Empowered by Innovation NEC

NEC ELECTRONICS

ANNUAL REPORT 2006

Year ended March 31, 2006

NEC ELECTRONICS

06

MISSION STATEMENT

NEC Electronics aims to be the partner of choice by providing differentiated semiconductor solutions based on advanced technologies that give our customers a competitive advantage.

NEC Electronics believes that raising customer satisfaction levels leads to increased sales and improved profitability, enhancing both enterprise and shareholder value. To this end, it operates and develops business in line with the following policies.

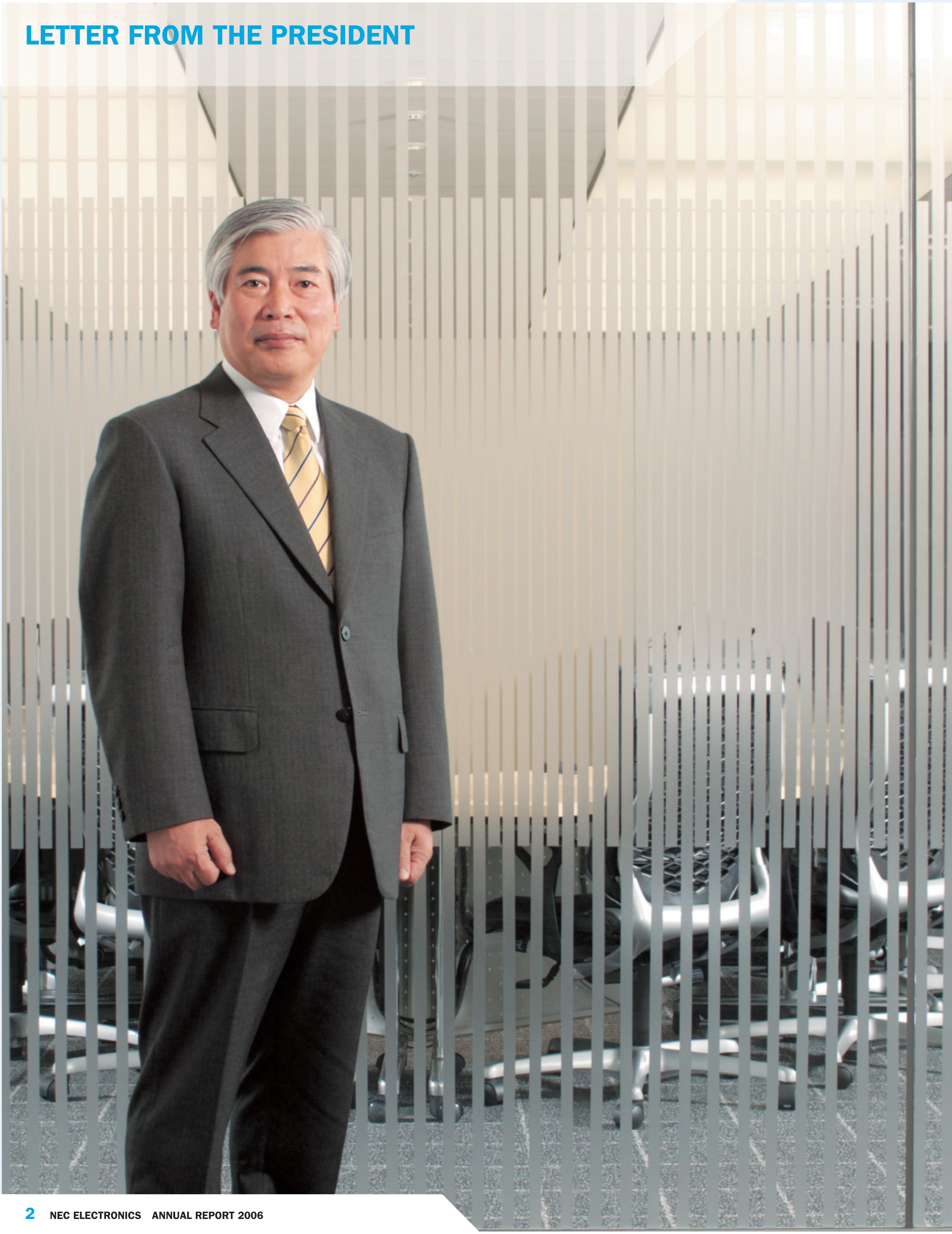
- Ensure all business activities focus on the needs of the customer, and deliver solutions tailored to meet customer needs and excellent product quality, increasing sales and earnings through improved customer satisfaction.
- Re-use core technologies and manufacturing resources throughout the three main product groups of SoC (system on chip), microcontrollers, and discrete semiconductors, and develop appropriate business processes for each product group to address the varying needs of customers with high-quality and low-cost solutions, thus achieving steady growth and profits.
- Cultivate customers around the world by leveraging the company’s position as an international player to secure global business opportunities and expand sales.

Contents

In this annual report, unless the context otherwise requires, references to “NEC Electronics,” “we,” “our,” and “us” are to NEC Electronics Corporation and its consolidated subsidiaries. The statements in this annual report with respect to NEC Electronics’ current plans, strategies, and beliefs, as well as other statements that are not historical facts are forward-looking statements. Such forward-looking statements are based on management’s assumptions and beliefs in light of the information currently available to it. These forward-looking statements involve risks and uncertainties that could cause actual results to differ materially from those discussed in the forward-looking statements, and therefore you should not place undue reliance on them. We do not intend to update these forward-looking statements, whether as a result of new information, future events or otherwise, except as may be required by applicable laws. The risks and uncertainties that could cause actual results to differ materially from such statements include, but are not limited to, general economic conditions in NEC Electronics’ markets, which are primarily Japan, Asia, North America and Europe; demand for, and competitive pricing pressure on, NEC Electronics’ products and services in the marketplace; NEC Electronics’ ability to continue to win acceptance for its products and services in these highly competitive markets; and fluctuations of currency exchange rates, particularly the rate between the yen and the U.S. dollar in which NEC Electronics makes significant sales.

