**—**	**—**	**—**
Debt securities	**—**	**—**	**—**	**—**	**—**	**—**
Other	**—**	**—**	**—**	**—**	**—**	**—**
Subtotal	**—**	**—**	**—**	**—**	**—**	**—**
Total	**¥136**	**¥412**	**¥275**	**$1,158**	**$3,507**	**$2,341**

	Millions of yen		
March 31, 2005	Acquisition cost	Carrying value	Unrealized gain or loss
Securities whose carrying value exceeds their acquisition cost:			
Equity securities	¥152	¥301	¥149
Debt securities	—	—	—
Other	—	—	—
Subtotal	152	301	149
Securities whose acquisition cost exceeds their carrying value:			
Equity securities	—	—	—
Debt securities	—	—	—
Other	—	—	—
Subtotal	—	—	—
Total	¥152	¥301	¥149

b) Sales of securities classified as other securities for the years ended March 31, 2006 and 2005 are summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Proceeds from sales	**¥94**	¥154	**$800**
Gains on sales	**82**	98	**698**
Losses on sales	**—**	19	**—**

c) The components of non-marketable securities classified as other securities at March 31, 2006 and 2005 were summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Other securities:			
Unlisted securities (except for OTC securities)	**¥304**	¥373	**$2,588**
Investments in limited partnerships	**391**	354	**3,329**
Total	**¥695**	¥727	**$5,916**

5. INVENTORIES

Inventories at March 31, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Work in process	**¥12,523**	¥14,736	**$106,606**
Purchased goods, materials and supplies	**4,220**	1,503	**35,924**
	¥16,744	¥16,239	**$142,539**

6. SHORT-TERM BANK LOANS AND LONG-TERM DEBT

Short-term bank loans and long-term debt are unsecured. The weighted average interest rates of short-term bank loans for the years ended March 31, 2006 and 2005 were approximately 0.7% and 0.6%, respectively. The weighted average interest rates of long-term debt for the year ended March 31, 2006 is approximately 1.0%. The annual maturities of the long-term debt are as follows:

Year ending March 31,	Millions of yen
2010	¥2,000
Thereafter	3,000
	¥5,000

The Group executed a ¥11,000 million ($93,640 thousand) committed borrowing facility with a domestic banking group during the fiscal year ended March 31, 2006. As of March 31, 2006, the Group drew ¥3,250 million ($27,666 thousand) from this facility.

7. INCOME TAXES

Income taxes applicable to the Company and its domestic subsidiaries comprise corporation, enterprise and inhabitants' taxes, which, in the aggregate, resulted in a statutory tax rate of approximately 40.7% for 2006 and 2005. Income taxes of the foreign subsidiaries are based generally on the tax rates applicable in their countries of incorporation.

The effective tax rates reflected in the consolidated statements of income for the years ended March 31, 2006 and 2005 differ from the statutory tax rate for the following reasons:

	2006	2005
Statutory tax rate	**40.7%**	40.7%
Effect of:		
Expenses not deductible for income tax purposes	**2.7**	5.3
Dividend income deductible for income tax purposes	**(0.1)**	(0.2)
Inhabitants tax per capita levy	**1.7**	3.1
Foreign tax credits	**6.0**	—
Tax credits	**(1.6)**	(1.3)
Other, net	**2.5**	2.9
Effective tax rates	**51.9%**	50.5%

The significant components of deferred tax assets and liabilities as of March 31, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Deferred tax assets:			
Accrued bonuses	**¥1,281**	¥1,115	**$10,905**
Social security on employee bonuses	**121**	—	**1,030**
Allowance for doubtful receivables	**406**	512	**3,456**
Accrued enterprise tax	**181**	115	**1,541**
Notes and accounts receivable	**192**	174	**1,634**
Loss on revaluation of inventories	**571**	—	**4,861**
Unrealized profit on inventories	**15**	8	**128**
Depreciation	**124**	—	**1,056**
Software	**400**	—	**3,405**
Foreign tax credits	**—**	329	**—**
Accrued retirement benefits	**5,807**	5,285	**49,434**
Other	**850**	755	**7,236**
Sub-total	**9,952**	8,297	**84,720**
Valuation allowance	**(384)**	(103)	**(3,269)**
Total	**9,567**	8,193	**81,442**
Deferred tax liabilities:			
Advanced depreciation of property and equipment	**(1)**	(1)	**(9)**
Unrealized holding gain on securities	**(112)**	(60)	**(953)**
Other	**(3)**	(1)	**(26)**
	(116)	(63)	**(987)**
Net deferred tax assets	**¥9,451**	¥8,129	**$80,455**

