Empowered by Innovation NEC

NEC ELECTRONICS

# FINANCIAL REPORT 2009

Year ended March 31, 2009

NEC ELECTRONICS

09

# FINANCIAL REPORT 2009

## NEC Electronics Corporation

***At March 31, 2008 and 2009 and***
***Years ended March 31, 2007, 2008 and 2009***
***with Report of Independent Auditors***

# Contents

# NEC Electronics Corporation

## Management's Discussion and Analysis

Fiscal Year Ended March 31, 2009
Compared with the Fiscal Year Ended March 31, 2008

The management's discussion and analysis covers consolidated financial statements that are prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP"). Certain discussions regarding future events contained in this section reflect management's judgments as of March 31, 2009, the balance sheet date of the year under review.

NEC Electronics Corporation and its consolidated subsidiaries ("NEC Electronics," "we," "our," or "us") are leading integrated providers of system-level semiconductor solutions for electronic products and systems across a variety of key markets in the communications, computing and peripherals, consumer electronics, and automotive and industrial sectors. NEC Electronics Corporation ("the Company") began semiconductor business operations in 1956, and our cumulative expertise and technical capabilities allow us to offer our customers a broad array of solutions, ranging from general-purpose semiconductors to custom semiconductors.

The Company was established on November 1, 2002 as a wholly owned subsidiary of NEC Corporation ("NEC"), the result of a separation by new incorporation (*shinsetsu bunkatsu*) under the corporate separation (*kaisha bunkatsu*) provisions of the former Japanese Commercial Code.

Pursuant to NEC's separation plan, substantially all of NEC's semiconductor business operations and related assets and liabilities, excluding those related to the general-purpose DRAM business, were transferred to the Company, at historical cost, in exchange for the issuance to NEC of 100,000,000 shares. At the time of the Company's initial public offering on July 24, 2003, the Company issued 23,500,000 shares and NEC sold 10,500,000 shares. NEC also sold an additional 3,000,000 shares in connection with such initial public offering. As a result, and as of March 31, 2009, NEC beneficially owns 70.0% of the Company's issued shares, including shares placed in the retirement benefit trust.

## Significant Accounting Policies and Estimates

The preparation of financial statements in accordance with U.S. GAAP requires management to make estimates and assumptions that affect the reported value of assets and liabilities, the disclosure of contingent assets and liabilities at the balance sheet date, and the reported amounts of revenues and expenses during the period presented. NEC Electronics evaluates its estimates and assumptions on an ongoing basis, and bases those estimates and assumptions on historical experience and on various other factors that are believed to be reasonable at the time the estimates and assumptions are made. Actual results may differ from these estimates and assumptions.

The Company believes when the following significant accounting policies are used, our estimates and assumptions could have a significant impact on our consolidated financial statements:

***Allowance for Doubtful Accounts***

NEC Electronics provides an allowance for doubtful accounts based on the historical write-off ratio for receivables and any specific doubtful accounts based on a case-by-case determination of collectibility. On the basis of information currently available, we consider the allowance for doubtful accounts to be adequate. However, changes in the underlying financial position of our customers, resulting in an impairment of their ability to make payments, may require additional provisions to this allowance.

***Inventories***

NEC Electronics analyzes all inventories, including slow-moving and obsolete inventories, and writes down such inventories to their estimated market value based on assumptions about future demand and market conditions.

If future demand and market conditions are less favorable than those projected, additional inventory write-downs may be required.

## Significant Accounting Policies and Estimates (Continued)

***Investments***

NEC Electronics holds investments with a long-range perspective to enhance partnerships with respect to such purposes as reinforcing the sales framework, joint development, and technical collaboration.

These investments consist of marketable equity securities, and the stock of companies that are not publicly traded for which fair values are practically difficult to reasonably estimate. Marketable equity securities and nonpublic companies' stocks are included in marketable securities and other and stated at fair value and at cost, respectively.

When a decline in the value of investments is deemed to be other-than-temporary, NEC Electronics recognizes an impairment loss to the extent of the decline. In determining if and when such a decline in value is other-than-temporary, we evaluate market conditions, trends of earnings, significance of the decline, the duration of the decline, and other key measures. The Company recorded ¥0.3 billion ($3 million) in gross unrealized holding losses in marketable securities as of March 31, 2009. The Company believes that there is no impairment in investments, other as of March 31, 2009.

Future adverse changes in market conditions or poor operating results by the companies in which we have invested could result in losses, or an inability to recover the carrying value of the investments that is not reflected in the current carrying value of an investment, possibly requiring an impairment charge in the future.

***Impairment of Long-lived Assets***

Long-lived assets to be held and used, including license fees and other intangibles, are evaluated for impairment using an estimate of undiscounted cash flows whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. If the estimate of undiscounted cash flows is less than the carrying amount of the assets, an impairment loss is recorded based on the fair value of the assets.

Long-lived assets to be disposed of by sales are evaluated at the lower of carrying amount or fair value less cost to sell.

We believe that there were no long-lived assets that required the recording of an impairment loss at March 31, 2009. Changes in future technology trends or strategy may cause an impairment of long-lived assets.

## Significant Accounting Policies and Estimates (Continued)

### *Deferred Tax Assets*

NEC Electronics has recorded deferred tax assets resulting on deductible temporary differences and net operating loss carryforwards, both of which will reduce taxable income in the future. We set up a valuation allowance to reduce deferred tax assets to an amount that is more likely than not to be realized.

We evaluate the necessity of a valuation allowance for each company based on the information currently available, such as historical income performance, estimates of future taxable income, and estimates of the timing of when temporary differences will reverse. As a result, based on estimates of the levels of future taxable income and other factors carried out at the Company, domestic subsidiaries, and its American subsidiary, NEC Electronics America, Inc., we recorded a valuation allowance of ¥149.5 billion ($1,510 million) at March 31, 2009.

### *Pension and Severance Plans*

NEC Electronics recorded pension and severance costs and liabilities that are calculated from actuarial valuations. Changes in the related pension and severance costs and liabilities may occur in the future due to changes in assumptions such as the discount rate, the rate of increase in future compensation level and the expected long-term rate of return on plan assets, in addition to changes in the number of employees covered. Assumptions are evaluated at least annually; if circumstances change we change these assumptions. We amortize variations in the assumptions or actual results that differ from the assumptions over the average remaining service period of employees.

NEC Electronics applied 2.5% for the expected long-term rate of return on plan assets for the fiscal years ended March 31, 2008 and 2009. To determine the expected long-term rate of return on plan assets, we consider current and expected asset allocations, as well as historical and expected long-term rates of return on various categories of plan assets.

The assumed discount rate as of March 31, 2009 was 2.8%.

### *Contingent Liabilities*

NEC Electronics is a defendant in several lawsuits and other litigation in which compensation for damages is being sought. At present, we have booked allowances to cover losses associated with these actions in such cases where these losses are reasonably estimable. Currently, no allowances have been made with respect to cases in which such losses cannot be reasonably estimated.

## Results of Operations

### *Net Sales*

Net sales decreased ¥141.3 billion, or 20.5%, to ¥546.5 billion ($5,520 million) for the fiscal year ended March 31, 2009, compared to net sales of ¥687.7 billion for the previous fiscal year. This outcome largely reflected lower year-on-year sales in all sectors, but was particularly felt in computing and peripherals and discrete, optical and microwave devices, where sales fell by more than 25% from the previous fiscal year.

Our net sales by market application were as follows:

### *Communications*

Net sales of semiconductors for communications applications decreased ¥10.2 billion, or 14.4%, to ¥60.2 billion ($608 million) for the fiscal year ended March 31, 2009, from ¥70.4 billion for the previous fiscal year. While sales mainly of camera LSIs for mobile phones increased year on year, this performance was offset by lower sales of baseband LSIs and LCD driver ICs for mobile phones.

### *Computing and Peripherals*

Net sales of semiconductors for computing and peripherals applications decreased ¥32.1 billion, or 26.9%, to ¥87.2 billion ($881 million) for the fiscal year ended March 31, 2009, from ¥119.4 billion for the previous fiscal year. This was primarily the result of lower sales of LCD driver ICs for computer monitors and LCD televisions, and a drop in sales of semiconductors for printers.

### *Consumer Electronics*

Net sales of semiconductors for consumer electronics applications decreased ¥15.2 billion, or 11.3%, to ¥119.3 billion ($1,205 million) for the fiscal year ended March 31, 2009, from ¥134.5 billion for the previous fiscal year. Although sales of EMMA series graphic LSIs for digital televisions and Blu-ray disc players rose year on year, sales of semiconductors for digital cameras and home appliances were down from the previous fiscal year.

### *Automotive and Industrial*

Net sales of semiconductors for automotive and industrial applications declined ¥21.8 billion, or 19.3%, to ¥91.5 billion ($924 million) for the fiscal year ended March 31, 2009, from ¥113.3 billion for the previous fiscal year. This downturn was mainly attributable to a year-on-year decrease in sales of automotive microcontrollers and semiconductors for industrial equipment.

### *Multi-market ICs*

Net sales of multi-market ICs decreased ¥19.2 billion, or 21.4%, to ¥70.5 billion ($712 million) for the fiscal year ended March 31, 2009, from ¥89.6 billion for the previous fiscal year. This decrease largely reflected lower sales of general-purpose microcontrollers and gate arrays year on year.

**Results of Operations (Continued)**

***Discrete, Optical and Microwave Devices***

Net sales of discrete, optical and microwave devices decreased ¥33.1 billion, or 26.2%, to ¥93.0 billion ($939 million) for the fiscal year ended March 31, 2009, from ¥126.1 billion for the previous fiscal year. The decline was mainly due to lower sales of discrete semiconductors and compound semiconductors, such as optical and microwave semiconductors, year on year.

***Other***

Other sales mainly consist of sales subsidiaries' resale of color LCD panels and other non-semiconductor products and services. Our other sales decreased ¥9.7 billion, or 28.2%, to ¥24.7 billion ($250 million) for the fiscal year ended March 31, 2009, from ¥34.5 billion for the previous fiscal year.

***Cost of Sales***

Cost of sales decreased ¥59.8 billion, or 12.3%, to ¥425.9 billion ($4,302 million) for the fiscal year ended March 31, 2009, from ¥485.7 billion for the previous fiscal year. The cost of sales as a percentage of net sales rose from 70.6% to 77.9%.

***Research and Development Expenses***

Research and development ("R&D") expenses decreased ¥1.9 billion, or 1.7%, to ¥110.4 billion ($1,115 million) for the fiscal year ended March 31, 2009, from ¥112.3 billion for the previous fiscal year. As a percentage of net sales, R&D expenses increased from 16.3% for the fiscal year ended March 31, 2008 to 20.2%. For the fiscal years ended March 31, 2008 and 2009, R&D expenses included net fees of ¥4.2 billion and ¥3.1 billion ($31 million), respectively, in connection with research provided by NEC's laboratories.

***Selling, General and Administrative Expenses***

Selling, general and administrative expenses decreased ¥6.1 billion, or 7.3%, to ¥78.5 billion ($793 million) for the fiscal year ended March 31, 2009, from ¥84.7 billion for the previous fiscal year. As a percentage of net sales, selling, general and administrative expenses increased from 12.3% for the fiscal year ended March 31, 2008 to 14.4%.

***Provision for Income Taxes***

NEC Electronics' loss before income taxes and provision for income taxes, for the fiscal years ended March 31, 2008 and 2009 were as follows:

| | **Year ended March 31,** | | |
|---|---|---|---|
| | **2008** | **2009** | **2009** |
| | *(Billions of yen)* | | *(Millions of U.S. dollars)* |
| Income (loss) before income taxes | ¥(3.3) | **¥(89.3)** | **$(902)** |
| Provision for (benefit from) income taxes: | | | |
| Current | 3.9 | **2.1** | **22** |
| Deferred | 8.4 | **(8.3)** | **(83)** |

## Results of Operations (Continued)

***Minority Interest in Income (Loss) of Consolidated Subsidiaries***
NEC Electronics recorded minority interest mainly in losses of a consolidated subsidiary in China of ¥0.3 billion ($3 million) for the fiscal year ended March 31, 2009, compared to minority interest in income of ¥0.3 billion for the fiscal year ended March 31, 2008.

***Net Loss***
NEC Electronics recorded a net loss of ¥82.6 billion ($835 million), representing 15.1% of net sales, for the fiscal year ended March 31, 2009, compared to a net loss of ¥16.0 billion for the previous fiscal year.

## Geographical Segment Analysis

Our net sales to external customers on a geographic basis were as follows:

***Japan***
Net sales in Japan decreased ¥68.6 billion, or 18.5%, to ¥301.6 billion ($3,047 million) for the fiscal year ended March 31, 2009, from ¥370.2 billion for the previous fiscal year. This was mainly the result of lower sales of baseband LSIs for mobile phones and discrete semiconductors.

***United States of America***
Net sales in the United States of America decreased ¥19.6 billion, or 33.7%, to ¥38.6 billion ($390 million) for the fiscal year ended March 31, 2009, from ¥58.3 billion for the previous fiscal year. The decrease was primarily due to a decline in sales of general-purpose microcontrollers and system memory for mobile phones.

***Europe***
Net sales in Europe decreased ¥21.5 billion, or 22.4%, to ¥74.5 billion ($752 million) for the fiscal year ended March 31, 2009, from ¥95.9 billion for the previous fiscal year. The decrease was primarily due to lower sales of general-purpose microcontrollers and semiconductors for automobiles.

***Asia***
Net sales in Asia, excluding Japan, decreased ¥31.6 billion, or 19.3%, to ¥131.7 billion ($1,331 million) for the fiscal year ended March 31, 2009, from ¥163.3 billion for the previous fiscal year. The decline was primarily due to lower sales of products such as LCD driver ICs for LCD televisions and computer monitors, and discrete semiconductors.

## Seasonality

NEC Electronics' main customers for semiconductor products are manufacturers of electronic products.

Our net sales are generally higher from July through December compared to the period from January through June. This is due to the higher volume of product sales to customers that manufacture consumer products for the year-end holiday season.

## Effect of Change in Exchange Rates on Foreign Currency

The average annual exchange rate of the Japanese yen against the U.S. dollar during the fiscal year ended March 31, 2009 was stronger compared to the fiscal year ended March 31, 2008. This decreased the yen-denominated amount of U.S. dollar-denominated sales, thereby contributing to decreased earnings. From time to time, we enter into foreign currency forward exchange contracts to reduce exposure to market risks from fluctuations in foreign currency exchange. We recorded a net foreign exchange loss of ¥3.6 billion ($37 million) for the fiscal year ended March 31, 2009. Assets and liabilities of foreign subsidiaries are translated into Japanese yen at the exchange rate in effect on the balance sheet date. Revenue and expenses are translated at the average exchange rate for the fiscal year. Adjustments resulting from the translation are accumulated and recorded in "accumulated other comprehensive income (loss)" in the consolidated balance sheets.
For details, see note 2 to our consolidated financial statements.

## Liquidity and Capital Resources

NEC Electronics' financial policy is to secure adequate liquidity and capital resources for its operations and to maintain the strength of its balance sheet. In order to secure stable long-term capital resources, the Company issued convertible bond notes with share acquisition rights (zero coupon unsecured yen convertible bonds due 2011) on May 27, 2004 and raised ¥110.0 billion. The bond is subject to certain covenants. Under the conditions of the covenants, during a certain period, bondholders have the right to claim conversion if the stock price exceeds 110% or more of the conversion price of ¥9,860 ($100), as of March 31, 2009. In addition, the bond carries a call option that gives the Company the right to call the bond at the principal amount after May 27, 2008, if the Company's stock price exceeds 130% or more of the conversion price for 30 consecutive trading days. As of March 31, 2009, the outstanding balance of convertible bonds was ¥110.0 billion ($1,111 million). In addition, we also have a revolving credit facility under which an aggregate of up to ¥15.0 billion ($152 million) in short-term loans is available to meet unforeseen short-term financing needs.

## Liquidity and Capital Resources (Continued)

As of March 31, 2009, the total amount of interest-bearing debt, including convertible bonds, borrowings, and obligations under certain capital leases, was ¥116.9 billion ($1,181 million). As of March 31, 2009, we had ¥101.3 billion ($1,023 million) in cash and cash equivalents to maintain liquidity. We believe that the cash and cash equivalents, the availability of short-term credit facilities, and the Company's cash flows from operating activities, are sufficient to meet its current cash requirements, including capital expenditures and debt service, for the foreseeable future. Moreover, the Company has obtained credit ratings from Rating and Investment Information, Inc. (R&I), one of Japan's major credit rating agencies. As of March 31, 2009, the Company's senior long-term credit and current short-term debt ratings from R&I are BBB+ and a-2, respectively.

## Financial Position

***Total Assets and Shareholders' Equity***

Total assets at March 31, 2009 totaled ¥482.5 billion ($4,874 million), a ¥133.8 billion decrease from ¥616.3 billion at March 31, 2008. This was mainly due to a decline of ¥43.8 billion in notes and accounts receivable, trade accompanying lower sales, and a ¥17.1 billion decrease in property, plant and equipment due to lower capital expenditures, depreciation and others, as well as a sharp drop in shareholders' equity largely reflecting a consolidated net loss of ¥82.6 billion ($835 million).