All the consolidated financial data in this annual report have been prepared in accordance with accounting principles generally accepted in the United States of America on a basis that reflects the historical consolidated financial statements of NEC Electronics Corporation assuming that it had existed as a stand-alone company for all periods prior to the corporate separation on November 1, 2002.

LETTER FROM THE PRESIDENT



During the fiscal year ended March 31, 2006, the global semiconductor market made a gradual recovery from the summer of 2005, after bottoming out in Asia and North America. However, the Japanese semiconductor market saw declines in demand due to saturation of the domestic mobile phone market, and was affected by larger-than-expected price drops for digital consumer goods. The European semiconductor market also experienced negative growth as the switch among users to 3G mobile handsets stalled.

In this business climate, we posted net sales of ¥646.0 billion ($5,521 million), due largely to a considerable decline in sales of semiconductors for mobile handsets.

Faced with this substantial slide in net sales, we strove to reduce costs, enacting a range of initiatives to enhance productivity and cost efficiency. These efforts notwithstanding, we posted a loss before income taxes of ¥42.4 billion ($362 million). Further, the booking of a valuation allowance against deferred tax assets resulted in a net loss of ¥98.2 billion ($839 million), a significant decline in profit compared with the previous fiscal year.

On the positive side, the past year also saw NEC Electronics carry out various measures for attaining future sales growth. On the product development front, we focused on creating globally competitive products. One example included expanding NEC Electronics' "All Flash" microcontroller lineup to support more efficient product development for our customers. At the same time, we started mass production and shipments of system LSIs for game consoles using cutting-edge embedded DRAM technology. We also began joint development with Toshiba Corporation and Sony Corporation on 45-nanometer process technology, set to become a core future technology. In terms of sales, we bolstered NEC Electronics' sales framework in China, where semiconductor growth is remarkably strong, by reorganizing and integrating previously dispersed marketing and design operations under NEC Electronics China. This company became the first Japan-based semiconductor manufacturer to acquire a license to import and sell semiconductor products manufactured outside of China.

We will improve our performance by expanding orders and sales through these initiatives, as we work to post profit as soon as possible.

Every one of us at NEC Electronics is fully committed to reestablishing solid business performance. To our stakeholders, we ask for your continued support and guidance as we move forward in this endeavor.

June 2006

Toshio Nakajima

President and CEO, NEC Electronics Corporation

MEASURES TO ENSURE GROWTH

Through the following 3 initiatives, NEC Electronics is determined to improve performance and attain greater growth.

1 INCREASE ORDERS AND SALES

2 BOLSTER COST COMPETITIVENESS

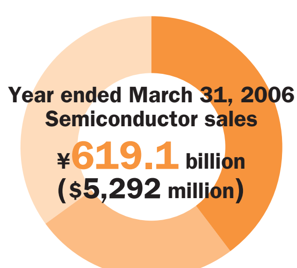
3 IMPLEMENT EFFICIENT DEVELOPMENT

INCREASING ORDERS AND SALES

To increase orders and sales, we are shifting development and design resources to our competitive products, with the aim of building a strong product portfolio. In parallel, we are enacting initiatives to strengthen the sales structure and optimize personnel allocation.

Developing a Strong Product Portfolio

We will strive to develop strong products through our 3 main product groups—SoC (system on chip), MCU (microcontrollers) and Components.



SoC Platform
ASIC, ASSP, memory
40%

MCU Platform
Microcontrollers
car audio controllers
25%

Components
Display drivers
analog ICs, discrete
compound semiconductor devices
35%

CY2005 32-bit MCU Global Share
(Revenue base)

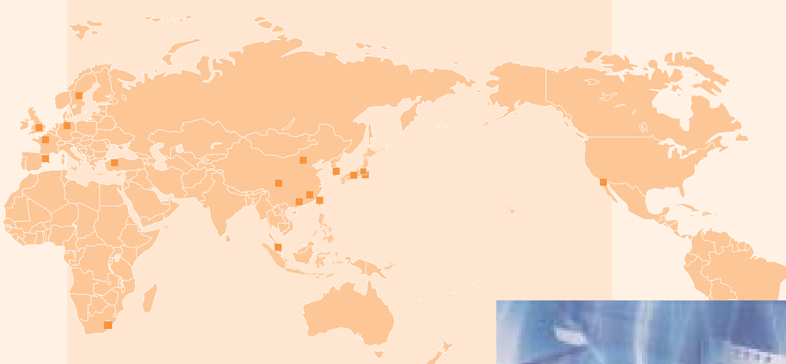
1	NEC Electronics	21%
2	Company A	20%
3	Company B	17%
4	Company C	13%
5	Company D	7%

Source: Gartner Dataquest (April 2006) GJ06238

SoC Platform: The EMMA Series

We continue to strengthen our ASSP (application-specific standard product) business. The EMMA Series graphics-processing LSIs for digital consumer electronics have been highly acclaimed for their innovative design concept and a wide variety of applicable software. Consequently, this series is adopted by many customers in the DVD recorder, digital TV and set-top box fields. Going forward, we plan to further enrich our product lineup to expand market share in this business area.

The Global Reach of the EMMA Series



MCU Platform: "All Flash" Microcontrollers

NEC Electronics is one of the world's most dominant players in microcontrollers, boasting the top global share in the 32-bit MCU (microcontroller) field. We will continue to strengthen our operations by enhancing the product lineup of "All Flash" microcontrollers, which provide customers with greater product development efficiency through their flexible architecture. Going forward, we are determined to expand our share in the microcontroller market.

Components: MOSFET

NEC Electronics is focusing on MOSFETs (metal oxide semiconductor field-effect transistors), used for power management in rechargeable lithium-ion batteries for mobile handsets and other devices. We have newly developed the world's smallest product, as well as best-performing MOSFET devices. We have captured a more than 50% worldwide market share in this field, and are striving to develop more competitive products.

2

BOLSTERING COST COMPETITIVENESS

NEC Electronics is constructing a production framework and pursuing cost-cutting measures that will support sales expansion.

300mm Wafer Line Expansion

To respond to increasing customer orders, we plan to boost capacity at NEC Yamagata Ltd.'s 300mm wafer line. Scheduled to take place during the fiscal year ending March 31, 2007, the capacity ramp-up enables monthly production of more than 10,000 wafers. Here, we are striving to achieve cost reductions in manufacturing through efficiencies of scale.