8. RETIREMENT BENEFIT PLANS

The Company and certain consolidated subsidiaries have defined benefit plans, (i.e., Welfare Pension Fund Plans ("WPFP")) and lump-sum payment plans, covering substantially all employees who are entitled to lump-sum or annuity payments, the amounts of which are determined by reference to their basic rates of pay, length of service, and the conditions under which termination occurs.

The following table sets forth the funded and accrued status of the plans, and the amounts recognized in the consolidated balance sheets as of March 31, 2006 and 2005 for the Company's and the consolidated subsidiaries' defined benefit plans:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Retirement benefit obligation	**¥(28,690)**	¥(24,823)	**$(244,233)**
Plan assets at fair value	**13,972**	9,925	**118,941**
Unfunded retirement benefit obligation	**(14,718)**	(14,897)	**(125,292)**
Unrecognized actuarial loss	**5,998**	6,694	**51,060**
Unrecognized prior service cost	**(5,633)**	(5,247)	**(47,953)**
Accrued employees' retirement benefits	**¥(14,353)**	¥(13,450)	**$(122,184)**

The components of retirement benefit expenses for the years ended March 31, 2006 and 2005 are outlined as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Service cost	**¥1,438**	¥1,362	**$12,241**
Interest cost	**685**	643	**5,831**
Expected return on plan assets	**(262)**	(213)	**(2,230)**
Amortization of actuarial loss	**582**	543	**4,954**
Amortization of prior service cost	**(385)**	(341)	**(3,277)**
Amortization of net retirement benefit obligation at transition	**—**	2,138	**—**
Total	**¥2,058**	¥4,131	**$17,519**

The assumptions used in accounting for the above plans were as follows:

	2006	2005
Discount rate	**2.5%**	2.5%
Expected return on plan assets	**2.5~3.5%**	2.5%

9. SHAREHOLDERS' EQUITY

In accordance with the Commercial Code of Japan (the "Code"), the Company has provided a legal reserve, which was included in retained earnings. The Code provides that an amount equal to at least 10% of the amount to be disbursed as a distribution of earnings be appropriated to the legal reserve until the total of such reserve and the capital surplus account equals 25% of the common stock account. The legal reserve amounted to ¥546 million ($4,648 thousand) as of both March 31, 2006 and 2005.

10. CONTINGENT LIABILITIES

At March 31, 2006, the Company was contingently liable as guarantor of indebtedness of the Company's employees in the aggregate amount of ¥236 million ($2,009 thousand).

11. LEASES

a) Finance leases

The following pro forma amounts represent the acquisition costs, accumulated depreciation and net book value of the leased property as of March 31, 2006 and 2005, which would have been reflected in the consolidated balance sheets if finance lease accounting had been applied to the finance leases currently accounted for as operating leases:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Acquisition costs:			
Machinery and vehicles	**¥ 135**	¥ 171	**$ 1,149**
Furniture and fixtures	**3,710**	4,273	**31,583**
Software	**412**	—	**3,507**
	¥4,258	¥4,444	**$36,248**
Accumulated depreciation:			
Machinery and vehicles	**¥ 71**	¥ 66	**$ 604**
Furniture and fixtures	**1,494**	2,091	**12,718**
Software	**117**	—	**996**
	¥1,683	¥2,157	**$14,327**
Net book value:			
Machinery and vehicles	**¥ 64**	¥ 105	**$ 545**
Furniture and fixtures	**2,216**	2,181	**18,864**
Software	**295**	—	**2,511**
	¥2,575	¥2,286	**$21,920**

Lease payments relating to finance leases accounted for as operating leases amounted to ¥1,012 million ($8,615 thousand) and ¥968 million for the years ended March 31, 2006 and 2005, respectively. The depreciation expense of the leased assets computed by the straight-line method over the respective lease terms and the interest expense portion included in the lease payments amounted to ¥943 million ($8,028 thousand) and ¥70 million ($596 thousand), respectively, for the year ended March 31, 2006 and ¥900 million and ¥64 million, respectively, for the year ended March 31, 2005.