Shareholders' equity was ¥128.1 billion ($1,294 million) at March 31, 2009, down ¥99.0 billion from ¥227.1 billion at March 31, 2008. This decrease was mainly attributable to a consolidated net loss of ¥82.6 billion ($835 million), coupled with deterioration of ¥16.4 billion ($166 million) in accumulated other comprehensive income (loss) from the impact of currency exchange rate and stock market volatility.

## Cash Flow

Net cash used in operating activities was ¥6.9 billion ($70 million) for the fiscal year ended March 31, 2009, a decrease of ¥50.2 billion from ¥43.3 billion in net cash provided for the previous fiscal year. Despite depreciation and amortization in the amount of ¥67.3 billion ($680 million), this result came mainly from posting a consolidated net loss of ¥82.6 billion ($835 million).

Net cash used in investing activities increased ¥11.5 billion to ¥49.3 billion ($498 million) for the fiscal year ended March 31, 2009, from ¥37.8 billion for the previous fiscal year. This was mainly due to payments for the purchase of property, plant and equipment in the amount of ¥53.0 billion ($536 million).

## Cash Flow (Continued)

Net cash used in financing activities was ¥4.3 billion ($43 million) for the fiscal year ended March 31, 2009, a decrease of ¥18.7 billion from ¥23.0 billion for the previous fiscal year, mainly as a result of payments on intangible assets purchase contracts.

## Capital Expenditures

NEC Electronics' capital expenditures for the fiscal years ended March 31, 2008 and 2009 were ¥56.1 billion and ¥56.6 billion ($571 million), respectively. For the fiscal year ended March 31, 2009, capital expenditures were largely allocated to the upgrade and expansion of our 300mm wafer production line, and assembly and testing lines.

## Off-balance Sheet Arrangements

NEC Electronics securitizes receivables by selling certain trade receivables to Special Purpose Entities ("SPEs") and others without recourse from time to time. The purpose of these securitization transactions is to enhance asset efficiency. NEC Electronics services, administers and collects the securitized trade receivables on behalf of the SPEs and others. We received proceeds from securitization transactions of ¥2.0 billion for the fiscal year ended March 31, 2008. No such proceeds were recorded for the fiscal year ended March 31, 2009.

NEC Electronics has also sold portions of its machinery and equipment to leasing companies and to certain SPEs, leasing them back for periods of less than five years, for the purpose of eliminating risks associated with a decline in the value of obsolete production facilities, as well as stabilizing cash flows. These transactions are treated as operating leases for accounting purposes. The amount of machinery and equipment sold for lease back to NEC Electronics in the fiscal years ended March 31, 2008 and 2009 were ¥18.6 billion and ¥4.5 billion ($45 million), respectively.

## Risk Factors

NEC Electronics recognizes the following as some of the most significant risk factors faced in its business operations.

***Impact of Market Fluctuations***
Although NEC Electronics carefully monitors changes in market conditions, it is difficult to completely avoid the impact of market fluctuations due to economic cycles in countries around the world and changes in the demand for end products. Market downturns, therefore, could lead to sales declines, as well as lower fab utilization rates, which may in turn result in diminished cost ratios, ultimately leading to a significant deterioration in profits.

**Risk Factors (Continued)**

***Foreign Currency Fluctuations***

The operating results and financial position of NEC Electronics are affected by fluctuations in foreign currency exchange markets. We take various measures to reduce risks relating to fluctuations in the foreign currency exchange markets, such as forward exchange contracts. However, significant fluctuations in the exchange rate may impact the yen values of foreign currency-denominated product sales, materials costs, and production costs in factories overseas. In addition, conversion of the Company's foreign currency-denominated assets and liabilities, and the foreign currency-denominated financial statements of the Company's overseas subsidiaries into Japanese yen for disclosure may also affect our assets and liabilities, as well as earnings and expenses.

***Impact of Countries' Legal Systems and Related Compliance***

NEC Electronics conducts development, production and sales activities all over the world. Consequently, we may encounter risks associated with the countries and regions where it operates. Such risks include political and social instability, changes in legal regulations and government policies pertaining to areas such as trade, employment and the environment that impact local business development, as well as deterioration in the economic outlook and underlying economic conditions.

***Natural Disasters***

Natural disasters such as earthquakes, typhoons, and floods, as well as accidents, acts of terror and other factors beyond the control of the NEC Electronics, could severely damage semiconductor manufacturing facilities and other facilities. NEC Electronics owns facilities in areas where earthquakes occur at a frequency higher than the global average. Consequently, the effects of earthquakes and other events could force a halt to manufacturing and other operations. We are insured against losses and damages relating to earthquakes, however, the insurance may be unable to cover all the losses and damages if the earthquake is extraordinarily severe.

***Competition***

The semiconductor industry is extremely competitive, and NEC Electronics is exposed to fierce competition from rival companies around the world in areas such as product performance, structure, pricing and quality. To maintain competitiveness, we take various measures including development of leading edge technologies, standardizing design, and cost reduction, but in the event that we are not competitive, our market share may decline, which may negatively impact the financial results. Price competition for the purpose of maintaining market share may also lead to sharp declines in the market price of our products. When this cannot be offset by cost reductions, our gross profit margin ratio may decline.

**Risk Factors (Continued)**

***Risks Associated with Products from Order to Final Shipment***

NEC Electronics receives orders from specific customers for the development of semiconductor products. There are cases where, after we have started product design work based on their unique specifications, customers decide to postpone or cancel the launch of the end products in which the ordered product is scheduled to be embedded. There is also the possibility that customer dissatisfaction with product function and/or performance could result in the semiconductor not being used. Further, the lackluster sale of end products in which products developed by us are embedded may prompt customers to reduce the volume of products ordered, or to postpone delivery dates. Such changes in product plans, order reductions, postponements and other actions on the part of the our sales and profitability.

***Risks Associated with Product Production***

**a. Production Process Risk**

Semiconductor products require extremely complex production processes. In an effort to increase yields from the materials used, NEC Electronics takes steps to properly control production processes and seeks ongoing improvements. However, the emergence of problems in these production processes could lead to worsening yields. This problem, in turn, could trigger shipment delays, reductions in shipment volume, or, at worst, the halting of shipments altogether.

**b. Procurement of Raw Materials, Components, and Production Facilities**

The timely procurement of necessary raw materials, components and production facilities is critical to semiconductor production. To avoid supply problems related to these essential raw materials, components and production facilities, NEC Electronics works diligently to develop close relationships with multiple suppliers. Some necessary materials, however, are available only from specific suppliers. Consequently, insufficient supply capacity amid tight demand for these materials, as well as natural disasters or accidents, deterioration in management conditions, withdrawal from business, or other events that impact the supplier, could preclude their timely procurement, or may result in sharply higher prices for these essential materials upon procurement.

**c. Product Defects, Anomalies and Malfunctions**

Although NEC Electronics makes an effort to improve the quality of semiconductor products and related software, they may contain defects, anomalies or malfunctions that are undetectable at the time of shipment due to increased sophistication of technologies and the diversity of ways in which our products are used by customers. These defects, anomalies or malfunctions could be discovered after NEC Electronics products are embedded in customers' end products, resulting in the return or exchange of our products, claims for compensatory damages, or discontinuation of the use of our products, which could negatively impact the profits and operating results of us. To prepare for such events, NEC Electronics has product liability insurance and recall insurance, but it is not guaranteed that the full costs of reimbursements would be covered by these.

**Risk Factors (Continued)**

**d. Risks Associated with Outsourced Production**

NEC Electronics outsources the manufacture of certain semiconductor products to external foundries and other entities. In doing so, we select its trusted outsourcers, rigorously screened in advance based on their technological capabilities, supply capacity, and other relevant traits. This screening notwithstanding, the possibility of delivery delays, product defects and other production-side risks stemming from outsourcers cannot be ruled out completely. In particular, inadequate production capacity among outsourcers could result in us being unable to supply enough products amid periods of high product demand.

***Risks Associated with Product Sales***

**a. Reliance on Key Customers**

NEC Electronics relies on certain key customers for the bulk of its product sales to end customers. During the fiscal year under review, sales to our top 10 end customers accounted for over 50% of consolidated net sales.

If these key customers decide to cease adopting our products, or to dramatically reduce order volume, our operating results could be negatively impacted.

**b. Reliance on Authorized Sales Agents**

In Japan and Asia, NEC Electronics sells the majority of its products via independent authorized sales agents, and relies on certain major authorized sales agents for the bulk of these sales. The inability of us to provide these authorized sales agents with competitive sales incentives or margins, or to secure sales volumes that the authorized sales agents consider appropriate, could result in a decision by such agents to replace our products with those of a competitor, which could cause a decrease in our sales.

***Retaining Human Resources***

There is fierce competition in the semiconductor industry for talented human resources such as managers, technicians, researchers, and developers. For this reason, there is a risk that we may be unable to indefinitely retain talented human resources with adequate backgrounds in science, technology or engineering, particularly in the fields of LSI design and semiconductor manufacturing process technology.

***Inadequate Pension Funds***

As of March 31, 2009, NEC Electronics had a total projected pension benefit obligation of ¥139.3 billion ($1,407 million). The fair value of our pension assets was ¥58.2 billion ($588 million) as of March 31, 2009, resulting in a shortfall in pension funds of ¥81.2 billion ($820 million) as of the same date. The management of pension assets encompasses equity securities, debt securities and other assets that are accompanied by market risk. Consequently, a fall in the market prices of these assets could exacerbate our pension shortfall.

**Risk Factors (Continued)**

Based on analyses of current market interest rates, on March 31, 2009, we applied a discount rate of 2.8% in the calculation of its pension benefit obligation. A decision to lower this discount rate would effectively increase our pension benefit obligation. We also applied an expected long-term rate of return on plan assets of 2.5% to the calculation of its net pension and severance costs for the fiscal year. A decision to lower this expected long-term rate of return would effectively increase our net pension and severance costs.

***Impairment of Long-Lived Assets***

NEC Electronics has recorded tangible fixed assets and many other long-lived assets in its consolidated balance sheet, and periodically reviews whether it will be able to recover the recorded residual value of these assets in the form of future cash flows. If these assets do not generate sufficient cash flows, we may be forced to recognize impairment in their value.

***Information Management***

NEC Electronics has in its possession a great deal of confidential information relating to its business activities. While such confidential information is managed according to internal regulations specifically designed for that purpose, there is always the risk that information may leak due to unforeseen circumstances. Should such an event occur, there is a likelihood that customer confidence and social trust would deteriorate, resulting in a negative effect on our performance.

***Environmental Factors***

NEC Electronics strives to decrease its environmental impact in accordance with the "NEC Electronics Environmental Policy," with respect to diversified and complex environmental issues such as global warming, air pollution, industrial waste, tightening of hazardous substance regulation, and soil pollution. There is the possibility that, regardless of whether or not there is negligence in its pursuit of business activities, NEC Electronics could bear legal or social responsibility for environmental problems. Should such an event occur, the burden of expenses for resolution could potentially be high, and we could suffer erosion in social trust.

**Risk Factors (Continued)**

***Legal Issues***

NEC Electronics conducts business activities on a global scale. As a consequence, there is a risk that we may become the subject of lawsuits, be requested to pay compensation for damages, or be named in other legal disputes. While a number of unresolved cases of this kind are typically pending at any particular time, with the exception of those discussed below, such cases are considered to have no major impact on our financial condition and operating results as of March 31, 2009.

NEC Electronics America, Inc. has resolved by settlement of class action civil antitrust lawsuits from direct purchasers (customers who had directly purchased DRAM from NEC Electronics in the past), but it is still in litigation, or in settlement negotiations, with several customers who have opted out of such class action lawsuits. NEC Electronics America, Inc. has also been named as one of the defendants in numerous class action civil lawsuits from indirect purchasers (customers who had purchased products containing DRAM), as well as a number of antitrust lawsuits filed by the Attorneys General of numerous states in the U.S.

Additionally, NEC Electronics is fully cooperating with and providing information to the European Commission in its investigation of potential violation of the competition laws. Fines may be imposed by the European Commission.

We are also subject to investigations by the U.S. Department of Justice, the European Commission, the Korea Fair Trade Commission, and the Competition Bureau of Canada in connection with potential antitrust violations in the thin-film transistor liquid crystal display (TFT-LCD) industry. In Canada, NEC Electronics America, Inc. is a defendant in numerous class action civil antitrust lawsuits seeking damages for alleged antitrust violations in the TFT-LCD industry.

While investigations in connection with potential antitrust violations in the SRAM industry conducted by the U.S. Department of Justice, the European Commission, and the Korea Fair Trade Commission have been closed, NEC Electronics America, Inc. and the Company remain defendants in numerous class action civil antitrust lawsuits in the United States and Canada seeking damages for alleged antitrust violations in the SRAM industry.

Although the outcome of the aforementioned investigations, antitrust lawsuits and settlement negotiations is not known at this time, NEC Electronics has recorded approximately ¥11.9 billion ($120 million) in probable and reasonably estimable payments and expenses related to the DRAM civil lawsuits and settlements in the U.S. and investigations by the European Commission. It is possible that such estimated amount may increase or decrease with the progress of such cases in the future. No other expenses pertaining to other civil lawsuits and official investigations have been recorded, since our liability for compensation pertaining to such lawsuits and its alleged behavior under such investigations remain undetermined. Consequently, any reasonable estimate of related expenses and losses is not feasible at this time.

## Relationship with Parent Company and Other Companies

### 1. Relationship with NEC

The Company is a subsidiary of NEC and as of March 31, 2009, NEC beneficially owns approximately 70.0% of the issued shares including its funding of the pension trust. As a result, NEC owns 2/3 of the Company’s voting rights and can therefore effectively control the outcome of all proposals that require shareholder approval.

### 2. Business Operation at NEC Electronics and its Intellectual Property Rights

When the Company was established by corporate separation, NEC transferred most of its semiconductor-related patents to the Company. However, NEC did not transfer some of its cross-licenses. As a subsidiary of NEC, the Company is the indirect beneficiary of these cross-licensing arrangements, but could cease to be a beneficiary if NEC direct or indirect ownership of the Company’s voting shares fell to equal to or less than 50%. The Company is negotiating with NEC to become the direct holder of patent cross-licenses when agreements are renewed; however, the risks remain until these agreements are re-signed.

### 3. “NEC” Brand Name License Agreement with NEC

The Company owns the right to use the letters “NEC” as part of its trade name and to use the “NEC” mark as its trademark and corporate mark pursuant to a brand name license agreement with NEC. However, NEC could terminate this agreement if it determines that the quality of products or services provided by the Company is inadequate or that its use of the “NEC” mark is detrimental to NEC, or if NEC’s ownership of the Company falls to 50% or less. Should the agreement be terminated, the Company would be forced to focus substantial corporate resources on the development and cultivation of its own new brand.