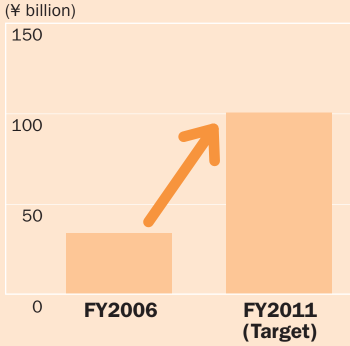
The 300mm wafer line at NEC Yamagata

Bolstering Sales Infrastructure

Strengthening Operations in China

At NEC Electronics, we are taking steps to bolster our sales framework in China, where the semiconductor market is showing strong growth. As one step, we became the first Japanese semiconductor manufacturer to obtain the rights to import and sell semiconductors produced outside of China to the domestic market. We also realigned and integrated sales and design operations dispersed across the country under NEC Electronics China Co., Ltd. Through collaboration with local dealers and software developers, the new company is working to open up new distribution channels. We stand committed to strengthening the operations required to promote sales expansion in China.

Sales Expansion in China



Redistribution of Design Resources

In the drive to achieve order and sales expansion, we are striving to optimize engineer assignments across the NEC Electronics Group. We will increase development efficiency by standardizing and sharing design rules and component libraries, thus allowing personnel to be reallocated to technical marketing activities that lead directly to increased orders, and to product development in fields where increased orders are foreseen.

Enhancing Cooperation With Semiconductor Distributors

We have concluded exclusive distribution contracts with leading semiconductor distributors in Japan and abroad, working closely with them to construct a strong global marketing and support network. Regarding products such as microcontrollers and discrete semiconductors, where product lines are extensive and customer requirements are manifold, partnerships with semiconductor distributors is essential to achieving higher sales. Focused on the future, we will continue to strengthen our partnerships with these distributors.

Enhancing Existing Line Capacity Through the TOP Project

At NEC Electronics, we are enacting the TOP (Transformation of Overall Productivity) Project, which aims to achieve significant increases in the productivity of existing lines. In its brief history, the project has already proven a success, with certain lines showing a 30% improvement in productivity. We intend to achieve Group-wide cost reductions by implementing this initiative at all of our manufacturing subsidiaries.

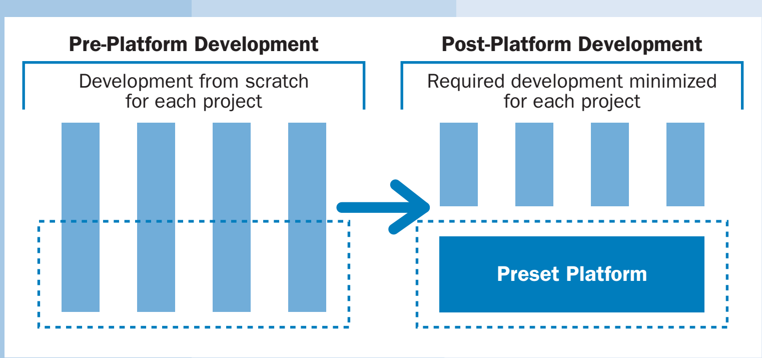
3 IMPLEMENT EFFICIENT DEVELOPMENT

NEC Electronics is working to enhance development efficiency that will create strong products and support sales growth.

Platform Architectures for Efficient Development

At NEC Electronics, we refer to a set of systems, ranging from semiconductor process technology and circuit design technology to development environments (tools and manuals), to support designers and software, including operating systems and drivers, as a "platform." We put in effort to enhance product development efficiency through development of a wide range of platforms with common architectures and interfaces.

Design Efficiency Enhanced Through Platforms



Consequently, our competitive platforms welcome the contribution of software and development tools from outside developers, which enhances our ability to propose competitive solutions to our customers. We will continue to create competitive platforms both to raise product development efficiency and to reinforce our capacity to deliver needed solutions to customers.

Leveraging Strategic Partners

At NEC Electronics, we seek strategic alliances with the aim of shortening development periods and strengthening our competitive edge, in addition to reducing development costs. We have entered into an alliance with Toshiba Corporation and Sony Corporation to jointly develop system LSI process technologies for the 45-nanometer* generation, which will become the fundamental semiconductor technology in future.

**1 nanometer (nm) is roughly equivalent to one-billionth of a meter.*

FINANCIAL HIGHLIGHTS

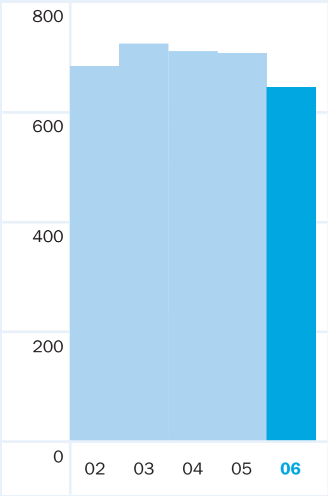
NEC Electronics Corporation and Consolidated Subsidiaries
For the years ended March 31