Future minimum lease payments (including the interest portion thereon) subsequent to March 31, 2006 and 2005 for finance leases accounted for as operating leases are summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Due within one year	**¥ 882**	¥ 752	**$ 7,508**
Due over one year	**1,764**	1,535	**15,017**
Total	**¥2,646**	¥2,288	**$22,525**

b) Operating leases

Future minimum operating lease payments subsequent to March 31, 2006 and 2005 for non-cancelable operating leases are summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Due within one year	**¥25**	¥25	**$213**
Due over one year	**39**	43	**332**
Total	**¥65**	¥69	**$553**

12. RESEARCH AND DEVELOPMENT COSTS

Research and development costs included in selling, general and administrative expenses amounted to ¥455 million ($3,873 thousand) and ¥428 million for the years ended March 31, 2006 and 2005, respectively.

13. AMOUNTS PER SHARE

	Yen		U.S. dollars
	2006	2005	**2006**
Net income	**¥ 60.56**	¥ 28.24	**$ 0.52**
Cash dividends applicable to the year	**14.00**	12.00	**0.12**
Net assets	**1,285.92**	1,231.28	**10.95**

Net income per share is computed based on the net income available for distribution to shareholders of common stock and the weighted-average number of shares of common stock outstanding during the year. There are no equity instruments issued that have dilutive effect on earnings per share.

Amounts per share of net assets is computed based on net assets available for distribution to the shareholders and the number of shares of common stock outstanding at the year end.

Cash dividends per share represent the cash dividends declared as applicable to the respective years together with the interim cash dividends paid.

14. DERIVATIVES

The Company has entered into foreign exchange forward contracts with major Japanese banks in order to manage certain risks arising from adverse fluctuations in foreign currency exchange rates.

At March 31, 2006 and 2005, the disclosure of fair value information for derivatives has been omitted since all derivatives have been accounted for as hedges.

15. RELATED PARTY TRANSACTIONS

The Company is a majority-owned subsidiary of NEC Corporation ("NEC"). Consolidated net sales included those to NEC in amounts of ¥58,220 million ($495,616 thousand) and ¥56,510 million for the years ended March 31, 2006 and 2005, respectively. In addition, the Company purchased communications equipment and other from NEC in amounts of ¥44,739 million ($380,855 thousand) and ¥47,112 million during the years ended March 31, 2006 and 2005, respectively.

The terms of the transactions referred to above were negotiated and determined on an arm's-length basis.

16. SEGMENT INFORMATION

The Company and its consolidated subsidiaries are primarily engaged in the manufacture and sale of products in Japan and foreign countries in three major segments: the Network integration/Support service segment, the Telecommunications engineering segment, and the Device sales segment.

Business segments

The business segment information for the Company and its consolidated subsidiaries for the years ended March 31, 2006 and 2005 is summarized as follows:

	Millions of yen					
Year ended March 31, 2006	Network integration / Support service	Telecommu-nications engineering	Device sales	Total	Eliminations or corporate	Consolidated
I. Sales:						
(1) Sales to third parties	**¥116,997**	**¥63,765**	**¥32,909**	**¥213,672**	**¥ —**	**¥213,672**
(2) Intersegment sales	**—**	**—**	**—**	**—**	**—**	**—**
Total sales	**116,997**	**63,765**	**32,909**	**213,672**	**—**	**213,672**
Operating expenses	**110,313**	**60,254**	**32,874**	**203,442**	**4,173**	**207,616**
Operating income	**¥ 6,684**	**¥ 3,510**	**¥ 35**	**¥ 10,230**	**¥ (4,173)**	**¥ 6,056**
II. Assets, depreciation expenses, capital expenditures:						
Assets	**¥ 54,165**	**¥35,474**	**¥13,766**	**¥103,406**	**¥31,504**	**¥134,911**
Depreciation expenses	**905**	**30**	**—**	**936**	**1,030**	**1,967**
Capital expenditures	**1,549**	**30**	**—**	**1,579**	**675**	**2,254**