NEC Electronics Corporation

## Consolidated Balance Sheets

| | March 31, | | |
|---|---|---|---|
| | **2008** | **2009** | **2009** |
| | *(Millions of yen)* | | *(Thousands of U.S. dollars)* |
| **Assets** | | | |
| Current assets: | | | |
| Cash and cash equivalents | ¥ 165,472 | **¥ 101,279** | **$ 1,023,020** |
| Notes and accounts receivable, trade: | | | |
| Related parties | 11,991 | **4,913** | **49,626** |
| Other | 84,513 | **47,777** | **482,596** |
| Allowance for doubtful notes and accounts | (152) | **(202)** | **(2,040)** |
| Inventories | 75,839 | **63,220** | **638,586** |
| Deferred tax assets | 899 | **693** | **7,000** |
| Prepaid expenses and other current assets | 5,553 | **4,497** | **45,424** |
| Total current assets | 344,115 | **222,177** | **2,244,212** |
| Investments: | | | |
| Marketable securities | 3,345 | **2,158** | **21,798** |
| Other: | | | |
| Affiliated companies | 539 | **846** | **8,545** |
| Other | 681 | **470** | **4,748** |
| | 4,565 | **3,474** | **35,091** |
| Property, plant and equipment: | | | |
| Land | 15,708 | **15,417** | **155,727** |
| Buildings | 239,406 | **241,115** | **2,435,505** |
| Machinery and equipment | 931,709 | **904,812** | **9,139,515** |
| Construction in progress | 21,717 | **19,879** | **200,798** |
| | 1,208,540 | **1,181,223** | **11,931,545** |
| Accumulated depreciation | (949,389) | **(939,144)** | **(9,486,302)** |
| | 259,151 | **242,079** | **2,445,243** |
| Other assets: | | | |
| Deferred tax assets | 2,062 | **2,120** | **21,414** |
| License fees and other intangibles | 5,471 | **10,833** | **109,424** |
| Other: | | | |
| Related parties | 479 | **1,330** | **13,434** |
| Other | 461 | **532** | **5,374** |
| | 8,473 | **14,815** | **149,646** |
| | ¥ 616,304 | **¥ 482,545** | **$ 4,874,192** |

*See notes to consolidated financial statements.*

# NEC Electronics Corporation

## Consolidated Balance Sheets (Continued)

| | March 31, 2008 | March 31, 2009 | 2009 |
|---|---|---|---|
| | *(Millions of yen)* | | *(Thousands of U.S. dollars)* |
| **Liabilities and shareholders' equity** | | | |
| Current liabilities: | | | |
| Short-term borrowings | ¥ 954 | **¥ 1,135** | **$ 11,465** |
| Current portion of long-term debt | 619 | – | – |
| Current portion of obligation under capital leases to related parties | 821 | **770** | **7,778** |
| Notes and accounts payable, trade: | | | |
| Related parties | 27,013 | **23,967** | **242,091** |
| Other | 81,123 | **54,796** | **553,495** |
| Accounts payable, other and accrued expenses: | | | |
| Related parties | 3,768 | **2,522** | **25,475** |
| Other | 53,463 | **48,919** | **494,130** |
| Accrued income taxes | 2,049 | **1,462** | **14,768** |
| Other current liabilities | 9,905 | **8,336** | **84,202** |
| Total current liabilities | 179,715 | **141,907** | **1,433,404** |
| Long-term liabilities: | | | |
| Long-term debt | 110,000 | **110,000** | **1,111,111** |
| Obligation under capital leases to related parties | 4,207 | **4,966** | **50,162** |
| Accrued pension and severance costs | 74,460 | **81,167** | **819,869** |
| Deferred tax liabilities | 11,068 | **3,915** | **39,545** |
| Other | 4,540 | **8,339** | **84,232** |
| | 204,275 | **208,387** | **2,104,919** |
| Minority shareholders' equity in consolidated subsidiaries | 5,176 | **4,121** | **41,627** |
| Commitments and contingent liabilities | | | |
| Shareholders' equity: | | | |
| Common stock: | 85,955 | **85,955** | **868,232** |
| Authorized – 400,000,000 shares | | | |
| Issued and outstanding – 123,500,000 shares | | | |
| Additional paid-in capital | 281,073 | **281,081** | **2,839,202** |
| Accumulated deficit | (114,896) | **(197,521)** | **(1,995,162)** |
| Accumulated other comprehensive income (loss) | (24,984) | **(41,374)** | **(417,919)** |
| Treasury stock, at cost: | | | |
| 2008 – 2,039 shares | (10) | | |
| 2009 – 2,306 shares | | **(11)** | **(111)** |
| | 227,138 | **128,130** | **1,294,242** |
| | ¥ 616,304 | **¥482,545** | **$4,874,192** |

## NEC Electronics Corporation

## Consolidated Statements of Operations

| | Year ended March 31, | | | |
|---|---|---|---|---|
| | 2007 | 2008 | 2009 | 2009 |
| | (Millions of yen) | | | (Thousands of U.S. dollars) |
| Sales and other income: | | | | |
| Net sales | ¥692,280 | ¥687,745 | **¥546,470** | **$5,519,899** |
| Gain on sales of property, plant and equipment and other | 2,548 | 1,861 | **2,032** | **20,525** |
| Net gain on business transfer | — | 2,040 | — | — |
| Interest and dividend income | 1,929 | 2,152 | **1,570** | **15,859** |
| Gain on disposition of investments in securities | 6,436 | — | **159** | **1,606** |
| | 703,193 | 693,798 | **550,231** | **5,557,889** |
| Costs and expenses: | | | | |
| Cost of sales | 502,086 | 485,683 | **425,918** | **4,302,202** |
| Research and development | 131,751 | 112,300 | **110,380** | **1,114,950** |
| Selling, general and administrative | 87,000 | 84,668 | **78,527** | **793,202** |
| Litigation and settlement expense | 1,435 | — | **9,543** | **96,394** |
| Restructuring charges | 4,192 | 7,931 | **4,935** | **49,849** |
| Loss on sales or disposal of property, plant and equipment and other | 9,229 | 4,634 | **6,000** | **60,606** |
| Interest expense | 698 | 741 | **319** | **3,222** |
| Net foreign exchange loss | 1,197 | 1,091 | **3,616** | **36,525** |
| Loss on investments in securities | 980 | 2 | **328** | **3,313** |
| | 738,568 | 697,050 | **639,566** | **6,460,263** |
| Loss before income taxes | (35,375) | (3,252) | **(89,335)** | **(902,374)** |
| Provision for (benefit from) income taxes | 5,105 | 12,285 | **(6,115)** | **(61,768)** |
| Loss before minority interest, equity in earning (loss) of affiliated companies | (40,480) | (15,537) | **(83,220)** | **(840,606)** |
| Minority interest in income (loss) of consolidated subsidiaries | 552 | 251 | **(288)** | **(2,909)** |
| Loss before equity in earning (loss) of affiliated companies | (41,032) | (15,788) | **(82,932)** | **(837,697)** |
| Equity in earning (loss) of affiliated companies | (468) | (207) | **307** | **3,101** |
| Net loss | ¥ (41,500) | ¥ (15,995) | **¥ (82,625)** | **$ (834,596)** |

| | 2007 | 2008 | 2009 | 2009 |
|---|---|---|---|---|
| | (Yen) | | | (U.S. dollars) |
| Basic net loss per share | ¥ (336.04) | ¥ (129.52) | **¥ (669.04)** | **$ (6.76)** |
| Diluted net loss per share | (336.04) | (129.52) | **(669.04)** | **(6.76)** |

*See notes to consolidated financial statements.*

# NEC Electronics Corporation

## Consolidated Statements of Changes in Shareholders' Equity

Millions of Yen

| | Common stock | Additional paid-in capital | Accumulated deficit | Accumulated other comprehensive income (loss) | Treasury stock, at cost | Total |
|---|---|---|---|---|---|---|
| **Balance at March 31, 2006** | ¥85,955 | ¥281,014 | ¥ (57,369) | ¥ (1,342) | ¥ (7) | ¥308,251 |
| Compensation expense for stock options | | 25 | | | | 25 |
| Comprehensive income (loss): | | | | | | |
| Net loss | | | (41,500) | | | (41,500) |
| Other comprehensive income (loss): | | | | | | |
| Foreign currency translation adjustments | | | | 2,789 | | 2,789 |
| Minimum pension liability adjustment, net of tax | | | | (878) | | (878) |
| Unrealized gains (losses) on marketable securities, net of tax | | | | (3,336) | | (3,336) |
| Unrealized gains (losses) on derivative financial instruments, net of tax | | | | 12 | | 12 |
| Comprehensive income (loss) | | | | | | (42,913) |
| Adjustment to initially apply SFAS No. 158, net of tax | | | | (262) | | (262) |
| Effect of change in fiscal year-end of certain subsidiary | | | (32) | | | (32) |
| Purchase of treasury stock, at cost | | | | | (1) | (1) |
| **Balance at March 31, 2007** | ¥85,955 | ¥281,039 | ¥ (98,901) | ¥ (3,017) | ¥ (8) | ¥265,068 |
| Compensation expense for stock options | | 34 | | | | 34 |
| Comprehensive income (loss): | | | | | | |
| Net loss | | | (15,995) | | | (15,995) |
| Other comprehensive income (loss): | | | | | | |
| Foreign currency translation adjustments | | | | (8,589) | | (8,589) |
| Pension liability adjustment, net of tax | | | | (11,800) | | (11,800) |
| Unrealized gains (losses) on marketable securities, net of tax | | | | (1,578) | | (1,578) |
| Comprehensive income (loss) | | | | | | (37,962) |
| Purchase of treasury stock, at cost | | | | | (2) | (2) |
| **Balance at March 31, 2008** | ¥85,955 | ¥281,073 | ¥(114,896) | ¥(24,984) | ¥(10) | ¥227,138 |
| Compensation expense for stock options | | **8** | | | | **8** |
| Comprehensive income (loss): | | | | | | |
| Net loss | | | **(82,625)** | | | **(82,625)** |
| Other comprehensive income (loss): | | | | | | |
| Foreign currency translation adjustments | | | | **(8,476)** | | **(8,476)** |
| Pension liability adjustment, net of tax | | | | **(7,211)** | | **(7,211)** |
| Unrealized gains (losses) on marketable securities, net of tax | | | | **(703)** | | **(703)** |
| Comprehensive income (loss) | | | | | | **(99,015)** |
| Purchase of treasury stock, at cost | | | | | **(1)** | **(1)** |
| **Balance at March 31, 2009** | **¥85,955** | **¥281,081** | **¥(197,521)** | **¥(41,374)** | **¥(11)** | **¥128,130** |

*See notes to consolidated financial statements.*

# NEC Electronics Corporation

## Consolidated Statements of Changes in Shareholders' Equity (Continued)

| | Thousands of U.S. dollars | | | | | |
|---|---|---|---|---|---|---|
| | Common stock | Additional paid-in capital | Accumulated deficit | Accumulated other comprehensive income (loss) | Treasury stock, at cost | Total |
| **Balance at March 31, 2008** | $868,232 | $2,839,121 | $(1,160,566) | $(252,364) | $(100) | $2,294,323 |
| Compensation expense for stock options | | **81** | | | | **81** |
| Comprehensive income (loss): | | | | | | |
| Net loss | | | **(834,596)** | | | **(834,596)** |
| Other comprehensive income (loss): | | | | | | |
| Foreign currency translation adjustments | | | | **(85,616)** | | **(85,616)** |
| Pension liability adjustment, net of tax | | | | **(72,838)** | | **(72,838)** |
| Unrealized gains (losses) on marketable securities, net of tax | | | | **(7,101)** | | **(7,101)** |
| Comprehensive income (loss) | | | | | | **(1,000,151)** |
| Purchase of treasury stock, at cost | | | | | **(11)** | **(11)** |
| **Balance at March 31, 2009** | **$868,232** | **$2,839,202** | **$(1,995,162)** | **$(417,919)** | **$(111)** | **$1,294,242** |

# NEC Electronics Corporation

## Consolidated Statements of Cash Flows

| | Year ended March 31, | | | |
|---|---|---|---|---|
| | 2007 | 2008 | 2009 | 2009 |
| | | *(Millions of yen)* | | *(Thousands of U.S. dollars)* |
| **Cash flows from operating activities:** | | | | |
| Net loss | ¥ (41,500) | ¥ (15,995) | **¥ (82,625)** | **$ (834,596)** |
| Adjustments to reconcile net loss to net cash provided by (used in) operating activities: | | | | |
| Depreciation and amortization | 82,960 | 75,067 | **67,346** | **680,263** |
| Deferred income taxes | 2,998 | 8,352 | **(8,259)** | **(83,424)** |
| Loss on property, plant and equipment, net | 5,983 | 3,559 | **5,547** | **56,030** |
| Realized (gain) loss on marketable securities | (6,383) | – | **6** | **61** |
| Provision for pension and severance costs, less payments | (1,115) | (7,962) | **(308)** | **(3,111)** |
| Equity in (earning) loss of affiliated companies | 468 | 207 | **(307)** | **(3,101)** |
| Minority interest in income (loss) of consolidated subsidiaries | 552 | 251 | **(288)** | **(2,909)** |
| Net gain on business transfer | – | (2,040) | **–** | **–** |
| (Increase) decrease in notes and accounts receivable | 15,985 | (3,710) | **39,117** | **395,121** |
| (Increase) decrease in inventories | (9,333) | 856 | **10,911** | **110,212** |
| Increase (decrease) in notes and accounts payable | 16,171 | (17,309) | **(31,166)** | **(314,808)** |
| Increase (decrease) in other current liabilities | (4,239) | 2,884 | **(7,841)** | **(79,202)** |
| Other, net | 4,184 | (898) | **934** | **9,434** |
| Net cash provided by (used in) operating activities | 66,731 | 43,262 | **(6,933)** | **(70,030)** |
| **Cash flows from investing activities:** | | | | |
| Proceeds from sales of property, plant and equipment | 39,803 | 20,653 | **6,271** | **63,343** |
| Additions to property, plant and equipment | (121,126) | (62,188) | **(53,035)** | **(535,707)** |
| Proceeds from sales of marketable securities | 3,660 | – | **–** | **–** |
| Investments in affiliated companies | (1,400) | – | **–** | **–** |
| (Increase) decrease in loans receivable | 242 | (2) | **(1)** | **(10)** |
| Proceeds from business transfer, net of cash transferred | – | 5,340 | **–** | **–** |
| Proceeds from sales of other investment securities | 198 | – | **159** | **1,606** |
| Purchase of other investment securities | – | (328) | **(154)** | **(1,556)** |
| Other, net | 126 | (1,244) | **(2,496)** | **(25,211)** |
| Net cash used in investing activities | (78,497) | (37,769) | **(49,256)** | **(497,535)** |
| **Cash flows from financing activities:** | | | | |
| Repayments of long-term debt | (7,191) | (15,980) | **(593)** | **(5,990)** |
| Increase (decrease) in short-term borrowings, net | (4,018) | (2,711) | **185** | **1,869** |
| Repayments of lease obligation to related parties | (1,865) | (1,765) | **(1,179)** | **(11,909)** |
| Payments on intangible assets purchase contracts | (2,196) | (2,527) | **(2,707)** | **(27,344)** |
| Other, net | (3) | (2) | **(1)** | **(10)** |
| Net cash used in financing activities | (15,273) | (22,985) | **(4,295)** | **(43,384)** |
| **Effect of exchange rate changes on cash and cash equivalents** | 1,595 | (2,408) | **(3,709)** | **(37,465)** |
| **Net decrease in cash and cash equivalents** | (25,444) | (19,900) | **(64,193)** | **(648,414)** |
| **Effect of change in fiscal year-end of certain subsidiary** | (244) | – | **–** | **–** |
| **Cash and cash equivalents at beginning of year** | 211,060 | 185,372 | **165,472** | **1,671,434** |
| **Cash and cash equivalents at end of year** | ¥ 185,372 | ¥ 165,472 | **¥ 101,279** | **$ 1,023,020** |

*See notes to consolidated financial statements.*

# NEC Electronics Corporation

## Consolidated Statements of Cash Flows (Continued)

| | Year ended March 31, | | | |
|---|---|---|---|---|
| | 2007 | 2008 | 2009 | 2009 |
| | | *(Millions of yen)* | | *(Thousands of U.S. dollars)* |
| **Supplemental disclosures of cash flow information:** | | | | |
| Cash paid during the year for: | | | | |
| Interest | ¥ 706 | ¥ 765 | **¥ 319** | **$ 3,222** |
| Income taxes | 33 | 4,572 | **2,903** | **29,323** |
| Non-cash investing and financing transaction: | | | | |
| Machinery and equipment obtained by capital leases | 220 | 928 | **2,095** | **21,162** |
| Intangible assets purchase contracts | 721 | – | **9,265** | **93,586** |

NEC Electronics Corporation

# Notes to Consolidated Financial Statements

## 1. Background and Basis of Presentation

NEC Electronics Corporation was formed on November 1, 2002 as a wholly owned subsidiary of NEC Corporation ("NEC") as a result of a separation by new incorporation (*shinsetsu bunkatsu)* under the corporate separation (*kaisha bunkatsu*) provisions of the former Japanese Commercial Code. Pursuant to NEC's separation plan, substantially all of NEC's semiconductor business operations and related assets and liabilities, excluding those related to the general-purpose DRAM business, were transferred to NEC Electronics Corporation, at historical cost, in exchange for the issuance to NEC of 100,000,000 shares of its common stock. On November 1, 2002, NEC Electronics Corporation acquired most of the assets that were intended to be transferred from NEC by operation of law. However, certain asset transfers, specifically, the investments in NEC Electronics (China) Co., Ltd., previously named Beijing Hua Hong NEC IC Design Co., Ltd., and Shougang NEC Electronics Co., Ltd., were subject to Chinese government approval and registration. These transfers were completed during the year ended March 31, 2004. The accompanying consolidated financial statements have been prepared on the basis that all intended asset transfers, including the investments in these Chinese subsidiaries, had been completed as planned for the periods prior to corporate separation. NEC had operated the businesses which were transferred to NEC Electronics Corporation as an internal division and through various business units and subsidiaries.

NEC Electronics Corporation and its subsidiaries (the "Company") is a leading integrated provider of system-level semiconductor solutions for electronic products and systems across a variety of key markets in the communications, computing and peripherals, consumer electronics, and automotive and industrial sectors.

## 2. Significant Accounting Policies

### *Use of estimates*

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

## 2. Significant Accounting Policies (continued)

***Basis of consolidation***

The consolidated financial statements include the accounts of NEC Electronics Corporation and all entities in which NEC Electronics Corporation has a controlling financial interest. All significant intercompany transactions and accounts are eliminated. For purposes of financial reporting, a certain foreign subsidiary has a December 31 fiscal year-end. Therefore, the Company recognizes the financial position and results of operations of such subsidiary on a basis of a three-month lag. There have been no significant transactions with such subsidiary during the periods from January 1 to March 31.