					Millions of yen	Thousands of U.S. dollars
For the year:	2002	2003	2004	2005	**2006**	**2006**
Net sales	¥684,268	¥725,093	¥711,986	¥708,014	**¥645,963**	**$5,521,051**
Communications	87,327	97,002	152,299	138,010	**107,995**	**923,034**
Computing and peripherals	143,713	125,901	138,227	140,941	**126,581**	**1,081,889**
Consumer electronics	119,789	147,127	88,294	101,278	**102,639**	**877,256**
Automotive and industrial	64,472	80,109	90,707	102,784	**103,780**	**887,009**
Multi-market ICs	85,245	84,465	79,988	78,575	**69,449**	**593,581**
Discrete, optical and microwave devices	112,347	117,971	122,095	118,172	**108,701**	**929,068**
Semiconductor sales	612,893	652,575	671,610	679,760	**619,145**	**5,291,837**
Other	71,375	72,518	40,376	28,254	**26,818**	**229,214**
Cost of sales	524,754	518,122	476,069	485,871	**477,476**	**4,080,991**
R&D expenses	99,759	96,666	99,450	107,942	**120,874**	**1,033,111**
Selling, general and administrative	99,772	80,102	81,870	81,025	**83,302**	**711,983**
Income (loss) before income taxes	(83,885)	15,090	44,389	26,409	**(42,386)**	**(362,274)**
Net income (loss)	(53,238)	9,622	28,066	16,031	**(98,198)**	**(839,299)**
Capital expenditures	90,114	54,383	103,034	163,173	**83,030**	**709,658**
Depreciation and amortization	110,661	88,414	82,392	95,999	**89,342**	**763,607**
Per share of common stock (in yen and U.S. dollars):						
Basic net income (loss) per share:			¥240.61	¥129.81	**¥(795.13)**	**$(6.80)**
Diluted net income (loss) per share:			240.61	120.30	**(795.13)**	**(6.80)**
At year-end:						
Total assets	¥630,115	¥655,489	¥741,515	¥814,222	**¥745,281**	**$6,369,923**
Shareholders' equity	232,942	238,927	371,739	393,863	**308,251**	**2,634,624**
Ratio of net income (loss) to shareholders' equity (ROE)		4.1%	9.2%	4.2%	**(28.0)%**	
Ratio of income (loss) before income taxes to total assets		2.3%	6.4%	3.4%	**(5.4)%**	

Note: U.S. dollar amounts are translated from yen, for convenience only, at the rate of ¥117=U.S.$1.

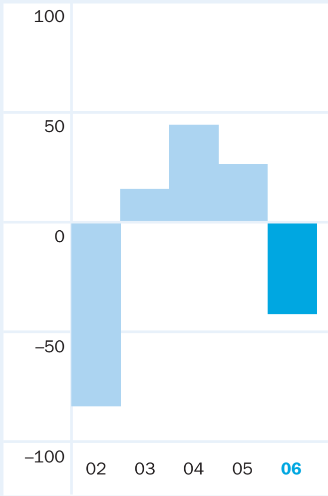
NET SALES

(¥ billion)



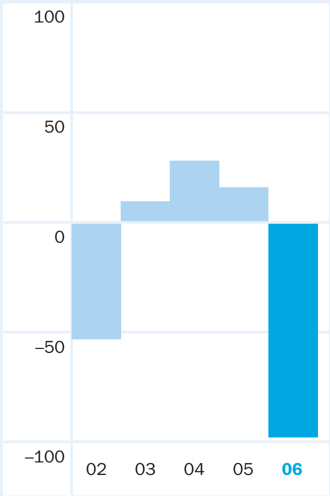
INCOME (LOSS) BEFORE INCOME TAXES

(¥ billion)



NET INCOME (LOSS)

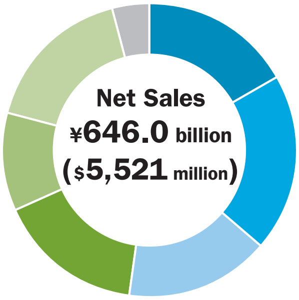
(¥ billion)



(Years ended March 31)

OVERVIEW OF THE YEAR ENDED MARCH 31, 2006

Sales Breakdown by Application



Communications	16.7%
Computing and Peripherals	19.6%
Consumer Electronics	15.9%
Automotive and Industrial	16.1%
Multi-market ICs	10.8%
Discrete, Optical and Microwave Devices	16.8%
Other	4.1%

For the fiscal year ended March 31, 2006, the United States economy showed continued growth as a result of strong consumer spending, stemming from an improved employment outlook and an increase in corporate capital expenditure, despite some causes for concern such as escalating crude oil prices and interest rate hikes. Asian economies, which rely heavily on exports to the United States, were also buoyed by the U.S. economy. Amid this global environment, the Japanese economy also showed strong consumer spending and corporate capital expenditure, maintaining a self-sustaining recovery.

In the overall semiconductor market, production adjustments, which are typically seen worldwide in the downward phase of a silicon cycle, began in the second half of the previous fiscal year and continued until the summer of 2005. From that point, the situation gradually began to improve, mainly due to increases in the use of semiconductors for notebook PCs and second-generation mobile phones in North America and Asia. However, the Japanese semiconductor market saw declines in demand due to saturation of the domestic mobile phone market, and was affected by larger-than-expected price drops for digital consumer goods. The European semiconductor market also experienced continued negative growth.

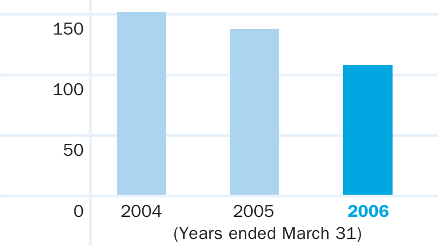
NEC Electronics posted net sales of ¥646.0 billion ($5,521 million), a decline of ¥62.1 billion (8.8 percent) from the previous fiscal year. This was mainly due to significant declines in sales of signal processing system LSIs for mobile phones and semiconductors for communications devices, such as system memories, as well as general sales declines across product areas excluding Automotive and Industrial, and Consumer Electronics.

Loss before income taxes was ¥42.4 billion ($362 million), a decrease of ¥68.8 billion from the previous year. This was due to a large decline in sales, severe price erosion, and lower utilization rates at manufacturing sites, which resulted in a sharp decline in the cost ratio. Net loss was ¥98.2 billion ($839 million), a ¥114.2 billion decrease year on year. This was a result of the consolidated loss before income taxes, as well as the recording of a valuation allowance against deferred tax assets in accordance with generally accepted accounting principles in the United States of America.