	Thousands of U.S. dollars					
Year ended March 31, 2006	Network integration / Support service	Telecommu-nications engineering	Device sales	Total	Eliminations or corporate	Consolidated
I. Sales:						
(1) Sales to third parties	**$995,973**	**$542,819**	**$280,148**	**$1,818,950**	**$ —**	**$1,818,950**
(2) Intersegment sales	**—**	**—**	**—**	**—**	**—**	**—**
Total sales	**995,973**	**542,819**	**280,148**	**1,818,950**	**—**	**1,818,950**
Operating expenses	**939,074**	**512,931**	**279,850**	**1,731,863**	**35,524**	**1,767,396**
Operating income	**$ 56,900**	**$ 29,880**	**$ 298**	**$ 87,086**	**$ (35,524)**	**$ 51,554**
II. Assets, depreciation expenses, capital expenditures:						
Assets	**$461,096**	**$301,983**	**$117,187**	**$ 880,276**	**$268,188**	**$1,148,472**
Depreciation expenses	**7,704**	**255**	**—**	**7,968**	**3,778**	**16,745**
Capital expenditures	**13,186**	**255**	**—**	**13,442**	**5,746**	**19,188**

	Millions of yen					
Year ended March 31, 2005	Network integration / Support service	Telecommu-nications engineering	Device sales	Total	Eliminations or corporate	Consolidated
I. Sales:						
(1) Sales to third parties	¥85,786	¥70,404	¥42,434	¥198,625	¥ —	¥198,625
(2) Intersegment sales	—	—	—	—	—	—
Total sales	85,786	70,404	42,434	198,625	—	198,625
Operating expenses	80,000	66,969	42,531	189,500	4,312	193,813
Operating income	¥ 5,785	¥ 3,434	¥ (96)	¥ 9,124	¥ (4,312)	¥ 4,812
II. Assets, depreciation expenses, capital expenditures:						
Assets	¥42,019	¥37,835	¥15,435	¥ 95,291	¥28,643	¥123,935
Depreciation expenses	696	30	—	727	984	1,712
Capital expenditures	1,886	39	—	1,926	904	2,830

Geographical segments

As net sales and total assets of the foreign operations constituted less than 10% of the consolidated totals for the years ended March 31, 2006 and 2005, the disclosure of geographical segment information has been omitted.

Overseas sales

As overseas sales constituted less than 10% of the consolidated net sales for the years ended March 31, 2006 and 2005, the disclosure of overseas sales information was omitted.

17. SUBSEQUENT EVENTS

a) On December 15, 2005, the Company entered into stock-for-stock exchange agreements under the Japanese Commercial Code with NEC Telenetworx, Ltd. The exchange was executed on April 1, 2006, and therefore NEC Telenetworx, Ltd. became a wholly owned subsidiaries of the Company.

b) The following appropriations of retained earnings of the Company, which have not been reflected in the accompanying consolidated financial statements for the year ended March 31, 2006, were approved at a meeting of the shareholders held on June 29, 2006:

	Millions of yen	Thousands of U.S. dollars
Cash dividends (¥7.00 = $0.060 per share)	¥293	$2,494
Bonuses to directors and statutory auditors	45	383

ERNST & YOUNG

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■ Tel : 03 3503 1100
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Report of Independent Auditors

The Board of Directors
NEC Networks & System Integration Corporation

We have audited the accompanying consolidated balance sheets of NEC Networks & System Integration Corporation and consolidated subsidiaries as of March 31, 2006 and 2005, and the related consolidated statements of income, shareholders' equity, and cash flows for the years then ended, all expressed in yen. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in Japan. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of NEC Networks & System Integration Corporation and consolidated subsidiaries at March 31, 2006 and 2005, and the consolidated results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in Japan.

Supplemental Information

On December 15, 2005, the Company entered into stock-for-stock exchange agreements under the Japanese Commercial Code with NEC Telenetworx, Ltd. The exchange was executed on April 1, 2006, and therefore, NEC Telenetworx, Ltd. became a wholly owned subsidiary of the Company.

The U.S. dollar amounts in the accompanying consolidated financial statements with respect to the year ended March 31, 2006 are presented solely for convenience. Our audit also included the translation of yen amounts into U.S. dollar amounts and, in our opinion, such translation has been made on the basis described in Note 3.