During the year ended March 31, 2007, a certain subsidiary changed the fiscal year-end to March 31 from December 31, in order to conform the subsidiary's year-end with that of the Company. The loss of the subsidiary for the months that exceed twelve months was directly charged to the accumulated deficit.

***Cash equivalents***

All highly liquid investments with an original maturity of three months or less are considered to be cash equivalents.

***Foreign currency translation***

Foreign currency transactions are measured at the applicable rates of exchange prevailing at the transaction dates. Assets and liabilities denominated in foreign currencies at the balance sheet date are remeasured at the applicable rates of exchange prevailing at that date. Exchange differences are charged or credited to income.

Assets and liabilities of foreign subsidiaries are translated into yen at applicable year-end rates of exchange, and all revenue and expense accounts are translated at average rates of exchange prevailing during the year. The resulting translation adjustments are accumulated and included in accumulated other comprehensive income (loss), classified as part of shareholders' equity.

***Allowance for doubtful accounts***

An allowance for doubtful accounts is provided based on credit loss history and an evaluation of any specific doubtful accounts.

**2. Significant Accounting Policies (continued)**

***Investments***

The Company classifies its marketable equity securities as available-for-sale, which are reported at fair value with unrealized gains and losses included in accumulated other comprehensive income (loss), net of tax. When a decline in value of the marketable security is deemed to be other-than-temporary, the Company recognizes an impairment loss to the extent of the decline. In determining if and when such a decline in value is other-than-temporary, the Company evaluates market conditions, trends of earnings, and other key measures. Realized gains or losses on the sale of marketable securities are based on the average cost of a particular security held at the time of sale.

The investments in affiliated companies (investees over which the Company has the ability to exercise significant influence, and corporate joint ventures) are accounted for by the equity method.

Other investment securities are stated at cost. The Company periodically evaluates whether the value of the investment has declined. When the fair value is less than its cost, the Company judges whether the decline of an investment value is temporary. The Company evaluates various conditions, such as the duration of the decline, significance of the decline, the financial position and the expected future performance of the investee as well as intention and ability, for the Company to maintain the investment. If the decline is deemed to be other-than-temporary, the Company recognizes the difference between the investment's cost and its fair value as an impairment loss.

***Inventories***

Inventories are stated at the lower of cost principally on a first-in, first-out basis or market.

The Company analyzes all inventory including slow moving and obsolete inventory, and writes down such inventory to its estimated market value based on assumptions about future demand and market conditions.

***Property, plant and equipment and depreciation***

Property, plant and equipment is stated at cost. Depreciation is computed principally using the declining-balance method at rates based on the following estimated useful lives of the assets: buildings, mainly 15 to 45 years, machinery and equipment, mainly 4 to 8 years. Maintenance and repairs, including minor renewals and betterments, are charged to income as incurred.

Leased assets meeting certain criteria are capitalized and amortized using the declining-balance method over the lease term.

**2. Significant Accounting Policies (continued)**

***License fees and other intangibles***

License fees and other intangibles are amortized on a straight-line method over their estimated useful lives.

***Impairment of long-lived assets***

Long-lived assets to be held and used, including license fees and other intangibles, are evaluated for impairment using an estimate of undiscounted cash flows whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. If the estimate of undiscounted cash flows is less than the carrying amount of the assets, an impairment loss is recorded based on the fair value of the assets.

Long-lived assets to be disposed of by sale are evaluated at the lower of carrying amount or fair value less cost to sell.

***Income taxes***

Deferred tax assets and liabilities are determined based on the difference between the financial statement and tax basis of assets and liabilities, using the enacted tax rates in effect for the year in which the temporary differences are expected to reverse. Deferred tax assets are also recognized for the estimated future tax benefits attributable to operating loss carryforwards. Valuation allowances are established to reduce deferred tax assets to their net realizable value if it is more likely than not that some portion or all of the deferred tax assets will not be realized.

Effective April 1, 2007, the Company adopted the provisions of the Financial Accounting Standards Board ("FASB") Interpretation No. 48, *Accounting for Uncertainty in Income Taxes—an Interpretation of FASB Statement No. 109, Accounting for Income Taxes* ("FIN No. 48"). FIN No. 48 clarifies the accounting for uncertainty in income taxes recognized in consolidated financial statements and prescribes recognition and measurement of a tax position. The Company recognizes interest and penalties related to unrecognized income tax benefits in interest expense and loss on sales or disposal of property, plant and equipment and other. Please refer to Note 10 for more information.

***Stock-based compensation***

The Company had accounted for its stock-based compensation plans under the fair value recognition provisions of Statement of Financial Accounting Standards ("SFAS") No. 123 (revised 2004), *Share-Based Payment*.

## 2. Significant Accounting Policies (continued)

### *Net income (loss) per share*

Basic net income (loss) per share is computed by dividing net income (loss) by the weighted-average number of shares of common stock outstanding for the period. Diluted net income (loss) per share assumes the dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock, or resulted in the issuance of common stock unless their inclusion would have an antidilutive effect.

### *Revenue recognition*

The Company recognizes revenue for transactions when the following criteria are met: persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the seller's price to the buyer is fixed or determinable, and collectibility is reasonably assured.

Revenue from sales of products is recognized when the customer has taken title to the product and the risk and rewards of ownership have been substantively transferred. Under normal terms and conditions, this may occur at the time of delivery to the customer's site or upon customer acceptance.

A sales rebate to certain distributors is provided based on the amount of purchases by the distributors and is recognized as a reduction of sales based on each of the underlying sales transactions that results in progress by the distributors toward earning the rebate.

### *Derivative financial instruments*

The Company recognizes all derivative financial instruments in the consolidated financial statements at fair value regardless of the purpose or intent for holding the derivative financial instruments. Changes in the fair value of derivative financial instruments are either recognized periodically in income or in shareholders' equity as a component of accumulated other comprehensive income (loss) depending on whether the derivative financial instruments qualify for hedge accounting, and if so, whether they qualify as a fair value hedge or a cash flow hedge. Changes in the fair value of derivative financial instruments accounted for as a fair value hedge are recorded in income along with the portion of the change in the fair value of the hedged item that relates to the hedged risk. Changes in the fair value of derivative financial instruments accounted for as a cash flow hedge, to the extent they are effective as a hedge, are recorded in accumulated other comprehensive income (loss), net of tax. Amounts recorded to accumulated other comprehensive income (loss) are reclassified into earnings when the hedged transaction effects earnings or is probable of not occurring. Changes in the fair value of derivative financial instruments not qualifying as a hedge are reported in income.

## 2. Significant Accounting Policies (continued)

***Securitization of receivables***

The Company has several securitization programs under which certain trade receivables are sold, without recourse, to Special Purpose Entities ("SPEs") and others. In certain securitizations, the Company has retained a subordinated interest.

When the Company sells the receivables in a securitization transaction, the carrying value of the receivables is allocated to the portion retained and the portion sold, based on their relative fair value at the sale date. Gain or loss on the sale of the receivables is calculated based on the allocated carrying value of the receivables sold. Retained interests are initially recorded at the allocated carrying value of the receivables and are periodically reviewed for impairment. The Company generally estimates fair value based on the present value of future expected cash flows using certain assumptions; credit losses and discount rates commensurate with the risks involved.

***Asset retirement obligations***

Asset retirement obligations are legal obligations associated with the retirement of long-lived assets. The Company recognizes the fair value of asset retirement obligations as a liability when a reasonable estimate can be made and the related asset retirement cost is capitalized as part of the carrying amount of the related asset. The asset retirement cost is depreciated over the estimated useful life of the related asset. Subsequent to initial recognition, the Company records changes in the asset retirement obligations resulting from the passage of time and revisions to either the timing or the amount of the original estimate of undiscounted cash flows at the end of each period.

***Reclassifications***

Certain amounts in the consolidated financial statements for the years ended March 31, 2007 and 2008 have been reclassified to conform to the year ended March 31, 2009 presentation.

**2. Significant Accounting Policies (continued)**

***New accounting standards***

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* ("SFAS No. 157"). SFAS No. 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. Effective April 1, 2008, the Company adopted SFAS No. 157. SFAS No. 157 applies under other accounting pronouncements that require or permit fair value measurements and does not require any new fair value measurements. In February 2008, the FASB issued FASB Staff Position ("FSP") No. FAS 157-2, *Effective Date of FASB Statement No. 157*, which delays the effective date of SFAS No. 157 for one year for nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis. In October 2008, the FASB issued FSP No. SFAS 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active*, which clarifies the application of SFAS No. 157 in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. The Company adopted SFAS No. 157 for the year ended March 31, 2009, and the adoption of SFAS No. 157 did not have a significant effect on financial position or results of operations. The details of effect of adopting SFAS No. 157 are described in Note 4.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations* ("SFAS No. 141(R)"). SFAS No. 141(R) establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree and the goodwill acquired in the business combination or a gain from a bargain purchase. SFAS No. 141(R) also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. SFAS No. 141(R) is effective for fiscal years beginning after December 15, 2008 and the Company will adopt SFAS No. 141(R) effective April 1, 2009. The impact that adoption of SFAS No. 141(R) will have on financial position and results of operation will be dependent upon the specific terms of any applicable future business combinations.

In December 2007, the FASB concurrently issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements*－*an amendment of Accounting Research Bulletin ("ARB") No. 51* ("SFAS No. 160"). SFAS No. 160 establishes accounting and reporting standards for the ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the noncontrolling interest, changes in parent's ownership interest, and the valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated. SFAS No. 160 also establishes disclosure requirements that clearly identify and distinguish between the interest of the parent and the interests of the noncontrolling owners. SFAS No. 160 is effective for fiscal years beginning after December 15, 2008 and the Company will adopt SFAS No. 160 effective April 1, 2009. The Company is currently evaluating the effect that the adoption of SFAS No. 160 will have on its financial position and the result of operations.

## 2. Significant Accounting Policies (continued)

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities—an amendment of FASB Statement No. 133* ("SFAS No. 161"). SFAS No. 161 changes the disclosure requirements for derivative instruments and hedging activities. The Company adopted SFAS No. 161 for the year ended March 31, 2009, and the adoption of SFAS No. 161 did not have a significant effect on financial position or results of operations. The details of effect of adopting SFAS No. 161 are described in Note 15.

## 3. U.S. Dollar Amounts

U.S. dollar amounts are included solely for the convenience of the readers of the consolidated financial statements. These translations should not be construed as representations that the yen amounts actually represent, or have been or could be converted into, U.S. dollars.

A rate of ¥99=U.S.$1, the approximate current rate at March 31, 2009, has been used for the purpose of presentation of the U.S. dollar amounts in the accompanying consolidated financial statements.

### 4. Fair Value Measurement

SFAS No. 157 clarifies that fair value is the price in an orderly transaction between market participants to sell the asset or transfer the liability at the measurement date.

SFAS No. 157 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into a three-level. Inputs refer to the assumptions that market participants would use in pricing the asset or liability, including assumptions about risk.

Level 1 inputs are quoted prices in active markets for identical assets or liabilities.
Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability.
Level 3 inputs are unobservable inputs for the asset or liability.

Assets and liabilities measured at fair value on a recurring basis as of March 31, 2009 were as follows:

| | **March 31, 2009** | **(Level 1)** | **(Level 2)** | **(Level 3)** |
|---|---|---|---|---|
| | | *(Millions of yen)* | | |
| Assets: | | | | |
| Cash and cash equivalents | **¥52,581** | **¥ —** | **¥52,581** | **¥ —** |
| Marketable securities | **2,158** | **2,158** | **—** | **—** |
| Prepaid expenses and other current assets | **35** | **—** | **35** | **—** |
| Total Assets | **¥54,774** | **¥2,158** | **¥52,616** | **¥ —** |
| Liabilities: | | | | |
| Other current liabilities | **¥ 1,000** | **¥ —** | **¥ 1,000** | **¥ —** |
| Other | **202** | **—** | **202** | **—** |
| Total Liabilities | **¥ 1,202** | **¥ —** | **¥ 1,202** | **¥ —** |

**4. Fair Value Measurement (continued)**

| | **March 31, 2009** | **(Level 1)** | **(Level 2)** | **(Level 3)** |
|---|---|---|---|---|
| | | *(Thousands of U.S. dollars)* | | |
| Assets: | | | | |
| Cash and cash equivalents | **$531,121** | **$ —** | **$531,121** | **$ —** |
| Marketable securities | **21,798** | **21,798** | **—** | **—** |
| Prepaid expenses and other current assets | **354** | **—** | **354** | **—** |
| Total Assets | **$553,273** | **$21,798** | **$531,475** | **$ —** |
| Liabilities: | | | | |
| Other current liabilities | **$ 10,101** | **$ —** | **$ 10,101** | **$ —** |
| Other | **2,040** | **—** | **2,040** | **—** |
| Total Liabilities | **$ 12,141** | **$ —** | **$ 12,141** | **$ —** |

Marketable securities which were measured at quoted prices in active markets for identical assets or liabilities were classified as Level 1.
Cash and cash equivalents include certificate of deposits and commercial paper. The Company classifies these instruments which were measured at inputs that are observable for the asset or liability as Level 2.
Other assets and liabilities include forward exchange contracts. The Company classifies these instruments which were measured at market inputs, such as foreign currency exchange rates and interest rates, that are validated using quotes obtained from counterparties or third parties as Level 2.

A portion of the Company’s investments in equity securities, included in investments, is regarded as the assets and liabilities that are measured at fair value on a nonrecurring basis. For the year ended March 31, 2009, the Company recognized other-than-temporary impairment losses on the investment of ¥322 million ($3,252 thousand) to zero. The Company classifies the investment which was measured at inputs that are significant unobservable for the asset or liability as Level 3. The resulting investment was valued using the latest available financial information, an estimate of future cash flows and others.

**5. Investments**

The summary of marketable equity securities at March 31, 2008 and 2009 which were classified as available-for-sale was as follows:

| | Cost | Gross unrealized holding gains | Gross unrealized holding losses | Fair value |
|---|---|---|---|---|
| | *(Millions of yen)* | | | |
| March 31, 2008 | ¥1,933 | ¥ 1,414 | ¥ (2) | ¥ 3,345 |
| **March 31, 2009** | **1,927** | **530** | **(299)** | **2,158** |

| | Cost | Gross unrealized holding gains | Gross unrealized holding losses | Fair value |
|---|---|---|---|---|
| | *(Thousands of U.S. dollars)* | | | |
| **March 31, 2009** | **$19,465** | **$5,353** | **$(3,020)** | **$21,798** |

The Company recognized other-than-temporary impairment loss on available-for-sale securities was ¥6 million ($61 thousand) for the year ended March 31, 2009.
At March 31, 2009, substantially all of the available-for-sale securities with unrealized losses had been in a continuous unrealized loss position for less than 12 months.

Investments in equity securities, included in investments, other, with an aggregate carrying amount of ¥527 million and ¥368 million ($3,717 thousand) at March 31, 2008 and 2009, respectively, consist of investments in securities of nonpublic companies. These investments were not evaluated for impairment at March 31, 2008 and 2009, respectively, because the Company did not identify any events or changes in circumstances that may have had a significant adverse effect on the fair value of those investments. The Company recognized other-than-temporary impairment losses on investments in securities of non public companies of ¥994 million and ¥322 million ($3,252 thousand) for the years ended March 31, 2007 and 2009, respectively.

The Company's investment in affiliated companies accounted for by the equity method together with a percentage of the Company's ownership of common stock at March 31, 2008 and 2009 were Adcore-tech Co., Ltd. (11.7%). Since Adcore-tech Co., Ltd. was a corporate joint venture, the Company accounts for the investment by the equity method.

## 6. Inventories

Inventories at March 31, 2008 and 2009 consisted of the following:

| | March 31, | | |
|---|---|---|---|
| | **2008** | **2009** | **2009** |
| | *(Millions of yen)* | | *(Thousands of U.S. dollars)* |
| Finished products | ¥19,674 | **¥14,453** | **$145,990** |
| Work in process | 46,896 | **38,377** | **387,646** |
| Raw materials | 9,269 | **10,390** | **104,950** |
| | ¥75,839 | **¥63,220** | **$638,586** |

## 7. License Fees and Other Intangibles

Intangible assets acquired for the year ended March 31, 2009 totaled ¥11,307 million ($114,212 thousand), which are subject to amortization and primarily consist of license fees of ¥10,896 million ($110,061 thousand). The weighted-average amortization period for license fees is approximately 5 years.