NEC ELECTRONICS AT A GLANCE

	Applications	Major Products
Communications 	Mobile handsets Broadband networking equipment Routers Mobile phone base stations	System LSIs Driver ICs for small TFT-LCDs System memories
Computing and Peripherals 	Computers Servers Workstations Computing peripherals Rewritable DVD drives Printers LCDs for PCs	System LSIs Microcontrollers Driver ICs for large TFT-LCDs
Consumer Electronics 	Digital consumer electronics Digital cameras DVD recorders Digital televisions Home appliances Game consoles	System LSIs Microcontrollers
Automotive and Industrial 	Automobiles Engine Body control Airbags Car audios Industrial Factory automation	Microcontrollers System LSIs
Multi-market ICs 	Wide range of electronics equipment	General-purpose microcontrollers Gate arrays General-purpose system memories
Discrete, Optical and Microwave Devices 	Wide range of electronics equipment	Diodes Transistors Optical semiconductors Microwave semiconductors

Net Sales (¥ Billion)



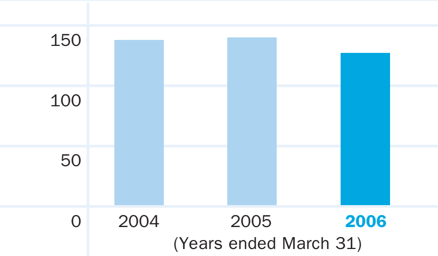
Trends in the Fiscal Year Ended March 31, 2006

Sales of semiconductors for mobile phones decreased considerably year on year. The saturation of the Japanese mobile phone market led to a decline in demand, resulting in decreased sales of signal processing system LSI chips and system memories. Sales volumes of LCD driver ICs for mobile phones increased, but this was offset by price declines, leading to nearly flat growth from the previous year.

Sales of semiconductors for broadband networking equipment also saw year-on-year declines, due to a decrease in demand for semiconductors for mobile phone base station systems.

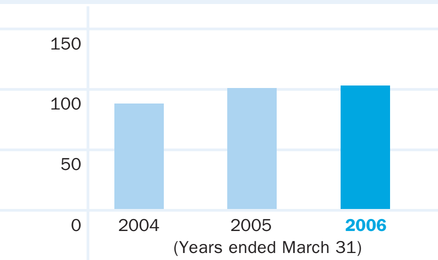
Customers*

Hitachi, Nokia, Panasonic Mobile Communications, Samsung Electronics, Sharp, Sony Ericsson Mobile Communications, NEC



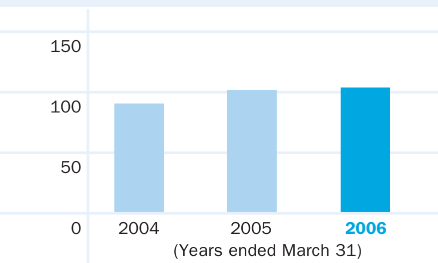
Sales of semiconductors for servers and workstations declined sharply year on year due to a decrease in sales to a major customer for servers. Sales of semiconductors for PC peripherals were nearly flat; although sales of LCD driver ICs for large PC monitors increased with the greater demand from LCD panel manufacturers, system LSI chips for PC interface applications decreased.

AUO, Canon, HP, LG Electronics, Pioneer, Samsung Electronics, Seiko Epson, NEC



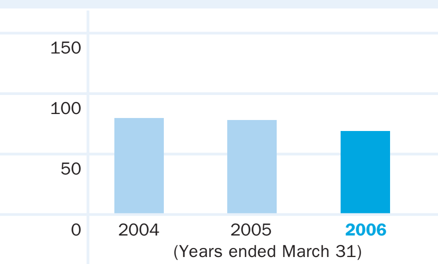
Sales of semiconductors for consumer electronics such as DVD recorders and digital cameras were affected by price declines resulting from the rapid growth of the domestic digital consumer electronics market, but sales volumes increased considerably, resulting in a year-on-year increase. However, sales of semiconductors for older consumer electronics such as videocassette recorders declined, leading to flat sales growth overall.

Canon, Casio Computer, Fuji Photo Film, Matsushita Electric Industrial, Microsoft, Nintendo, Pioneer, Sanyo Electric, Sharp, Sony, Toshiba, Victor Company of Japan



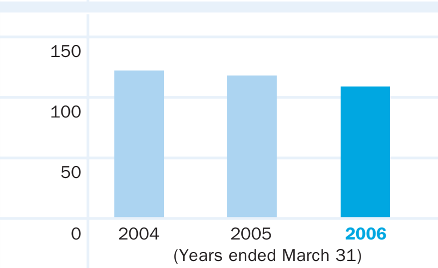
Sales of automotive semiconductors increased significantly during the previous fiscal year, and sales of devices for car audio systems, which are similar in nature to consumer electronics, declined as a result of price deterioration, leading to overall flat sales. Additionally, sales of factory automation semiconductors increased, but sales of industrial semiconductors overall remained flat year on year.

Advantest, Delphi, DENSO, Fanuc, Pioneer, Robert Bosch, Siemens, Toyota, Yaskawa Electric



Sales of general purpose microcontrollers declined due to a downturn in the market.

Matsushita Electric Industrial, Sony, NEC



Sales of discrete devices declined due to a decrease in demand resulting from production adjustments. Sales of optical and microwave products also declined year on year.

Motorola, Sony, NEC

** The list of customers is neither comprehensive nor necessarily representative.*

CORPORATE SOCIAL RESPONSIBILITY (CSR)

NEC Electronics recognizes that it is essential to build a solid relationship of trust and cooperation with all of our stakeholders. When we listed on the stock market in July 2003, we committed to a transparent and trustworthy style of management and have been working hard to ensure it ever since. In order to thoroughly implement this philosophy, we established the NEC Electronics Guiding Principles in June 2004 to promote management guidelines for CSR promotion at NEC Electronics and its subsidiaries, making our position on CSR known within and outside the company. Each and every executive and employee pledges to share the spirit of the Guiding Principles and join together in a concerted effort to promote CSR.

NEC Electronics Guiding Principles

At NEC Electronics, we are dedicated to cultivating trust with every individual and organization, including customers, shareholders, investors, trading partners and employees.

We pledge to conduct our business with integrity, beyond legal compliance, by acting responsibly as concerned corporate citizens, while providing superior semiconductor solutions based on advanced technologies.

NEC Electronics is committed to the following Guiding Principles.

- **Customer Focus**
  To provide optimized solutions and comprehensive support that exceed the highest expectations of our customers and earn their unwavering loyalty.
- **Ethical Business Practices**
  To promote free and fair market competition through transparent and ethical business practices, which are conveyed to the public through our actions and communications.
- **Community Involvement**
  To implement activities which contribute to both local and international communities, while respecting the history, culture, and human rights of each region.
- **Environmental Protection**
  To promote sustainable development by minimizing the environmental impact of our products throughout their entire life cycles.
- **Corporate Culture**
  To foster a corporate culture that respects individuality and encourages innovation, where all employees are proud to be part of the NEC Electronics team.