Ernst & Young ShinNihon

June 29, 2006

DIRECTORS AND CORPORATE AUDITORS

(As of June 29, 2006)

Directors:

President

Masahiko Yamamoto

Senior Vice Presidents and Members of the Board

Tatsu Fujita

Yukio Yamazaki

Hiroshi Miwa

Tooru Rokusha

Koshiro Konno

Member of the Board

Kazuo Tsuzuki

Corporate Auditors:

Masayuki Komura (full-time)

Norikazu Tomioka (full-time)

Harutome Umezawa

Hiroaki Tomoda

Tetsujiro Arano

NETWORK

(As of March 1, 2006)

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Shinagawa-ku, Tokyo 140-8620,
Japan
Tel: +81-3-5463-1111
Fax: +81-3-5463-7781
http://www.nesic.co.jp

Domestic Regional Offices:

Hokkaido, Tohoku, Shinetsu, Kitakanto, Chiba, Kanagawa, Shizuoka, Chubu, Hokuriku, Kansai, Keiji, Kobe, Chugoku, Shikoku, Kyushu

Overseas Representative Offices:

Brazil, Thailand, Philippines, Indonesia, China

Subsidiaries and Affiliates:

NEC Telenetworx, Ltd.
Head Office: Tokyo, Japan
Established: April 1975

TOYO NETWORK SYSTEMS CO., LTD.
Head Office: Kanagawa, Japan
Established: May 2006

NEC Networks & System Integration Engineering, Ltd.
Head Office: Tokyo, Japan
Established: October 1992

NEC Networks & System Integration Services, Ltd.
Head Office: Tokyo, Japan
Established: July 1988

NESIC Ascerent, Ltd.
Head Office: Tokyo, Japan
Established: September 1995

NESIC BRASIL S/A
Head Office: São Paulo, Brazil
Established: November 1976

NESIC (Thailand) Ltd.
Head Office: Bangkok, Thailand
Established: March 1991

NESIC PHILIPPINES INC.
Head Office: Manila, The Philippines
Established: April 1991

P.T. NESIC BUKAKA
Head Office: Jakarta, Indonesia
Established: May 1993

NESIC (GUANGZHOU) CO., LTD.
Head Office: Guangzhou, China
Established: August 1998

Networks & System Integration Saudi Arabia Co. Ltd.
Head Office: Al-Khobar, Saudi Arabia
Established: April 2006

NEC Networks & System Integration Corporation

Established:
November 26, 1953

Number of Employees:
2,913 (non-consolidated)
4,897 (consolidated)

Fiscal Year:
April 1 — March 31
Annual meeting held in June

Common Stock Authorized:
100,000,000 shares

Issued:
43,069,207 shares

Number of Shareholders:
14,884

Paid-in Capital:
¥13,122 million

Listing:
The Tokyo Stock Exchange, First Section
(Ticker Code: 1973)

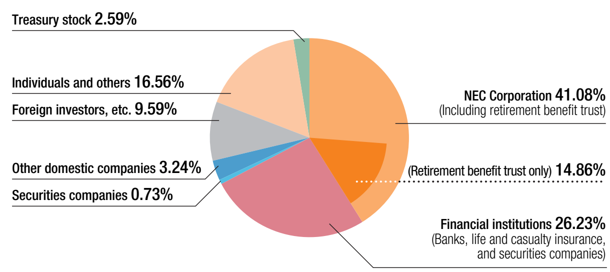
Transfer Agent:
The Sumitomo Trust and Banking Company, Limited
4-4 Marunouchi 1-chome, Chiyoda-ku,
Tokyo 100-8233, Japan

Independent Auditors:
Ernst & Young ShinNihon

Major Shareholders:

Name of Shareholder	Number of Shares Held (Thousands)	Percentage of Total Shares Outstanding
NEC Corporation	11,291	26.22%
Japan Trustee Services Bank, Ltd.* (The Sumitomo Trust and Banking Company, Limited beneficiary trust account, NEC Corporation retirement benefit trust account)	6,400	14.86
Japan Trustee Services Bank, Ltd. (trust account)	5,065	11.76
The Master Trust Bank of Japan, Ltd. (trust account)	2,547	5.92
Sumitomo Realty & Development Co., Ltd.	1,200	2.79
NEC Networks & System Integration Corporation (treasury stock)	1,115	2.59
Employees' Stock Ownership Plan	819	1.90
Trust & Custody Services Bank, Ltd. (trust account A)	540	1.26
Trust & Custody Services Bank, Ltd. (trust account B)	465	1.08
CBNY DFA International Cap	441	1.02