License fees and other intangibles subject to amortization at March 31, 2008 and 2009 consisted of the following:

| | March 31, | | | | | |
|---|---|---|---|---|---|---|
| | **2008** | | **2009** | | **2009** | |
| | **Gross carrying amount** | **Accumulated amortization** | **Gross carrying amount** | **Accumulated amortization** | **Gross carrying amount** | **Accumulated amortization** |
| | *(Millions of yen)* | | | | *(Thousands of U.S. dollars)* | |
| License fees | ¥13,505 | ¥ (9,887) | **¥15,856** | **¥(6,720)** | **$160,162** | **$(67,879)** |
| Other | 4,350 | (2,497) | **3,955** | **(2,258)** | **39,949** | **(22,808)** |
| | ¥17,855 | ¥(12,384) | **¥19,811** | **¥(8,978)** | **$200,111** | **$(90,687)** |

## 7. License Fees and Other Intangibles (continued)

The aggregate amortization expense for the years ended March 31, 2007, 2008 and 2009 was ¥4,352 million, ¥4,848 million and ¥4,724 million ($47,717 thousand), respectively. The estimated amortization expense for the next five years is as follows:

| **Year ending March 31:** | *(Millions of yen)* | *(Thousands of U.S. dollars)* |
|---|---|---|
| 2010 | ¥4,472 | $45,172 |
| 2011 | 3,722 | 37,596 |
| 2012 | 1,658 | 16,747 |
| 2013 | 305 | 3,081 |
| 2014 | 142 | 1,434 |

Intangibles with indefinite useful lives at March 31, 2008 and 2009 were insignificant.

## 8. Short-Term Borrowings and Long-Term Debt

Short-term borrowings at March 31, 2008 and 2009 were as follows:

| | **March 31,** | | |
|---|---|---|---|
| | **2008** | **2009** | **2009** |
| | *(Millions of yen)* | | *(Thousands of U.S. dollars)* |
| Loans, principally from banks, including bank overdrafts | | | |
| Secured (average interest rate of 2.40% in 2009) | ¥ — | **¥ 185** | **$ 1,869** |
| Unsecured (average interest rate of 1.25% in 2008 and 1.09% in 2009) | 954 | **950** | **9,596** |
| | ¥954 | **¥1,135** | **$ 11,465** |

At March 31, 2009, notes receivables trade with book value of ¥185 million ($1,869 thousand) were pledged as collateral for loans.

At March 31, 2009, the Company had unused lines of credit for short-term financing aggregating ¥15,000 million ($151,515 thousand) with commitment fees on the unused portion ranging from 0.15% to 0.18% subject to an annual renewal, and ¥7,510 million ($75,859 thousand) with no commitment fees generally with maturities within one year.

**8. Short-Term Borrowings and Long-Term Debt (continued)**

Long-term debt at March 31, 2008 and 2009 was as follows:

| | March 31, | | |
|---|---|---|---|
| | 2008 | 2009 | 2009 |
| | *(Millions of yen)* | | *(Thousands of U.S. dollars)* |
| Loans, principally from banks | | | |
| Unsecured (due through 2009, with interest rate of 5.00% at March 31, 2008) | ¥ 619 | **¥ —** | **$ —** |
| Zero coupon unsecured yen convertible bonds due 2011, convertible currently at ¥9,860 for one common share, redeemable before maturity date | 110,000 | **110,000** | **1,111,111** |
| | 110,619 | **110,000** | **1,111,111** |
| Less – portion due within one year | (619) | **—** | **—** |
| | ¥110,000 | **¥110,000** | **$1,111,111** |

The convertible bonds are contingently convertible based on market price. The conversion prices of the convertible bonds are subject to adjustment if there is a share split or consolidation of shares or, in certain circumstances, if new shares are issued at a price less than the current quoted market price. In addition, the bonds carry a call option that gives the Company the right to call the bonds at the principal amount, if the Company's stock price is 130% or more of the conversion price for 30 consecutive trading days after May 27, 2008.

At March 31, 2009, annual maturities on long-term debt during the next five years are as follows:

| **Year ending March 31:** | *(Millions of yen)* | *(Thousands of U.S. dollars)* |
|---|---|---|
| 2010 | ¥ – | $ – |
| 2011 | – | – |
| 2012 | 110,000 | 1,111,111 |
| 2013 | – | – |
| 2014 | – | – |

**9. Pension and Severance Plans**

NEC Electronics Corporation and domestic subsidiaries have severance indemnity plans and non-contributory defined benefit pension plans, including cash balance pension plans. NEC Electronics Corporation and certain domestic subsidiaries previously had contributory defined benefit pension plans that included a governmental welfare component which would otherwise be provided by the Japanese government.

Effective November 1, 2002, in connection with the corporation separation, the Company assumed responsibility for pension and severance benefits for its active employees as of that date, located in Japan, related to the severance indemnity plans and contributory defined benefit pension plans. The related plan assets remained with the trusteed fund associated with NEC's plans. In the consolidated financial statements, benefit obligations are based upon the participant data for the Company's employees. Plan assets were allocated based upon benefit obligations.

NEC Electronics Corporation and certain domestic subsidiaries have a "point-based benefits system," under which benefits are calculated based on accumulated points allocated to employees each year according to their job classification and their performance.

NEC Electronics Corporation and certain domestic subsidiaries have cash balance pension plans. Under the cash balance pension plans, each participant has an account which is credited yearly based on the current base rate of pay, their job classification and interest crediting rate calculated based on the market interest rate.

NEC Electronics Corporation and certain domestic subsidiaries reduced the future portion of the defined benefit pension plans and introduced the defined contribution pension plans during the year ended March 31, 2008.

Most foreign subsidiaries have various retirement plans covering substantially all of their employees. These plans are mainly defined contribution plans and also defined benefit plans. The funding policy for the defined contribution plans is to annually contribute an amount equal to a certain percentage of the participant's annual salary.

The Company adopted SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans–an amendment of FASB Statements No.87, 88,106, and 132(R)* ("SFAS No.158"), effective March 31, 2007. The Company recognizes the difference between projected benefit obligations and fair value of plan assets in the consolidated balance sheet. The Company also recognizes as a component of accumulated other comprehensive income, net of tax, prior service costs and actuarial losses that arise during the period but are not recognized as components of net periodic benefit cost. The adoption of SFAS No. 158 had no effect on profit and loss for the year ended March 31, 2007 and the following periods.

## 9. Pension and Severance Plans (continued)

Reconciliations of beginning and ending balances of the benefit obligations and the fair value of the plan assets were as follows:

| | March 31, | | |
|---|---|---|---|
| | 2008 | 2009 | 2009 |
| | *(Millions of yen)* | | *(Thousands of U.S.dollars)* |
| Change in benefit obligations: | | | |
| Benefit obligations at beginning of year | ¥144,383 | **¥144,404** | **$1,458,626** |
| Service cost | 4,882 | **5,574** | **56,303** |
| Interest cost | 3,627 | **3,610** | **36,465** |
| Actuarial loss (gain) | 700 | **(6,835)** | **(69,040)** |
| Benefits paid | (9,888) | **(7,422)** | **(74,970)** |
| Plan amendment | 700 | − | − |
| Benefit obligations at end of year | 144,404 | **139,331** | **1,407,384** |
| Change in plan assets: | | | |
| Fair value of plan assets at beginning of year | 73,011 | **69,964** | **706,707** |
| Actual return on plan assets | (8,794) | **(13,793)** | **(139,323)** |
| Employer's contributions | 7,794 | **5,698** | **57,555** |
| Benefits paid | (2,047) | **(3,705)** | **(37,424)** |
| Fair value of plan assets at end of year | 69,964 | **58,164** | **587,515** |
| Funded status | ¥(74,440) | **¥(81,167)** | **$ (819,869)** |

For the year ended March 31, 2007, as part of the employer's contributions, the Company contributed certain marketable equity securities to an employee retirement benefit trust. The securities held in the trust are qualified as plan assets. The fair value of these securities at the time of contribution was ¥5,021 million. Upon contribution of these available-for-sale securities, a gross unrealized gain of ¥3,550 million was recognized in the consolidated statements of operations for the year ended March 31, 2007.

## 9. Pension and Severance Plans (continued)

Amounts recognized on the consolidated balance sheet as of March 31, 2008 and 2009 were as follows:

| | March 31, | | |
|---|---|---|---|
| | 2008 | 2009 | 2009 |
| | *(Millions of yen)* | | *(Thousands of U.S.dollars)* |
| Amounts recorded to accumulated other comprehensive (income) loss, before net of tax | ¥ 34,230 | **¥ 41,265** | **$ 416,818** |
| Prior service cost * | (19,736) | **(18,017)** | **(181,990)** |
| Actuarial loss * | 53,966 | **59,282** | **598,808** |
| Amounts recognized in the consolidated balance sheets consist of: | | | |
| Other assets | 20 | **—** | **—** |
| Accrued pension and severance costs | (74,460) | **(81,167)** | **(819,869)** |
| Net amounts recognized | ¥(74,440) | **¥(81,167)** | **$ (819,869)** |

*(*) Prior service cost and actuarial loss are amortized on a straight-line basis over the average remaining service period of employees expected to receive benefits under the plan, which is 16 years for the years ended March 31, 2008 and 2009.*

The accumulated benefit obligations for all defined benefit pension plans were ¥144,404 million and ¥139,331 million ($1,407,384 thousand) as of March 31, 2008 and 2009, respectively.

## 9. Pension and Severance Plans (continued)

The projected benefit obligations and the fair value of plan assets for pension plans with projected benefit obligations in excess of plan assets, and the accumulated benefit obligations and the fair value of plan assets for pension plans with accumulated benefit obligations in excess of plan assets at March 31, 2008 and 2009 were as follows:

| | March 31, | | |
|---|---|---|---|
| | 2008 | 2009 | 2009 |
| | *(Millions of yen)* | | *(Thousands of U.S. dollars)* |
| Plans with projected benefit obligations in excess of plan assets: | | | |
| Projected benefit obligations | ¥142,147 | **¥139,331** | **$1,407,384** |
| Fair value of plan assets | 67,687 | **58,164** | **587,515** |
| Plans with accumulated benefit obligations in excess of plan assets: | | | |
| Accumulated benefit obligations | 142,147 | **139,331** | **1,407,384** |
| Fair value of plan assets | 67,687 | **58,164** | **587,515** |

The weighted-average assumptions used to determine benefit obligations at March 31, 2008 and 2009 were as follows:

| | March 31, | |
|---|---|---|
| | 2008 | 2009 |
| Discount rate | 2.5% | **2.8%** |
| Rate of increase in future compensation level | 2.0% – 3.0% | **2.0% – 3.0%** |

The weighted-average assumptions used to determine net pension and severance cost for the years ended March 31, 2007, 2008 and 2009 were as follows:

| | Year ended March 31, | | |
|---|---|---|---|
| | 2007 | 2008 | 2009 |
| Discount rate | 2.5% | 2.5% | **2.5%** |
| Rate of increase in future compensation level | 2.4% – 3.8% | 2.0% – 3.0% | **2.0% – 3.0%** |
| Expected long-term rate of return on plan assets | 2.5% | 2.5% | **2.5%** |

The basis for determining the long-term rate is a combination of historical returns and prospective return assumptions derived from a combination of research and industry forecast.

## 9. Pension and Severance Plans (continued)

The allocation for the plan assets at March 31, 2008 and 2009 was as follows:

| | March 31, | |
|---|---|---|
| Asset category: | **2008** | **2009** |
| Equity securities | 32% | **32%** |
| Debt securities | 29% | **29%** |
| Short-term investments | 12% | **10%** |
| Others | 27% | **29%** |

Target allocation of equity securities, debt securities, short-term investments and others is 35%, 30%, 10% and 25%, respectively.

The Company's objective is to secure the required long-term total returns, while taking allowable risks, to ensure the payment of pension benefits, lump-sum benefits at death, and other lump-sum benefits to participants and annuitants, etc. in the future. The fund seeks to achieve the long-term investment returns that exceed the expected interest rate, which is required for the cash balance pension plan adopted by the Company.

To achieve the investment objective of the plan assets, the fund shall strive to select appropriate assets for the eligible investment, establish the asset allocation policy, which is the optimum combination of assets for the future in consideration of the expected rate of return and risk, etc. thereof, and maintain the asset allocation through rebalancing, etc. Such asset allocation policy is established from a medium-to-long term view of three to five years. The asset allocation policy is reviewed as necessary where the conditions thereof changed from the time of establishment of the asset allocation policy.

Components of net pension and severance cost for all defined benefit plans, including both the Company's and the employees' contributory portion of such plans, for the years ended March 31, 2007, 2008 and 2009 were as follows:

| | Year ended March 31, | | | |
|---|---|---|---|---|
| | **2007** | **2008** | **2009** | **2009** |
| | *(Millions of yen)* | | | *(Thousands of U.S. dollars)* |
| Service cost | ¥7,015 | ¥4,882 | **¥5,574** | **$56,303** |
| Interest cost | 3,441 | 3,627 | **3,610** | **36,465** |
| Expected return on plan assets | (1,679) | (1,898) | **(1,774)** | **(17,919)** |
| Amortization of unrecognized prior service cost | (1,762) | (1,719) | **(1,719)** | **(17,364)** |
| Amortization of actuarial loss | 2,820 | 2,781 | **3,416** | **34,506** |
| Net pension and severance cost for all defined benefit plans | ¥9,835 | ¥7,673 | **¥9,107** | **$91,991** |

**9. Pension and Severance Plans (continued)**

The estimated amounts of prior service cost and actuarial loss included in accumulated other comprehensive income (loss) at March 31, 2009, that are expected to be amortized into net periodic benefit cost over the next year are ¥ 1,700 million ($17,172 thousand) and ¥3,800 million ($38,384 thousand), respectively.

The total cost for all defined benefit and defined contribution plans was as follows:

| | Year ended March 31, | | | |
|---|---|---|---|---|
| | **2007** | **2008** | **2009** | **2009** |
| | *(Millions of yen)* | | | *(Thousands of U.S. dollars)* |
| Net pension and severance cost for all defined benefit plans | ¥ 9,835 | ¥7,673 | **¥ 9,107** | **$ 91,991** |
| Cost for defined contribution plans | 875 | 1,758 | **1,982** | **20,020** |
| Total cost for all defined benefit and defined contribution plans | ¥10,710 | ¥9,431 | **¥11,089** | **$112,011** |

Cost for defined contribution plans includes the amount of cost recognized of ¥1,070 million and ¥1,115 million ($11,263 thousand) for NEC Electronics Corporation and certain domestic subsidiaries' contributions to the plans for the years ended March 31, 2008 and 2009, respectively.

The Company also contributes to multiemployer plan. The amount of contributions to multiemployer plans for the years ended March 31, 2007, 2008 and 2009 were ¥220 million, ¥246 million and ¥264 million ($2,667 thousand), respectively.

The Company expects to contribute approximately ¥5,400 million ($54,545 thousand) to its pension plans in fiscal year ending March 31, 2010.

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

| **Year ending March 31:** | *(Millions of yen)* | *(Thousands of U.S. dollars)* |
|---|---|---|
| 2010 | ¥ 4,900 | $ 49,495 |
| 2011 | 5,100 | 51,515 |
| 2012 | 4,700 | 47,475 |
| 2013 | 4,800 | 48,485 |
| 2014 | 4,800 | 48,485 |
| 2015 – 2019 | 26,100 | 263,636 |

## 10. Income Taxes

The components of loss before income taxes and the provision for (benefit from) income taxes were as follows:

| | Year ended March 31, | | | |
|---|---|---|---|---|
| | 2007 | 2008 | 2009 | 2009 |
| | (Millions of yen) | | | (Thousands of U.S. dollars) |
| Income (loss) before income taxes: | | | | |
| NEC Electronics Corporation and domestic subsidiaries | ¥(42,547) | ¥ (18,343) | **¥(78,314)** | **$(791,051)** |
| Foreign subsidiaries | 7,172 | 15,091 | **(11,021)** | **(111,323)** |
| | ¥(35,375) | ¥ (3,252) | **¥(89,335)** | **$(902,374)** |
| Provision for (benefit from) income taxes: | | | | |
| Current: | | | | |
| NEC Electronics Corporation and domestic subsidiaries | ¥ 453 | ¥ 787 | **¥ 97** | **$ 979** |
| Foreign subsidiaries | 1,654 | 3,146 | **2,047** | **20,677** |
| | 2,107 | 3,933 | **2,144** | **21,656** |
| Deferred: | | | | |
| NEC Electronics Corporation and domestic subsidiaries | 3,962 | 1,256 | **(8,413)** | **(84,980)** |
| Foreign subsidiaries | (964) | 7,096 | **154** | **1,556** |
| | 2,998 | 8,352 | **(8,259)** | **(83,424)** |
| | ¥ 5,105 | ¥ 12,285 | **¥ (6,115)** | **$ (61,768)** |

The Company is subject to a number of different income taxes which, in the aggregate, result in a statutory tax rate in Japan of approximately 40.5% for the years ended March 31, 2007, 2008 and 2009. A reconciliation between the reported total income tax provision (benefit) and the amount computed by multiplying the loss before income taxes by the statutory tax rate was as follows:

| | Year ended March 31, | | | |
|---|---|---|---|---|
| | 2007 | 2008 | 2009 | 2009 |
| | (Millions of yen) | | | (Thousands of U.S. dollars) |
| Expected tax benefit | ¥(14,327) | ¥ (1,317) | **¥(36,181)** | **$(365,465)** |
| Increase in taxes resulting from: | | | | |
| Changes in valuation allowance | 19,043 | 13,110 | **34,720** | **350,707** |
| International tax rate differences | 770 | 58 | **(431)** | **(4,354)** |
| Undistributed earnings of foreign subsidiaries | 12 | — | **(8,202)** | **(82,848)** |
| Non-deductible expenses for tax purposes | 223 | 570 | **3,936** | **39,758** |
| Other | (616) | (136) | **43** | **434** |
| Income tax provision (benefit) | ¥ 5,105 | ¥12,285 | **¥ (6,115)** | **$ (61,768)** |

**10. Income Taxes (continued)**

Income tax provision (benefit) decreased mainly due to the reversal of the provision for deferred tax liability. Japanese Tax Reform, a measure to treat the dividends received from foreign subsidiaries as non-taxable income was passed by the Diet at March 27, 2009 and gazetted at March 31, 2009.