CSR management system

In June 2004, NEC Electronics set up a company-wide system for CSR promotion that included the establishment of a Corporate Social Responsibility Promotion Committee chaired by the President of NEC Electronics. With the established committee, we created and are implementing a management system that puts the NEC Electronics Guiding Principles into practice.

Creating a corporate culture we take pride in

NEC Electronics believes that a safe, healthy work environment free of discrimination and harassment is essential in bringing out each employee's individuality and capabilities to the fullest extent. All employees at NEC Electronics play a role in building a corporate culture we take pride in. We undertake measures such as promoting awareness of human rights issues, and implementing a family-friendly workplace program to enhance work and family life. This year, we moved forward in creating barrier-free workplaces and developing of a mental health management system.

Commitment to customer satisfaction

At NEC Electronics, we believe it is our mission as a company to provide optimal solutions that satisfy our customers. "It's all for the customer's success" is the core objective for our efforts to improve customer satisfaction. For example, we conduct surveys to determine CS levels in order to reflect feedback from customers in the products and services we provide. Additionally, every organization of the NEC Electronics group has acquired ISO 9001 and ISO/TS16949 certification for quality management systems, and carries out continual improvements to quality management at each stage of product development, production, and sales and marketing.

Strengthening relationships with our trading partners

NEC Electronics strives to maintain and improve mutual understanding and strong relationships of trust with purchasing and sales business partners. To this end, we issue a set of CSR Guidelines that specify tasks we would like our purchasing partners to undertake from the standpoint of CSR. Additionally, we regularly hold top executive meetings with sales partner companies, and support their sales representative training activities in order to further build stronger relationships with our partners.

Community involvement

As a semiconductor manufacturer, NEC Electronics is involved in environmental conservation activities globally as well as in local communities. We engage in community-based activities that respond to the special concerns of communities in Japan and overseas. In addition, we have developed systems and a work environment that make it easier for employees to participate in volunteer work. In the fiscal year ended March 31, 2006, NEC Electronics reached an agreement with Kanagawa Prefecture, Japan, to take part in the "Kanagawa Water-source Forest Creation Project." As a partner, NEC Electronics has established a "Semiconductor Forest" (see note) area within the Yadoriki Water-source Forest in the prefecture's Tanzawa district. Here, NEC Electronics employees take part in nature-watching events as well as brush-clearing and other volunteer activities. In December 2005, NEC Electronics was recognized for these activities with a certificate of appreciation from Kanagawa Prefecture.

(Note on "Semiconductor Forest")
NEC Electronics manufactures and sells semiconductors, found in digital consumer electronics, mobile phones and other devices. It consumes enormous volumes of water in the process of producing these semiconductors. Because of this, the NEC Electronics Group is involved in a variety of programs to conserve water resources in every region where it operates. "Semiconductor Forest" was established on July 1, 2005 in Kanagawa Prefecture's Yadoriki Water-source Forest, as designated by the Kanagawa Water-source Forest Creation Project.

Conserving the global environment

NEC Electronics bases environmental management policies on contributing to the conservation of the global environment in the course of our business activities in the semiconductor industry. There are three pillars that support our environmental activities: 1) We produce eco-products by incorporating environmental considerations into the entire product life cycle from the design and development stages; 2) We aim to reduce greenhouse gas emissions which cause global warming and to cut back hazardous chemical substances as a part of our eco-factory effort; and 3) We offer environmental education programs that raise employees' awareness of environmental issues, and disclose information on our eco-activities to the public.

**Please refer to the NEC Electronics Corporate Social Responsibility Report and Environment Report for more details.*
http://www.necel.com/csr/en

CORPORATE GOVERNANCE

Fundamental Corporate Governance Policy

- In recognition of the fact that, in addition to efficient execution of management, assurance of sound and transparent management is essential to continuously increasing its corporate value, NEC Electronics is committed to improve its management structure and to implement measures toward further strengthening its corporate governance.
- NEC Electronics has adopted the corporate auditor system for its corporate governance, and has a corporate governance structure with the Board of Corporate Auditors that monitors the actions of NEC Electronics' directors in the business execution of their duties. NEC Electronics believes that its audit structure for corporate governance is sufficiently functional, through full-time auditors, who can effectively obtain high quality information from relevant divisions using their knowledge and understanding of the business, while the meetings of the Board of Corporate Auditors, which includes part-time auditors, conduct analysis of the information.
- The Corporate Governance Committee meets at least once a month to discuss and offer proposals and recommendations involving corporate governance issues and other important corporate governance policies.

Corporate Governance Measures

NEC Electronics' Governance Structures

1. The Board of Directors is composed of five directors for faster and more efficient management.
2. The Board of Corporate Auditors is composed of four corporate auditors, including two outside corporate auditors. Of the two outside corporate auditors, one has judicial experience and one comes from NEC Corporation, the parent company of NEC Electronics. The Board of Corporate Auditors establishes audit policies and holds auditor's meetings. At the meetings, corporate auditors exchange information and deliberate on each corporate auditor's audit status. The Board also receives regular reports from independent auditors on their audit services and exchanges viewpoints on them.
3. NEC Electronics has introduced the Corporate Officer System to clarify responsibilities for conducting business operations and for quick decision-making in the execution of business activities.

Basic Policy Regarding the Internal Control System

NEC Electronics has decided basic policies for the establishment of the Internal Control System such as those described below, and implements them.

1. Compliance framework

- NEC Electronics has adopted the NEC Electronics Guiding Principles and the NEC Electronics Group Code of Conduct to establish corporate ethics and ensure compliance policies throughout the NEC Electronics Group. Directors and corporate officers take the lead in putting these principles into practice. Simultaneously, the Legal Division carries out practical activities to keep officers and employees informed about these principles, while the Internal Auditing Division audits the actual state of compliance implementation.
- Major compliance-related issues are deliberated and decided by the CSR Promotion Committee. The compliance promotion system, awareness-raising programs and other fundamental issues, meanwhile, are ensured under its fundamental company regulation regarding compliance, the NEC Electronics Group Compliance Program. In addition to these compliance measures, NEC Electronics has set up help lines for the NEC Electronics Group and its business partners to report on compliance violation issues.