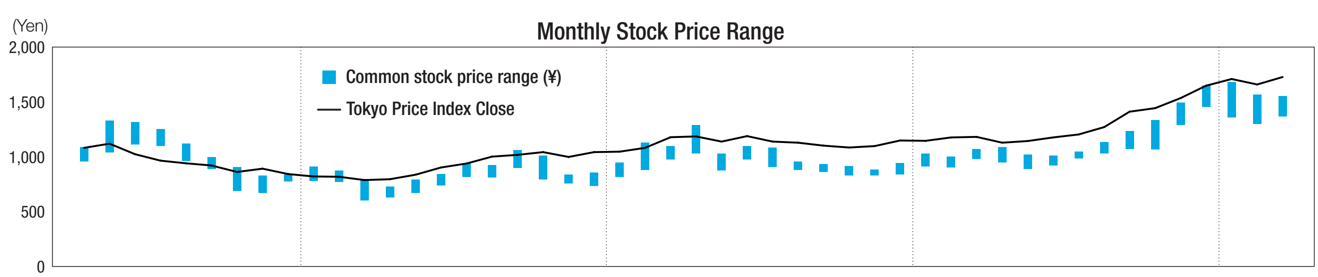
Composition of Shareholders:

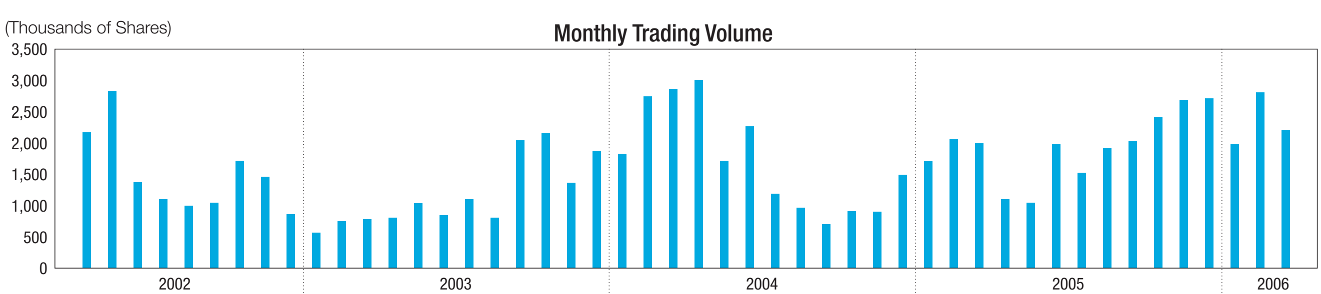


* Shares held by Japan Trustee Services Bank, Ltd. (The Sumitomo Trust and Banking Company, Limited beneficiary trust account, NEC Corporation retirement benefit trust account) give NEC Corporation material voting rights because NEC Corporation has contributed shares of the Company to its retirement benefit trust. The percentage of material voting rights held by NEC Corporation as of March 31, 2006 was 42.41%.

Note: As of April 1, 2006, NEC Corporation held 19,106 thousand shares (38.58% of total voting rights), and held 51.50% of material voting rights with the inclusion of 6,400 thousand shares (12.92% of total voting rights) held by Japan Trustee Services Bank, Ltd. (The Sumitomo Trust and Banking Company, Limited beneficiary trust account, NEC Corporation retirement benefit trust account). NEC received these shares as part of a distribution totaling 7,815 thousand shares (6,704 thousand newly issued common shares and 1,110 thousand treasury shares) of the Company's stock in connection with a share exchange that made NEC Telenetworx, Ltd., of which NEC Corporation was the parent company, a wholly owned subsidiary of the Company. The percentage of total voting rights is a pro forma calculation based on conditions as of March 31, 2006.

Monthly Stock Data (Tokyo Stock Exchange)





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