The significant components of deferred tax assets and liabilities at March 31, 2008 and 2009 were as follows:

| | March 31, | | |
|---|---|---|---|
| | 2008 | 2009 | 2009 |
| | *(Millions of yen)* | | *(Thousands of U.S. dollars)* |
| Deferred tax assets: | | | |
| Accrued pension and severance costs | ¥ 31,731 | **¥ 34,805** | **$ 351,566** |
| Research and development costs | 10,382 | **9,521** | **96,172** |
| Accrued bonus | 5,635 | **2,808** | **28,364** |
| Investments | 4,419 | **4,804** | **48,525** |
| Inventories | 3,764 | **7,668** | **77,455** |
| Property, plant and equipment | 5,873 | **7,100** | **71,717** |
| Operating loss carryforwards | 49,604 | **78,967** | **797,646** |
| Other | 7,748 | **7,199** | **72,717** |
| | 119,156 | **152,872** | **1,544,162** |
| Less – valuation allowance | (115,058) | **(149,530)** | **(1,510,404)** |
| Total | ¥ 4,098 | **¥ 3,342** | **$ 33,758** |
| Deferred tax liabilities: | | | |
| Tax deductible reserve | ¥ 1,561 | **¥ 1,131** | **$ 11,424** |
| Marketable securities | 572 | **94** | **950** |
| Tax on undistributed earnings | 7,824 | **1,225** | **12,374** |
| Gain on securities contributed to employee retirement benefit trust | 1,438 | **1,438** | **14,525** |
| Other | 838 | **574** | **5,798** |
| Total | ¥ 12,233 | **¥ 4,462** | **$ 45,071** |

The deferred tax assets and liabilities were included in deferred tax assets, deferred tax liabilities and other current liabilities on the consolidated balance sheets.

The valuation allowance was primarily related to deferred tax assets of NEC Electronics Corporation, its domestic subsidiaries and NEC Electronics America, Inc. The net changes in the total valuation allowance for the years ended March 31, 2007, 2008 and 2009 were increase of ¥20,944 million, ¥19,559 million and ¥34,472 million ($348,202 thousand), respectively.

The tax benefits of operating loss carryforwards utilized for the years ended March 31, 2007 and 2008 were ¥2,931 million and ¥396 million, respectively.

**10. Income Taxes (continued)**

At March 31, 2009, the Company had operating loss carryforwards amounting to ¥195,758 million ($1,977,354 thousand) of which ¥179,064 million ($1,808,728 thousand) relate to domestic subsidiaries and will expire during the period from 2013 through 2016. The remainder of ¥16,694 million ($168,626 thousand) relates to a foreign subsidiary with no expiration date.

Effective April 1, 2007, the Company adopted the provisions of FIN No.48. A reconciliation of the beginning and ending amount of unrecognized tax benefits was as follows:

| | March 31, | | |
|---|---|---|---|
| | 2008 | 2009 | 2009 |
| | *(Millions of yen)* | | *(Thousands of U.S. dollars)* |
| Balance at beginning of year | ¥ — | **¥2,889** | **$29,182** |
| Additions for tax positions of the current year | 2,581 | — | — |
| Additions for tax positions of the prior years | 308 | **358** | **3,616** |
| Reductions for tax positions of the prior years | — | — | — |
| Settlements | — | — | — |
| Lapse of the applicable statute of limitations | — | — | — |
| Other | — | **(48)** | **(485)** |
| Balance at end of year | ¥2,889 | **¥3,199** | **$32,313** |

At March 31, 2008 and 2009, the Company had ¥2,889 million and ¥3,199 million ($32,313 thousand) of total unrecognized tax benefits, of which ¥308 million and ¥668 million ($6,747 thousand) ,respectively, represents the amount of unrecognized tax benefits that, if recognized, would affect the effective income tax rate in future periods.

Both interest and penalties accrued related to unrecognized income tax benefits at March 31, 2008 and 2009 and interest and penalties included in consolidated statements of operations for the year ended March 31, 2008 and 2009 are not material.

Although it is difficult to estimate the range of any increase or decrease in uncertain tax position, the Company does not believe it is reasonably possible that the total amount of unrecognized tax benefits would materially change in the next 12 months. The Company estimates that the unrecognized tax benefits associated with transfer pricing matters at March 31, 2010 could be reduced approximately by ¥700 million ($7,071 thousand).

The Company which files income tax returns in Japan and foreign tax jurisdictions is generally no longer subject to income tax examinations by tax authorities for years prior to 2000.

## 11. Shareholders' Equity

(1) Retained earnings

The Japanese Company Law provides that an amount equal to 10% of distributions from retained earnings paid by NEC Electronics Corporation and domestic subsidiaries be appropriated as a legal reserve. No further appropriation is required when the total amount of additional paid-in capital and the legal reserve equals 25% of the stated capital. The Japanese Company Law also provides that the additional paid-in capital and the legal reserve are available for appropriations by the resolution of the shareholders.

The amount of retained earnings available for dividends under the Japanese Company Law is calculated at ¥52,332 million ($528,606 thousand) at March 31, 2009 based on the NEC Electronics Corporation's financial information prepared in accordance with accounting principles generally accepted in Japan.

At the June 27, 2006 shareholders' meeting of NEC Electronics Corporation, the shareholders approved a proposal to reclassify additional paid-in capital in the amount ¥84,618 million to eliminate for the accumulated deficit under the former Japanese Commercial Code. Such adjustment was not recorded for purpose of accounting principles generally accepted in the United States of America, because it did not meet all of the requirements associated with accounting for quasi-reorganizations.

## 11. Shareholders' Equity (continued)

(2) Other comprehensive income (loss)

Changes in accumulated other comprehensive income (loss) were as follows:

| | Year ended March 31, | | | |
|---|---|---|---|---|
| | 2007 | 2008 | 2009 | 2009 |
| | (Millions of yen) | | | (Thousands of U.S. dollars) |
| Foreign currency translation adjustments: | | | | |
| Balance at beginning of year | ¥ 7,713 | ¥ 10,502 | **¥ 1,913** | **$ 19,323** |
| Change in the current period | 2,789 | (8,589) | **(8,476)** | **(85,616)** |
| Balance at end of year | ¥ 10,502 | ¥ 1,913 | **¥ (6,563)** | **$ (66,293)** |
| Minimum pension liability adjustment: | | | | |
| Balance at beginning of year | ¥(14,797) | ¥ – | **¥ –** | **$ –** |
| Change in the current period | (878) | – | **–** | **–** |
| Adjustment to initially apply SFAS No. 158 | 15,675 | – | **–** | **–** |
| Balance at end of year | ¥ – | ¥ – | **¥ –** | **$ –** |
| Unrealized gains (losses) on marketable securities: | | | | |
| Balance at beginning of year | ¥ 5,754 | ¥ 2,418 | **¥ 840** | **$ 8,485** |
| Change in the current period | (3,336) | (1,578) | **(703)** | **(7,101)** |
| Balance at end of year | ¥ 2,418 | ¥ 840 | **¥ 137** | **$ 1,384** |
| Unrealized gains (losses) on derivative financial instruments: | | | | |
| Balance at beginning of year | ¥ (12) | ¥ – | **¥ –** | **$ –** |
| Change in the current period | 12 | – | **–** | **–** |
| Balance at end of year | ¥ – | ¥ – | **¥ –** | **$ –** |
| Pension liability adjustment: | | | | |
| Balance at beginning of year | ¥ – | ¥(15,937) | **¥(27,737)** | **$(280,172)** |
| Change in the current period | – | (11,800) | **(7,211)** | **(72,838)** |
| Adjustment to initially apply SFAS No. 158 | (15,937) | – | **–** | **–** |
| Balance at end of year | ¥(15,937) | ¥(27,737) | **¥(34,948)** | **$(353,010)** |
| Total accumulated other comprehensive income (loss): | | | | |
| Balance at beginning of year | ¥ (1,342) | ¥ (3,017) | **¥(24,984)** | **$(252,364)** |
| Change in the current period | (1,413) | (21,967) | **(16,390)** | **(165,555)** |
| Adjustment to initially apply SFAS No. 158 | (262) | – | **–** | **–** |
| Balance at end of year | ¥ (3,017) | ¥(24,984) | **¥(41,374)** | **$(417,919)** |

## 11. Shareholders' Equity (continued)

(2) Other comprehensive income (loss) (continued)

The tax effect allocated to the changes in each component of other comprehensive income (loss) was as follows:

| | Year ended March 31, | | |
|---|---|---|---|
| | Before-tax amount | Tax (expense) or benefit | Net-of-tax amount |
| | | *(Millions of yen)* | |
| **2007:** | | | |
| Foreign currency translation adjustments | ¥ 2,789 | ¥ – | ¥ 2,789 |
| Minimum pension liability adjustment | (1,373) | 495 | (878) |
| Unrealized gains (losses) on marketable securities: | | | |
| Unrealized holding gains arising during period | 730 | (296) | 434 |
| Less: reclassification adjustments for gains realized in net income (loss) | (6,336) | 2,566 | (3,770) |
| Unrealized gains (losses) on derivative financial instruments: | | | |
| Net changes in fair value of derivative financial instruments | 17 | (6) | 11 |
| Less: reclassification adjustments for losses realized in net income (loss) | 2 | (1) | 1 |
| Other comprehensive income (loss) | ¥(4,171) | ¥2,758 | ¥(1,413) |
| **2008:** | | | |
| Foreign currency translation adjustments | ¥ (8,589) | ¥ – | ¥ (8,589) |
| Unrealized gains (losses) on marketable securities: | | | |
| Unrealized holding gains arising during period | (2,652) | 1,074 | (1,578) |
| Pension liability adjustment: | | | |
| Prior service cost from plan amendment during period | (700) | – | (700) |
| Less: amortization of prior service cost included in net periodic pension cost | (1,719) | 398 | (1,321) |
| Actuarial loss from changes in measures of the benefit obligation or plan assets during period | (11,392) | (524) | (11,916) |
| Less: amortization of actuarial loss included in net periodic pension cost | 2,781 | (644) | 2,137 |
| Other comprehensive income (loss) | ¥(22,271) | ¥ 304 | ¥(21,967) |

**11. Shareholders' Equity (continued)**

(2) Other comprehensive income (loss) (continued)

| | Year ended March 31, | | |
|---|---|---|---|
| | Before-tax amount | Tax (expense) or benefit | Net-of-tax amount |
| | (Millions of yen) | | |
| **2009:** | | | |
| Foreign currency translation adjustments | ¥ (8,476) | ¥ – | ¥ (8,476) |
| Unrealized gains (losses) on marketable securities: | | | |
| Unrealized holding gains arising during period | (1,187) | 480 | (707) |
| Less: reclassification adjustments for losses realized in net income (loss) | 6 | (2) | 4 |
| Pension liability adjustment: | | | |
| Less: amortization of prior service cost included in net periodic pension cost | (1,719) | 178 | (1,541) |
| Actuarial loss from changes in measures of the benefit obligation or plan assets during period | (8,732) | – | (8,732) |
| Less: amortization of actuarial loss included in net periodic pension cost | 3,416 | (354) | 3,062 |
| Other comprehensive income (loss) | ¥(16,692) | ¥ 302 | ¥(16,390) |

| | Year ended March 31, | | |
|---|---|---|---|
| | Before-tax amount | Tax (expense) or benefit | Net-of-tax amount |
| | (Thousands of U.S. dollars) | | |
| **2009:** | | | |
| Foreign currency translation adjustments | $ (85,616) | $ – | $ (85,616) |
| Unrealized gains (losses) on marketable securities: | | | |
| Unrealized holding gains arising during period | (11,990) | 4,848 | (7,142) |
| Less: reclassification adjustments for losses realized in net income (loss) | 61 | (20) | 41 |
| Pension liability adjustment: | | | |
| Less: amortization of prior service cost included in net periodic pension cost | (17,364) | 1,798 | (15,566) |
| Actuarial loss from changes in measures of the benefit obligation or plan assets during period | (88,202) | – | (88,202) |
| Less: amortization of actuarial loss included in net periodic pension cost | 34,506 | (3,576) | 30,930 |
| Other comprehensive income (loss) | $(168,605) | $ 3,050 | $(165,555) |

## 12. Stock Compensation Plan

The Company has a stock option plan (the "Plan") approved by the shareholders under which options were granted to directors, corporate officers and certain upper-level employees to purchase shares of common stock. In principle, the options will be vested after two years from the date of grant under the condition that option holders will be employed by the Company at the date of exercising the option.

The terms of the options are subject to adjustment if there is a share split or consolidation of shares. The Plan provides that options generally lapse automatically at termination of service before the exercise date and generally remain exercisable for one year after termination of service during the exercise period.

The options granted during the year ended March 31, 2007 are exercisable over a period of four years commencing two years after the date of grant.

The stock option activity for the year ended March 31, 2009 was as follows:

| | **Number of shares** | **Weighted-average exercise price** | | **Weighted-average remaining contractual term** | **Aggregate intrinsic value** | |
|---|---|---|---|---|---|---|
| | *(Shares)* | *(Yen)* | *(U.S. dollars)* | *(Years)* | *(Millions of Yen)* | *(Thousands of U.S. dollars)* |
| Outstanding at beginning of year | **72,000** | **¥3,927** | **$39.67** | | | |
| Granted | – | – | – | | | |
| Excised | – | – | – | | | |
| Forfeited | – | – | – | | | |
| Expired | – | – | – | | | |
| Outstanding at end of year | **72,000** | **3,927** | **39.67** | **3.3** | **–** | **–** |
| Exercisable at end of year | **72,000** | **3,927** | **39.67** | **3.3** | **–** | **–** |

**12. Stock Compensation Plan (continued)**

The qualifying stock option of the right indetermination for the year ended March 31, 2009 was as follows:

| | **March 31, 2009** | | |
|---|---|---|---|
| | **Number of shares** | **Weighted-average fair value per option** | |
| | *(Shares)* | *(Yen)* | *(U.S. dollars)* |
| Outstanding at beginning of year | **72,000** | **¥937** | **$9.46** |
| Granted | – | – | – |
| Forfeited | – | – | – |
| Vested | **(72,000)** | **937** | **9.46** |
| Outstanding at end of year | – | – | – |

The fair value of the qualifying stock option to which the right is fixed is ¥67 million ($677 thousand) for the year ended March 31, 2009.
The Company recognized ¥25 million, ¥34 million and ¥8 million ($81 thousand) of compensation expense as selling, general and administrative expenses for the years ended March 31, 2007, 2008 and 2009, respectively. As of March 31, 2009, there was no unrecognized compensation expense related to stock options.

The weighted-average fair value per option at the date of grant during the year ended March 31, 2007 was ¥937. The compensation expense is based on the grant-date fair value estimated. The fair value of options granted is estimated using the Black-Scholes option pricing model with the following weighted-average assumptions.

| | **Year ended March 31,** | | |
|---|---|---|---|
| | **2007** | **2008** | **2009** |
| Expected life | 4 years | – | – |
| Expected volatility | 39.40% | – | – |
| Expected dividend | 0.22% | – | – |
| Risk-free interest rate | 1.09% | – | – |

The expected life is calculated by the simplified method using vesting term and contractual term of the options. The computation of expected volatility is based on the historical volatility of the Company's stock. The computation of risk-free interest rate is based on the long-term rate of return on Japanese Government Bonds.