2. Information management framework

- NEC Electronics properly prepares, saves and manages various documents pertaining to business operations based on legal regulations and the company's own fundamental regulation rules regarding document management. Trade secrets and personal information are both properly and strictly managed in accordance with the company's own fundamental regulations regarding the management and protection of these types of information.
- The fundamental issues pertaining to the management and security of information are deliberated by the Information Management and Security Committee. The Information Management and Security Committee also continuously carries out measures for maintaining and improving information security based on the company's own pertinent fundamental regulations.

3. Risk management framework

- NEC Electronics is establishing a risk management framework in line with the company's own fundamental regulations devised regarding risk management. These rules classify companywide management risks, designate the corporate officers and the division responsible for each classified risk category, and other fundamental issues. Each responsible corporate officer and division is charged with devising and carrying out measures to prevent their specific category of risk from materializing, as well as preparing countermeasures in case of the actual materialization of risks. Matters of particular importance to the company's risk management are placed on the Board of Directors' agenda following prior discussion by the Executive Committee.
- When serious risks materialize, NEC Electronics sets up a Crisis Countermeasures Committee or Emergency Headquarters to respond to the situation in accordance with the particular category of risk involved.

4. Framework for ensuring effective execution of business activities

- The Executive Committee discusses issues of importance to the company's management prior to a meeting of the Board of Directors in order to enhance the Board's deliberation. Furthermore, authority is properly transferred from directors to corporate officers and other employees by office routine regulations, decision-making and authorization procedures regulations and other pertinent fundamental regulations.

5. The NEC Electronics Group's Internal Control System

- Important matters concerning business operations of NEC Electronics Group's Japan-based subsidiaries are approved at each subsidiary's General Meeting of Shareholders. NEC Electronics makes the decision based on its own assessment of the seriousness of the issue being decided, then exercises its shareholder's rights.
- The company's responsible divisions oversee the routine management of subsidiaries based on NEC Electronics Guiding Principle and the NEC Electronics Group Code of Conduct. Evaluation, maintenance and improvement of NEC Electronics Group's internal control systems over financial reporting are performed in accordance with the U.S. Sarbanes-Oxley Act of 2002.
- Examinations of subsidiaries are performed by the corporate auditors and the Internal Auditing Division in cooperation with the subsidiaries' own corporate auditors and internal auditing staff members.

6. Corporate auditors' auditing framework

- NEC Electronics has established a Corporate Auditors Office composed of specialized staff members that assist the corporate auditors' audit activities. The company also bears the cost of obtaining expert advice from outside specialists when the Board of Corporate Auditors requires such for its audits.

- Corporate auditors receive reports as needed from directors and other officers regarding the status of business execution, as well as regular reports, depending on the specific duty, from general managers of divisions such as the Internal Auditing Division, Legal Division and Accounting Division.
- Corporate auditors may attend all important company meetings as they deem necessary, and are guaranteed a right to access to all critical corporate information, including the inspection of important authorization documents such as the minutes, decision records and other documents of important meetings.
- Regular meetings are held to provide the corporate auditors and directors with the opportunity to exchange viewpoints.

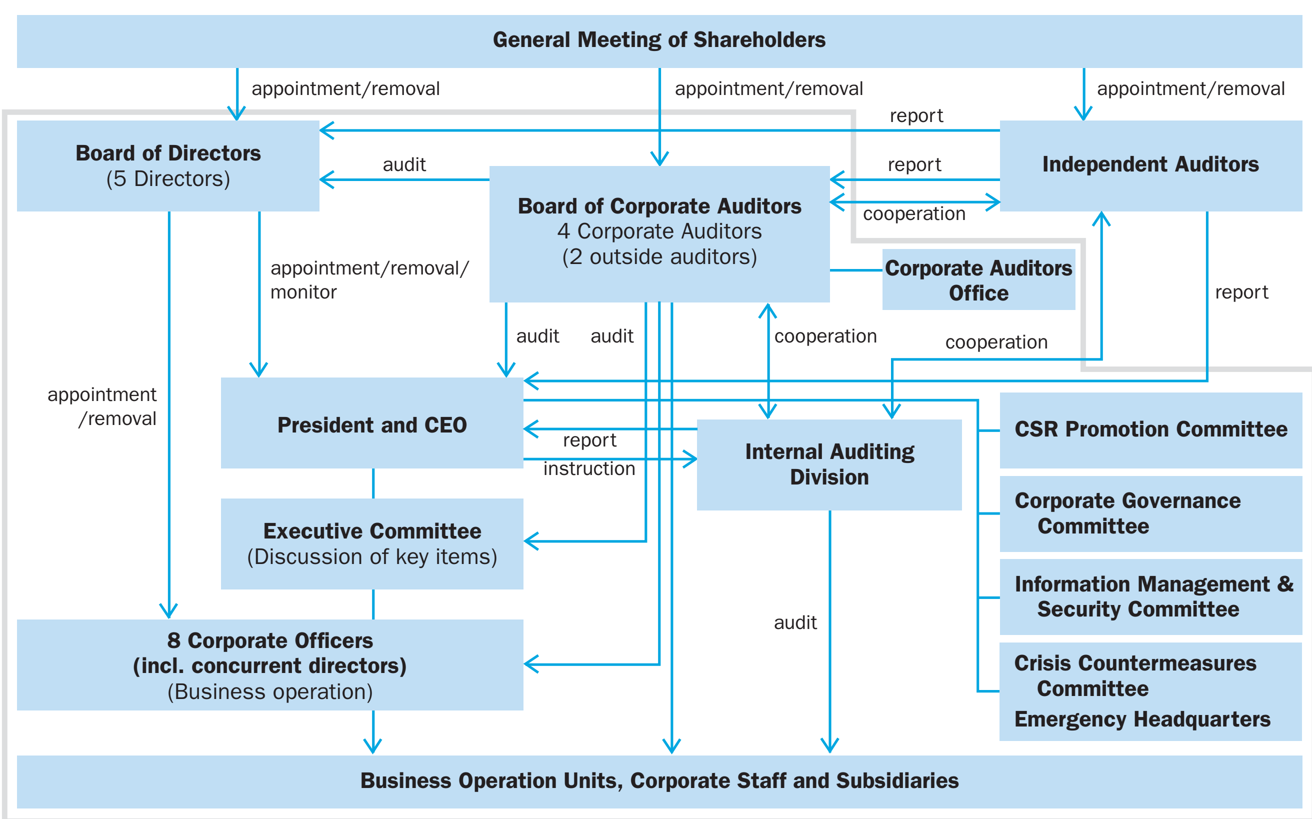
Internal Audits and Audit of Financial Statements

