Q&A at IR Briefing for Financial Results for the First Half of Fiscal Year Ending March 31, 2016 (FY 2015)

NEC Networks & System Integration Corporation

Date and Time: Friday, October 30, 2015 from 10:30-11:30

Person A

Q: Do you view the investment cuts by telecom carriers as a temporary lull in their capital spending activities? Or do you see this as more of a structural phenomenon that will linger for the time being?

A: At the beginning of the current fiscal year, we expected the business environment with telecom carriers to be severe, but in reality it grew far worse than even we anticipated. We believe that the current business environment with telecom carriers will remain severe in the immediate future, stretching even beyond the second half of the current fiscal year, because the area coverage rate has already reached a necessary and sufficient level, making it unnecessary for telecom carriers to further intensify investments to beat the competition. We think that it will take some time before investments start recovering, backed by the introduction of new technologies such as 5G. Until then, we expect the business environment with telecom carriers remain challenging.

Q: Please tell us about your cost reduction initiatives and growth strategy for the carrier networks business.

A: In the business with telecom carriers, investments in mobile communications base stations represent one of the key areas we consider to be extremely important. Compared with the corresponding period of the previous fiscal year, in terms of revenue the performance of this business area for the first half of this fiscal year fell by half. We expect the severe environment for this business area to continue for the time being in the future, and thus we find it necessary to move management resources to other growth business areas in order to further reduce fixed costs. Furthermore, we are committed to improving profitability by implementing measures aimed at achieving greater operational efficiency, such as initiatives to reduce outsourcing costs while promoting in-house business operation.

We believe that the business with telecom carriers will not be strong enough to drive and achieve overall sales growth for the time being. Given this situation, we will seek to build up businesses with government administration offices and corporate customers, leveraging the expertise in large-scale network construction, highly reliable technologies, and maintenance service capabilities that we have acquired through the business with telecom carriers. These businesses include the Internet-of-Things (IoT)* business, which takes advantage of the services we can provide as a mobile virtual network operator (MVNO). In this business, we will optimize our knowhow related to the business with telecom carriers.

Q: Am I correct in understanding that you will remain focused on moving management resources, rather than merely trying to reduce fixed costs by conducting business restructuring measures?

A: That is correct. We will move our management resources to growth areas, such as businesses related to corporate customers and social infrastructure.

Q: Are there any new developments in your business related to next-generation 4K/8K TV broadcasting?

A: As far as 4K/8K TVs are concerned, our main focus is related to the CATV business. The 4K broadcasting services were launched on an experimental basis this year for only the CS channels. We expect to see noticeable developments in this business, beginning in or after the next fiscal year. Meanwhile, we have started seeing replacement demand emerge in the broadcasting industry for studio equipment used to provide terrestrial digital broadcasting services. We expect to see replacement demand from regional TV stations at some point over the next year because they traditionally tend to follow the lead of the major key broadcasting companies in Tokyo when replacing their studio equipment.

Person B

Q: You stated earlier that you expect capital spending by telecom carriers to remain severe for the time being. Do you see any difference among telecom carriers in their stance towards capital spending? What is your idea about the schedule for 5G?

A: In general, we expect capital spending among telecom carriers to remain severe. We think that carriers are likely to only make the minimum investment necessary, if they make any investments at all. In any case, we certainly believe that the scale of future investments made by telecom

carriers will not be as significant as it was before.
The schedule for 5G will be made in view of factors such as the Tokyo Olympics. There are still a few years between now and then, and until then there will be no major investment theme.

Q: You mentioned that the replacement demand for voice network systems is a positive factor. Could you provide us with a rough idea of its potential impact on business?

A: We have enjoyed our competitive advantage in voice network systems for years. It just so happens that around 800 of our corporate customers using voice network systems will need to update their current systems in the very near future. We expect to see this replacement demand emerge between now and the next fiscal year, totaling around JPY20 billion. Needless to say, expectations for replacement demand will all come to nothing if they are not transformed into actual business. We will pursue every possible means to ensure we cash in on the replacement demand because we are targeting our existing customers in this business.

Q: It seems to have become more evident recently that the fire-fighting network system business is leveling off. Despite this recent trend, you still expressed expectations for growth in related business area such as disaster-prevention radio systems. Please tell us more about your expectations here.

A: There are two important points for us to remember regarding the fire-fighting networks system business. One is related to the fire-fighting emergency radio systems, for which demand has been leveling off in recent months because of the progress made in the migration to digital fire-fighting systems ahead of the May 2016 deadline. The other point is related to the systems used in the command and control centers that receive one-one-nine (119) emergency calls. The command system is also designed to tackle widespread disasters by integrating pre-merger discrete systems belonging to individual fire departments that are to be consolidated as a result of municipal mergers. We expect a certain level of demand for the command system to remain for the time being because there is no fixed deadline for system migration.

In addition, there are quite a few municipal governments that have not yet introduced a disaster prevention radio system for providing local residents with information in times of emergency. We expect to continue seeing new demand for this system related to a variety of municipal projects in terms of scale and the timing for completing system introduction because there is also no fixed deadline for introduction for this product either.

Person C

Q: Please elaborate on the state of competition and profitability in relation to the IoT business.

A: The IoT consists of extensive areas of applications, with a large number of competitors in this field. In this business environment, we take advantage of our strength as an MVNO operator that provides network operation services. We understand that today we are only one of the few system integrators who can provide network operation services. To be more specific, our competitive edge lies in the optimal connection fee for using the IoT system. For example, we can offer reduced rates in a flexible manner to customers who wish to only use our network operation services at night for surveillance purposes. Furthermore, we will promote partner alliances to enhance service channels. We do not consider network operation services to be our main source of revenue. We would rather try to cash in on our services related to system integration as well as maintenance/operation, things that our customers will need when they introduce the IoT system. We only recently launched this business in October this year. We will take further steps to expand sales and reduce costs, aiming to enhance revenue and profitability in the future.

Q: NESIC is in a strong financial position, with an equity ratio of around 50%. It also has more than JPY40 billion in cash and deposits, indicating that it has a sufficiently high cash position. Please tell us about expected uses of this cash.

A: We intend to keep around JPY20 billion cash on hand as working capital. The rest will be used for M&As and other investment opportunities in a flexible manner, aiming to achieve further growth.

Person D

Q: You stated that given the increasingly severe business environment for telecom carriers, you would try to improve profitability by implementing measures to reduce costs, such as reforming the business structure for maintenance services. What do you predict for the carrier networks business in terms of its profitability on a full-year basis?

A: Based on the results for the first half of this year, we will further intensify and implement initiatives to reduce costs in the second half. Given the extremely severe business environment for telecom carriers in the second half, we have revised our original estimate for operating income in the carrier networks business downward by JPY2.0 billion to JPY4.9 billion on a full-year basis at this time.

Q: I understand you are doing well in the space-related business. Do you expect any big deal projects to come up in the near future?

A: Infrastructure works related to satellite earth stations temporarily boosted the segment’s revenue in the first half of the current fiscal year. That said, we do not expect for the revenue to continue expanding in the years to come.

Q: You have announced your intention to increase dividends for the ninth consecutive business year. Please tell us about management’s resolve regarding future dividend increases beyond the current fiscal year.

A: Basically, I would like to increase dividends beyond the current fiscal year just as we have done in the past, but we also need to take into consideration the changing market environment and capital needs for large-scale investment opportunities.

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