## 13. Net Loss Per Share

A reconciliation of the denominators of the basic and diluted per share computations for net loss was as follows:

| | Year ended March 31, | | | |
|---|---|---|---|---|
| | **2007** | **2008** | **2009** | **2009** |
| | | *(Millions of yen)* | | *(Thousands of U.S. dollars)* |
| Net loss | ¥(41,500) | ¥(15,995) | **¥(82,625)** | **$(834,596)** |

| | Year ended March 31, | | |
|---|---|---|---|
| | **2007** | **2008** | **2009** |
| | | *(Number of shares)* | |
| Weighted-average number of shares of common stock outstanding | 123,498,823 | 123,498,165 | **123,497,808** |
| Weighted-average number of shares of diluted common stock outstanding | 123,498,823 | 123,498,165 | **123,497,808** |

| | Year ended March 31, | | | |
|---|---|---|---|---|
| | **2007** | **2008** | **2009** | **2009** |
| Net loss per share | | *( Yen)* | | *(U.S. dollars)* |
| Basic | ¥(336.04) | ¥(129.52) | **¥(669.04)** | **$(6.76)** |
| Diluted | (336.04) | (129.52) | **(669.04)** | **(6.76)** |

Certain stock options and convertible bonds are not included in the computation of diluted net loss per share for the periods presented since the inclusion would be antidilutive. The number of shares with the potential to have a dilutive effect on net loss per share in the future is as follows:

| | Year ended March 31, | | |
|---|---|---|---|
| | **2007** | **2008** | **2009** |
| | | *( Number of shares)* | |
| Convertible bonds | 11,156,100 | 11,156,100 | **11,156,100** |
| Stock options | 307,000 | 72,000 | **72,000** |

## 14. Related Parties

In the normal course of business, the Company purchases components, supplies, and services from and sells its products to NEC and NEC's affiliates. The Company purchases and leases machinery and equipment from NEC and NEC's affiliates.

The Company accesses NEC's laboratories and utilizes NEC's research on fundamental technologies. NEC allocates any expenses related to such basic research for each period. Also, research and development expenses for custom products are partially recouped from NEC and NEC's affiliates. NEC Logistics, Ltd., a wholly owned subsidiary of NEC, provides the Company with its logistics services, including packing, coordination of product transportation, and inventory management, and charges a fee. NEC manages financing activities geographically through its financing subsidiaries. When the Company had an excess of funds, it provided the funds to NEC's financing subsidiaries and received interest of 2.25% ~ 5.09%, 2.75% ~ 5.50% and 0.00% ~ 4.85% for the years ended March 31, 2007, 2008 and 2009, respectively. The Company has entered into a multi-year agreement with NEC under which NEC serves as prime contractor for the implementation of the Company's new global information management system. At March 31, 2008 and 2009, ¥12,506 million and ¥9,094 million ($91,859 thousand) of software and hardware were included in property, plant and equipment, respectively, and ¥2,277 million and ¥268 million of expenses related to the implementation of the system have been charged to income for the years ended March 31, 2007 and 2008, respectively. There was no expenses related to the implementation of the system to NEC for the year ended March 31, 2009. NEC has granted the Company the right to use the letters "NEC" as part of its trade name and to use the "NEC" mark as its trademark and corporate mark pursuant to a brand name license agreement. In this connection, NEC charges a brand fee to the Company based on a percentage of sales. NEC has also provided advertising and other administrative services to the Company. At March 31, 2008 and 2009, leasehold deposit to NEC's affiliates are included in other assets account. As discussed in Note 20, the settlement fees for DRAM class actions and others, which were determined by arrangement with NEC, was ¥3,222 million for the year ended March 31, 2007. The Company paid these amounts to the claimants, or indirectly through NEC. There was no payment for the years ended March 31, 2008 and 2009. The Company is guaranteed part of payment for operating leases. At March 31, 2009, ¥55,171 million ($557,283 thousand) was guaranteed by NEC.

**14. Related Parties (continued)**

Transactions with related parties for the years ended March 31, 2007, 2008 and 2009 were as follows:

| | Year ended March 31, 2007 | | |
|---|---|---|---|
| | NEC | NEC's affiliates | Total |
| | *(Millions of yen)* | | |
| Sales | ¥3,753 | ¥43,376 | ¥47,129 |
| Purchases of components, supplies, and services | 3,868 | 43,808 | 47,676 |
| Purchases of machinery and equipment | 3,456 | 6,328 | 9,784 |
| Shipping and handling cost | – | 9,783 | 9,783 |
| Lease payment | 5,175 | 3,323 | 8,498 |
| Research and development | 5,635 | 13,981 | 19,616 |
| Recoupment of research and development | 2,463 | 400 | 2,863 |
| Advertising cost | – | 12 | 12 |
| Brand fee | 4,620 | – | 4,620 |
| Other selling, general and administrative | 5,409 | 11,083 | 16,492 |
| Interest income | – | 114 | 114 |
| Sublease rentals receipt | – | 192 | 192 |

| | Year ended March 31, 2008 | | |
|---|---|---|---|
| | NEC | NEC's affiliates | Total |
| | *(Millions of yen)* | | |
| Sales | ¥2,993 | ¥42,376 | ¥45,369 |
| Purchases of components, supplies, and services | 4,099 | 39,419 | 43,518 |
| Purchases of machinery and equipment | 961 | 5,453 | 6,414 |
| Shipping and handling cost | 3 | 9,036 | 9,039 |
| Lease payment | 5,045 | 3,339 | 8,384 |
| Research and development | 4,179 | 13,293 | 17,472 |
| Recoupment of research and development | 6,051 | 338 | 6,389 |
| Advertising cost | – | 7 | 7 |
| Brand fee | 4,496 | – | 4,496 |
| Other selling, general and administrative | 4,523 | 9,450 | 13,973 |
| Interest income | – | 135 | 135 |
| Sublease rentals receipt | – | 187 | 187 |

**14. Related Parties (continued)**

| | Year ended March 31, 2009 | | |
|---|---|---|---|
| | **NEC** | **NEC's affiliates** | **Total** |
| | *(Millions of yen)* | | |
| Sales | **¥4,310** | **¥30,465** | **¥34,775** |
| Purchases of components, supplies, and services | **2,823** | **33,831** | **36,654** |
| Purchases of machinery and equipment | **957** | **15,174** | **16,131** |
| Shipping and handling cost | **5** | **7,771** | **7,776** |
| Lease payment | **4,918** | **3,063** | **7,981** |
| Research and development | **3,080** | **12,741** | **15,821** |
| Recoupment of research and development | **9,871** | **260** | **10,131** |
| Advertising cost | **–** | **30** | **30** |
| Brand fee | **3,559** | **–** | **3,559** |
| Other selling, general and administrative | **3,746** | **8,910** | **12,656** |
| Interest income | **–** | **85** | **85** |
| Sublease rentals receipt | **–** | **122** | **122** |

| | Year ended March 31, 2009 | | |
|---|---|---|---|
| | **NEC** | **NEC's affiliates** | **Total** |
| | *(Thousands of U.S. dollars)* | | |
| Sales | **$43,536** | **$307,727** | **$351,263** |
| Purchases of components, supplies, and services | **28,515** | **341,727** | **370,242** |
| Purchases of machinery and equipment | **9,666** | **153,273** | **162,939** |
| Shipping and handling cost | **51** | **78,494** | **78,545** |
| Lease payment | **49,677** | **30,939** | **80,616** |
| Research and development | **31,111** | **128,697** | **159,808** |
| Recoupment of research and development | **99,707** | **2,626** | **102,333** |
| Advertising cost | **–** | **303** | **303** |
| Brand fee | **35,949** | **–** | **35,949** |
| Other selling, general and administrative | **37,838** | **90,000** | **127,838** |
| Interest income | **–** | **859** | **859** |
| Sublease rentals receipt | **–** | **1,232** | **1,232** |

## 15. Financial Instruments

(1) Fair value of financial instruments

The carrying amounts of cash and cash equivalents, notes and accounts receivable-trade, prepaid expenses and other current assets, short-term borrowings, notes and accounts payable-trade, accounts payable, other and accrued expenses, accrued income taxes and other current liabilities approximated fair value because of their short-term maturities. The carrying amounts and the estimated fair value of long-term debt, including current portion, at March 31, 2008 and 2009 were summarized as follows:

| | March 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2008 | | 2009 | | 2009 | |
| | **Carrying amount** | **Estimated fair value** | **Carrying amount** | **Estimated fair value** | **Carrying amount** | **Estimated fair value** |
| | *(Millions of yen)* | | | | *(Thousands of U.S. dollars)* | |
| Long-term debt, including current portion | ¥(110,619) | ¥(104,717) | **¥(110,000)** | **¥(85,756)** | **$(1,111,111)** | **$(866,222)** |

The fair value of long-term debt is estimated using market quotes, or where market quotes are not available, observable inputs or using estimated discounted future cash flows. The carrying amounts and the estimated fair value of investments were disclosed in Note 5.

(2) Derivative financial instruments

The Company utilizes derivative financial instruments to manage fluctuations in foreign currency exchange rates and interest rates. The Company has policies and procedures for risk management and the approval, reporting and monitoring of derivative financial instruments. The Company's policies prohibit holding or issuing derivative financial instruments for trading purposes.

## 15. Financial Instruments (continued)

(2) Derivative financial instruments (continued)

*Forward exchange contracts*

NEC Electronics Corporation and its certain subsidiaries have forward exchange contracts with financing subsidiaries of NEC or financial institutions to offset the adverse impact of fluctuations in foreign currency exchange rates on assets and liabilities denominated in foreign currencies arising from the Company's operating activities. Such forward exchange contracts are not designated as hedging instruments under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and changes in fair value of forward exchange contracts are recognized in income, thereby effectively offsetting the remeasurement of the assets and liabilities denominated in foreign currencies. The related receivable or payable is included in other current assets or other current liabilities or other long-term liabilities.

A certain subsidiary has entered into forward exchange contracts, which are designated as hedging instruments for forecasted transactions. Such forward exchange contracts are designated as a cash flow hedge and, accordingly, the effective portion of the derivative's gain or loss is initially reported as a component of accumulated other comprehensive income (loss) and subsequently reclassified into earnings when the forecasted transactions effect earnings, and the ineffective portion of the gain or loss is reported in earnings immediately. At March 31, 2009, there were no forward exchange contracts qualifying as a cash flow hedge.

*Interest rate swap agreements*

The Company entered into interest rate swap agreements to manage interest rate risk exposure associated with underlying debt. Certain interest rate swap agreements were designated as a fair value hedge. The interest rate swap agreements utilized by the Company effectively modified the Company's fixed-rate debt to a floating rate. The agreements involved the receipt of fixed rate amounts in exchange for floating rate interest payments over the life of the agreements without an exchange of the underlying principal amount.

There were no significant gains or losses on derivative financial instruments or portions thereof that were either ineffective as hedges, excluded from assessment of hedge effectiveness, or where the underlying risk did not occur for the years ended March 31, 2007, 2008 and 2009.

The counterparties to the Company's derivative transactions are financing subsidiaries of NEC or major financial institutions. As a normal business risk, the Company is exposed to credit loss in the event of nonperformance by the counterparties, however, the Company does not anticipate nonperformance by the counterparties to these agreements, and no material losses are expected.

**15. Financial Instruments (continued)**

(2) Derivative financial instruments (continued)

The nominal amount of forward exchange contracts at March 31, 2009 was as follows:

| | March 31, 2009 | |
|---|---|---|
| | *(Millions of yen)* | *(Thousands of U.S. dollars)* |
| To sell foreign currencies | **¥23,237** | **$234,717** |
| To buy foreign currencies | **8,195** | **82,778** |

The estimated fair value of forward exchange contracts the related receivable or payable at March 31, 2009 was as follows:

| | March 31, 2009 | | |
|---|---|---|---|
| | **Consolidated balance sheet location** | **Estimated fair value** | |
| | | *(Millions of yen)* | *(Thousands of U.S. dollars)* |
| Derivatives not designated as hedging instruments under SFAS No. 133 | | | |
| Assets derivatives: | | | |
| Forward exchange contracts | Prepaid expenses and other current assets | **¥ 121** | **$ 1,223** |
| Total | | **¥ 121** | **$ 1,223** |
| Liability derivatives: | | | |
| Forward exchange contracts | Other current liabilities | **¥1,086** | **$10,970** |
| | Other long-term liabilities | **202** | **2,040** |
| Total | | **¥1,288** | **$13,010** |

(*) Under FASB Interpretation No. 39, *Offsetting of Amounts Related to Certain Contracts an interpretation of Accounting Principles Board Opinion No. 10 and FASB Statement No. 105*, the Company offset of ¥86 million ($869 thousand) of prepaid expenses and other current assets of assets derivatives and ¥1,086 million ($10,970 thousand) of other current liabilities of liability derivatives in consolidated balance sheet.

**15. Financial Instruments (continued)**

(2) Derivative financial instruments (continued)

The effect of derivative instruments on the statement of financial performance for three months ended March 31, 2009 was as follows:

| | Three months ended March 31, 2009 | | |
|---|---|---|---|
| | **Location of gain or (loss) recognized in income on derivatives** | **Amounts of gain or (loss) recognized in income** | |
| | | *(Millions of yen)* | *(Thousands of U.S. dollars)* |
| Derivatives in SFAS No. 133 fair value hedging relationships | | | |
| Forward exchange contracts | Net foreign exchange loss | **¥(1,775)** | **$(17,929)** |

**16. Securitization of Receivables**

The Company has several securitization programs under which certain trade receivables are sold, without recourse, to SPEs and others. In certain securitizations, the Company has retained a subordinated interest.

The Company services, administers and collects the securitized trade receivables on behalf of the SPEs and others and the costs and fees of servicing, administrating and collecting are not significant. For the year ended March 31, 2008, the Company has recorded losses of ¥2 million related to the securitization transactions.

The Company had no retained interests in the receivables sold for the year ended March 31, 2008.

A summary of cash flows received from SPEs and others for all securitization activities that occurred in the years ended March 31, 2007, 2008 and 2009 was as follows:

| | Year ended March 31, | | | |
|---|---|---|---|---|
| | **2007** | **2008** | **2009** | **2009** |
| | *(Millions of yen)* | | | *(Thousands of U.S. dollars)* |
| Proceeds from new securitization | ¥ – | ¥1,998 | **¥ –** | **$ –** |

**17. Advertising Costs**

The Company expenses advertising costs as incurred. Advertising expenses amounted to ¥944 million, ¥1,033 million and ¥798 million ($8,061 thousand) for the years ended March 31, 2007, 2008 and 2009, respectively.

**18. Restructuring Charges**

For the year ended March 31, 2006 and 2007, the Company implemented a series of restructuring programs consisting closing a prototype line in Japan and a manufacturing plant in Ireland. As a result, the Company recognized restructuring charges of aggregating ¥5,875 million, of which ¥4,192 million was incurred during the year ended March 31, 2007. For the year ended March 31, 2007, the charges consisted of personnel costs of ¥2,375 million, accelerated depreciation of equipment of ¥1,258 million, contract termination costs of ¥413 million, and other costs of ¥146 million. The Company had paid all of the restructuring costs by March 31, 2007.

For the year ended March 31, 2008, the Company announced the closure of a plant in Indonesia. As a result, the Company recognized restructuring charges of ¥1,386 million for the year ended March 31, 2008. For the year ended March 31, 2008, the charges consisted of personnel costs of ¥305 million, accelerated depreciation of equipment of ¥688 million, contract termination costs of ¥37 million, and other costs of ¥356 million. The Company has substantially completed the restructuring plan.

For the year ended March 31, 2008, the Company implemented enhanced early retirement programs with special additional payment, along with previously earned retirement benefit, to those employees fulfilling certain conditions, such as age and duration of employment, and voluntarily leaving the Company as a measure to support changes, which include shifting development facilities and reorganizing manufacturing subsidiaries in Japan. As a result, the Company recognized restructuring charges of ¥6,545 million for the year ended March 31, 2008. The remaining liability balance as of March 31, 2008 was ¥2,068 million ($20,889 thousand) and the Company finished all the payment during the year ended March 31, 2009.

For the year ended March 31, 2009, the Company made a decision to shift development, prototype and manufacturing line for advanced process from Sagamihara Plant to Yamagata area. As a result, the Company recognized restructuring charges of ¥3,602 million ($36,384 thousand) for the year ended March 31, 2009. The charges consisted of personnel costs of ¥267 million ($2,697 thousand), accelerated depreciation, loss of disposal and loss of sales of equipment of ¥2,912 million ($29,414 thousand), contract termination costs of ¥38 million ($384 thousand), and other costs of ¥385 million ($3,889 thousand). The remaining liability balance as of March 31, 2009 was ¥400 million ($4,040 thousand) and will be paid during the year ended March 31, 2010. This restructuring program is expected to be completed by the end of the year ending March 31, 2010 and the total restructuring costs are estimated to be approximately ¥4,700 million ($47,475 thousand).

## 18. Restructuring Charges (Continued)

For the year ended March 31, 2009, the Company made a decision to implement a fixed cost reduction program in addition to the above mentioned, and executed personnel reduction at several oversea sites as a part of program. As a result, the Company recognized restructuring charges of ¥1,333 million ($13,465 thousand) for the year ended March 31, 2009. The remaining liability balance as of March 31, 2009 was ¥464 million ($4,687 thousand) and will be paid during the year ending March 31, 2010. This program is expected to be completed by the end of the year ending March 31, 2011 and the total restructuring costs are estimated to be approximately ¥6,300 million ($63,636 thousand).

Restructuring charges for the years ended March 31, 2007, 2008 and 2009 consisted of the following:

| | **Year Ended March 31, 2007** | | | | |
|---|---|---|---|---|---|
| | **Personnel costs** | **Accelerated depreciation of equipment** | **Contract termination costs** | **Other costs** | **Total** |
| | | | *(Millions of yen)* | | |
| Accrual at March 31, 2006 | ¥ 1,010 | ¥ — | ¥ — | ¥ — | ¥ 1,010 |
| Restructuring charges | 2,375 | 1,258 | 413 | 146 | 4,192 |
| Non-cash settlement | — | (1,258) | — | (99) | (1,357) |
| Cash payments | (3,385) | — | (413) | (47) | (3,845) |
| Accrual at March 31, 2007 | ¥ — | ¥ — | ¥ — | ¥ — | ¥ — |

| | **Year Ended March 31, 2008** | | | | |
|---|---|---|---|---|---|
| | **Personnel costs** | **Accelerated depreciation of equipment** | **Contract termination costs** | **Other costs** | **Total** |
| | | | *(Millions of yen)* | | |
| Accrual at March 31, 2007 | ¥ — | ¥ — | ¥ — | ¥ — | ¥ — |
| Restructuring charges | 6,850 | 688 | 37 | 356 | 7,931 |
| Non-cash settlement | — | (688) | — | (325) | (1,013) |
| Cash payments | (4,782) | — | (37) | (31) | (4,850) |
| Accrual at March 31, 2008 | ¥ 2,068 | ¥ — | ¥ — | ¥ — | ¥ 2,068 |

| | **Year Ended March 31, 2009** | | | | |
|---|---|---|---|---|---|
| | **Personnel costs** | **Accelerated depreciation of equipment** | **Contract termination costs** | **Other costs** | **Total** |
| | | | *(Millions of yen)* | | |
| **Accrual at March 31, 2008** | **¥ 2,068** | **¥ —** | **¥ —** | **¥ —** | **¥ 2,068** |
| **Restructuring charges** | **1,600** | **2,912** | **38** | **385** | **4,935** |
| **Non-cash settlement** | **—** | **(2,912)** | **—** | **—** | **(2,912)** |
| **Cash payments** | **(3,167)** | **—** | **—** | **(23)** | **(3,190)** |
| **Foreign currency translation adjustments** | **(37)** | **—** | **—** | **—** | **(37)** |
| **Accrual at March 31, 2009** | **¥ 464** | **¥ —** | **¥ 38** | **¥ 362** | **¥ 864** |

## 18. Restructuring Charges (continued)

| | Year Ended March 31, 2009 | | | | |
|---|---|---|---|---|---|
| | Personnel costs | Accelerated depreciation of equipment | Contract termination costs | Other costs | Total |
| | *(Thousands of U.S. dollars)* | | | | |
| **Accrual at March 31, 2008** | **$ 20,889** | **$ —** | **$ —** | **$ —** | **$ 20,889** |
| **Restructuring charges** | **16,162** | **29,414** | **384** | **3,889** | **49,849** |
| **Non-cash settlement** | **—** | **(29,414)** | **—** | **—** | **(29,414)** |
| **Cash payments** | **(31,990)** | **—** | **—** | **(232)** | **(32,222)** |
| **Foreign currency translation adjustments** | **(375)** | **—** | **—** | **—** | **(375)** |
| **Accrual at March 31, 2009** | **$ 4,686** | **$ —** | **$ 384** | **$ 3,657** | **$ 8,727** |

## 19. Leasing Arrangements

The Company leases certain land, buildings, facilities and equipment for its own use.

The gross amounts of leased assets under capital lease which are leased from NEC, included in buildings, was ¥7,213 million ($72,859 thousand), at March 31, 2008 and 2009. Accumulated depreciation of the leased assets at March 31, 2008 and 2009 were ¥3,395 million and ¥3,677 million ($37,141 thousand), respectively. In addition, the gross amounts of leased assets under capital leases, the majority of which is from NEC's affiliates, included in machinery and equipment, were ¥2,978 million and ¥4,563 million ($46,091 thousand) at March 31, 2008 and 2009, respectively. Accumulated depreciation of the leased assets at March 31, 2008 and 2009 were ¥2,039 million and ¥3,845 million ($38,838 thousand), respectively.

The following is a schedule by year of the future minimum lease payments under capital leases together with the present value of the net minimum lease payments at March 31, 2009:

| **Year ending March 31:** | *(Millions of yen)* | *(Thousands of U.S. dollars)* |
|---|---|---|
| 2010 | ¥ 969 | $ 9,788 |
| 2011 | 805 | 8,131 |
| 2012 | 639 | 6,455 |
| 2013 | 552 | 5,576 |
| 2014 | 498 | 5,030 |
| 2015 and thereafter | 3,118 | 31,495 |
| Total minimum lease payments | 6,581 | 66,475 |
| Less – amount representing interest | (845) | (8,535) |
| Present value of net minimum lease payments | 5,736 | 57,940 |
| Less – current obligation | (770) | (7,778) |
| Long-term lease obligation | ¥ 4,966 | $ 50,162 |

**19. Leasing Arrangements (continued)**

Rental expense under operating leases were ¥32,985 million, ¥32,753 million and ¥34,276 million ($346,222 thousand) for the years ended March 31, 2007, 2008 and 2009, respectively. The rental expense for the years ended March 31, 2007, 2008 and 2009 included the rental expense of ¥7,425 million, ¥7,375 million and ¥7,659 million ($77,364 thousand) under operating leases with NEC's affiliates, respectively.

Sublease rentals received for the years ended March 31, 2007, 2008 and 2009 were ¥306 million, ¥231 million and ¥122 million ($1,232 thousand), respectively. The sublease rentals received for the years ended March 31, 2007, 2008 and 2009 included the sublease rentals received of ¥192 million, ¥187 million and ¥122 million ($1,232 thousand) with NEC's affiliates, respectively. The future minimum sublease rentals receipt at March 31, 2009 was ¥1,109 million ($11,202 thousand).

For the years ended March 31, 2007, 2008 and 2009, the Company mainly executed sale and lease back agreements for certain machinery and equipment at their net book values. The proceeds were ¥38,555 million, ¥18,596 million and ¥4,499 million ($45,444 thousand), respectively, and the lease terms are all less than 5 years. The leases are being accounted for as operating leases.

Certain leases require additional payments based on production volume. Contingent rentals under the leasing agreements were ¥6,592 million, ¥6,703 million and ¥6,566 million ($66,323 thousand) for the years ended March 31, 2007, 2008 and 2009, respectively.

The Company has several leasing agreements for machinery and equipment which are accounted for as operating leases. Certain of these lease agreements provide for purchase options or renewal options. In addition, under the leasing agreements, the Company is obligated to guarantee the residual value of machinery and equipment when the Company returns such machinery and equipment at the end of the lease term. At March 31, 2009, the maximum amount of the recognized residual value guaranteed was approximately ¥25,000 million ($252,525 thousand) and the lease term was one to five years.

Future minimum rental payments pursuant to operating leases are as follows:

| **Year ending March 31:** | *(Millions of yen)* | *(Thousands of U.S. dollars)* |
|---|---|---|
| 2010 | ¥22,216 | $224,404 |
| 2011 | 11,504 | 116,202 |
| 2012 | 6,442 | 65,071 |
| 2013 | 3,081 | 31,121 |
| 2014 | 1,177 | 11,889 |
| 2015 and thereafter | 1,284 | 12,970 |

## 20. Commitments and Contingent Liabilities

Commitments outstanding at March 31, 2009 for the purchase of property, plant and equipment approximated ¥13,400 million ($135,354 thousand).

The Company conducts business activities on a global scale. As a consequence, there is a risk that the Company may become the subject of lawsuits, be requested to pay compensation for damages, or be named in other legal disputes. While a number of unresolved cases of this kind are typically pending at any particular time, with the exception of those discussed below, such cases are considered to have no major impact on the Company's financial condition and operating results at March 31, 2009.

NEC Electronics America, Inc. has resolved by settlement of class action civil antitrust lawsuits from direct purchasers (customers who had directly purchased DRAM from the Company in the past), but it is still in litigation, or in settlement negotiations, with several customers who have opted out of such class action lawsuits. NEC Electronics America, Inc. has also been named as one of the defendants in numerous class action civil lawsuits from indirect purchasers (customers who had purchased products containing DRAM), as well as a number of antitrust lawsuits filed by the Attorneys General of numerous states in the U.S.

Additionally, the Company is fully cooperating with and providing information to the European Commission in its investigation of potential violation of the competition laws. Fines may be imposed by the European Commission.

The Company is also subject to investigations by the U.S. Department of Justice, the European Commission, the Korea Fair Trade Commission, and the Competition Bureau of Canada in connection with potential antitrust violations in the thin-film transistor liquid crystal display (TFT-LCD) industry. In Canada, NEC Electronics America, Inc. is a defendant in numerous class action civil antitrust lawsuits seeking damages for alleged antitrust violations in the TFT-LCD industry.

While investigations in connection with potential antitrust violations in the SRAM industry conducted by the U.S. Department of Justice, the European Commission, and the Korea Fair Trade Commission have been closed, NEC Electronics America, Inc. and NEC Electronics Corporation remain defendants in numerous class action civil antitrust lawsuits in the United States and Canada seeking damages for alleged antitrust violations in the SRAM industry.

## 20. Commitments and Contingent Liabilities (Continued)

Although the outcome of the aforementioned investigations, antitrust lawsuits and settlement negotiations is not known at this time, the Company has recorded probable and reasonably estimable losses in the amount of approximately ¥11,900 million ($120,202 thousand) as "Accounts payable, other and accrued expenses" for the DRAM civil lawsuits and settlements in the U.S. and investigations by the European Commission. It is possible that such estimated amount may increase or decrease with the progress of such cases in the future. No other expenses pertaining to other civil lawsuits and official investigations have been recorded, since the Company's liability for compensation pertaining to such lawsuits and its alleged behavior under such investigations remain undetermined. Consequently, any reasonable estimate of related expenses and losses is not feasible at this time.

## 21. Segment Information

The operating segment of the Company is only the semiconductor business, excluding those related to the general-purpose DRAM business.

Sales to external customers by market application for the years ended March 31, 2007, 2008 and 2009 were as follows:

| | Year ended March 31 | | | |
|---|---|---|---|---|
| | **2007** | **2008** | **2009** | **2009** |
| | *(Millions of yen)* | | | *(Thousands of U.S. dollars)* |
| Communications | ¥ 99,641 | ¥ 70,350 | **¥ 60,199** | **$ 608,071** |
| Computing and Peripherals | 123,714 | 119,352 | **87,237** | **881,182** |
| Consumer Electronics | 120,757 | 134,546 | **119,330** | **1,205,353** |
| Automotive and Industrial | 106,097 | 113,320 | **91,492** | **924,162** |
| Multi-market ICs | 88,961 | 89,643 | **70,478** | **711,899** |
| Discrete, Optical and Microwave Devices | 120,563 | 126,064 | **92,999** | **939,384** |
| Other | 32,547 | 34,470 | **24,735** | **249,848** |
| | ¥692,280 | ¥687,745 | **¥546,470** | **$5,519,899** |

**21. Segment Information (continued)**

Sales, which are attributed to geographic areas based on the country location of the Company, geographic profit (loss) for the years ended March 31, 2007, 2008 and 2009 and long-lived assets at March 31, 2008 and 2009 were as follows.

| | Year ended March 31, | | | |
|---|---|---|---|---|
| | 2007 | 2008 | 2009 | 2009 |
| | *(Millions of yen)* | | | *(Thousands of U.S. dollars)* |
| Net sales: | | | | |
| Japan | ¥377,298 | ¥370,238 | **¥301,617** | **$3,046,636** |
| United States of America | 67,458 | 58,256 | **38,638** | **390,283** |
| Europe | 88,908 | 95,936 | **74,468** | **752,202** |
| Asia | 158,616 | 163,315 | **131,747** | **1,330,778** |
| Total | ¥692,280 | ¥687,745 | **¥546,470** | **$5,519,899** |

The majority of sales in Europe for the years ended March 31, 2007, 2008 and 2009 were sales of a subsidiary in Germany. The sales in China for the years ended March 31, 2007, 2008 and 2009 were ¥98,348 million, ¥93,093 million and ¥72,445 million ($731,768 thousand), respectively.

Although the disclosure of geographic profit (loss) is not required under accounting principles generally accepted in the United States of America, the Company discloses this information as supplemental information due to the disclosure requirements in Japan as follows.

| | Year ended March 31, | | | |
|---|---|---|---|---|
| | 2007 | 2008 | 2009 | 2009 |
| | *(Millions of yen)* | | | *(Thousands of U.S. dollars)* |
| Geographic profit (loss): | | | | |
| Japan | ¥ (38,877) | ¥ (9,386) | **¥ (66,287)** | **$ (669,566)** |
| United States of America | (1,006) | 755 | **(5,326)** | **(53,798)** |
| Europe | 100 | 2,023 | **(238)** | **(2,404)** |
| Asia | 11,226 | 11,702 | **3,496** | **35,313** |
| Total | ¥ (28,557) | ¥ 5,094 | **¥ (68,355)** | **$ (690,455)** |

**21. Segment Information (continued)**

| | March 31, | | |
|---|---|---|---|
| | 2008 | 2009 | 2009 |
| | *(Millions of yen)* | | *(Thousands of U.S. dollars)* |
| Long-lived assets: | | | |
| Japan | ¥228,272 | **¥222,444** | **$2,246,909** |
| United States of America | 12,717 | **13,281** | **134,151** |
| Europe | 1,491 | **1,085** | **10,960** |
| Asia | 23,062 | **17,530** | **177,071** |
| Total | ¥265,542 | **¥254,340** | **$2,569,091** |

(*) Geographic profit (loss) is presented as net sales less cost of sales, research and development expenses, and selling, general and administrative expenses.

Geographic areas are based on the country of location of the Company other than Japan and the United States of America:

Europe: Germany, Ireland and the United Kingdom

Asia: China, Singapore, Taiwan, Malaysia, South Korea and Indonesia

Sales to NEC and NEC's affiliates accounted for 7%, 7% and 6% of total sales for the years ended March 31, 2007, 2008 and 2009, respectively. In addition, the Company sells a significant portion of its semiconductor products through a network of independent sales distributors. The Company relies on six key distributors for 62%, 64% and 67% of total sales for the years ended March 31, 2007, 2008 and 2009, respectively. At March 31, 2008 and 2009, the Company had accounts receivable, trade of ¥43,779 million and ¥24,097 million ($243,404 thousand), respectively, from these distributors. In addition, at March 31, 2008 and 2009, the Company had guarantee deposits received of ¥684 million ($6,909 thousand), from these distributors as collateral.

## 22. Subsequent Event

Having been approved by the Board of Directors on April 27, 2009, NEC Electronics Corporation, on the same day, signed a memorandum of understanding with Renesas Technology Corporation (“Renesas”) , to enter into negotiations to integrate their business operations.

In the semiconductor market, as global competition on performance, architecture, price, and quality grows increasingly severe, manufacturers are faced to keep abreast of these changes. In light of this fierce condition, NEC Electronics Corporation and Renesas have agreed to initiate joint deliberations to integrate their business operations around April 2010, to further strengthen their business foundations and technological assets while increasing corporate value through enhanced customer satisfaction. Both companies also agreed on maintaining public listing for the new company.

Terms and conditions of this business integration will be discussed through future negotiations and both companies plan to sign definitive agreement at the end of July 2009. Implementation of the planned business integration is conditional upon approval at the Extraordinary General Meetings of Shareholders and the authorization by the relevant government agencies.

Corporate profile of Renesas, as of March 31, 2009 is as follows:

| | |
|---|---|
| Name of Company: | Renesas Technology Corporation |
| Major Operations: | Development, design, manufacture, sale, and servicing of SoC products, discrete semiconductor products; and memory products |
| Headquarters: | 2-6-2, Ootemachi, Chiyoda-ku, Tokyo, Japan |
| Established: | April 1, 2003 |
| Capital: | ¥77,000 million ($777,778 thousand) |
| Stockholders and Ownership Ratios: | |
| | Hitachi, Ltd.: 55% Mitsubishi Electric Corporation: 45% |

Influence of the memorandum of understanding cannot be reasonably estimated, and the impact on performance of the Company for future periods cannot be calculated.

ERNST & YOUNG

Ernst & Young ShinNihon LLC
Hibiya Kokusai Bldg.
2-2-3 Uchisaiwai-cho
Chiyoda-ku, Tokyo, Japan 100-0011

Tel : +81 3 3503 1191
Fax: +81 3 3503 1277

# Report of Independent Auditors

The Board of Directors
NEC Electronics Corporation

We have audited the accompanying consolidated balance sheets of NEC Electronics Corporation and consolidated subsidiaries (the "Company") as of March 31, 2008 and 2009, and the related consolidated statements of operations, changes in shareholders' equity, and cash flows for each of the three years in the period ended March 31, 2009, 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 Electronics Corporation and consolidated subsidiaries at March 31, 2008 and 2009, and the consolidated results of their operations and their cash flows for each of the three years in the period ended March 31, 2009, in conformity with accounting principles generally accepted in the United States.

The U.S. dollar amounts in the accompanying consolidated financial statements with respect to the year ended March 31, 2009 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 LLC

June 25, 2009