1. Internal audits

Internal audits are performed by the Internal Auditing Division, which is supervised by the President of NEC Electronics. Specifically, the division serves as an autonomous third party for investigating and evaluating other parts of the management organization, including divisions responsible for business operation units, corporate staff, consolidated subsidiaries and other areas. This is carried out from a compliance, risk management and internal control perspective. The division also proposes concrete measures for rectifying or improving problems that arise.

2. Audit of financial statements

Independent Auditors who performed NEC Electronics' audit were Sadahiko Yoshimura and Kazuya Oki, partners of Ernst & Young ShinNihon. The audit team included certified public accountants and junior accountants, as well as other specialists.



(As of July 1, 2006)

FINANCIAL SECTION

MANAGEMENT'S DISCUSSION AND ANALYSIS

Fiscal Year Ended March 31, 2006
Compared with the Fiscal Year Ended March 31, 2005

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, 2006, 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 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, 2006, NEC beneficially owns 70.04% of the Company's issued shares, including 5.02% of 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 Notes and Accounts

NEC Electronics provides an allowance for doubtful notes and accounts based on the historical write-off ratio for receivables and any specific doubtful notes and accounts based on a case-by-case determination of collectibility. On the basis of information currently available, we consider the allowance for doubtful notes and accounts to be adequate. However, changes in the underlying financial condition 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 inventory, 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.

Investments

NEC Electronics holds investments with a long-range perspective for such purposes as promoting sales measures, 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 investments, 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. There were no significant gross unrealized holding losses in marketable securities as of March 31, 2006. The Company also believes that there is no impairment in investments, other as of March 31, 2006.

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, 2006. Changes in future technology trends or strategy may cause an impairment of long-lived assets.

Deferred Tax Assets

NEC Electronics has recorded deferred tax assets resulting from deductible temporary differences and net operating loss carry-forwards, 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 NEC Electronics Corporation and its consolidated subsidiaries in Japan, we recorded a valuation allowance of ¥74.6 billion ($637 million) at March 31, 2006.

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. In accordance with U.S. GAAP, variations in the assumptions or actual results that differ from the assumptions are amortized 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, 2005 and 2006. 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, 2006 was 2.5%.

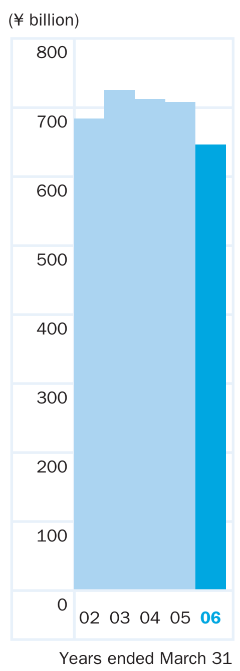
Results of Operations

Net Sales

Net sales decreased ¥62.1 billion, or 8.8%, to ¥646.0 billion ($5,521 million) for the fiscal year ended March 31, 2006, compared to net sales of ¥708.0 billion for the previous fiscal year, due to lower sales in our core semiconductor business, which decreased ¥60.6 billion, or 8.9%, to ¥619.1 billion ($5,292 million).

Our net sales by market application were as follows:

NET SALES



Communications

Net sales of semiconductors for communications applications decreased ¥30.0 billion, or 21.7%, to ¥108.0 billion ($923 million) for the fiscal year ended March 31, 2006, from ¥138.0 billion for the previous fiscal year. Along with a substantial drop in sales of signal-processing system LSIs and system memories for mobile phones, this decline resulted from lower sales of semiconductors for broadband networking equipment due to decreased demand for semiconductors for mobile phone base station systems.

Computing and Peripherals

Net sales of semiconductors for computing and peripherals applications decreased ¥14.4 billion, or 10.2%, to ¥126.6 billion ($1,082 million) for the fiscal year ended March 31, 2006, from ¥140.9 billion for the previous fiscal year. Net sales declined mainly from a sharp fall in sales of semiconductors for servers and workstations due to lower sales to a major customer for servers.

Consumer Electronics

Net sales of semiconductors for consumer electronics applications increased ¥1.4 billion, or 1.3%, to ¥102.6 billion ($877 million) for the fiscal year ended March 31, 2006, from ¥101.3 billion for the previous fiscal year. Although sales of semiconductors for digital consumer electronics such as DVD recorders and digital cameras increased, sales of semiconductors for conventional consumer electronics, including VCRs decreased, causing total sales to remain flat.

Automotive and Industrial

Net sales of semiconductors for automotive and industrial applications increased ¥1.0 billion, or 1.0%, to ¥103.8 billion ($887 million) for the fiscal year ended March 31, 2006, from ¥102.8 billion for the previous fiscal year. Semiconductors for automotive applications held steady despite an impact from price drops in products including semiconductors for car audios. Additionally, sales of factory automation semiconductors increased, but sales of industrial semiconductors overall remained flat from the previous fiscal year.

Multi-market ICs

Net sales of multi-market ICs decreased ¥9.1 billion, or 11.6%, to ¥69.4 billion ($594 million) for the fiscal year ended March 31, 2006, from ¥78.6 billion for the previous fiscal year. The decline largely reflected lower sales of general-purpose microcontrollers, the result of a downturn in the market.

Discrete, Optical and Microwave Devices

Net sales of discrete, optical and microwave devices decreased ¥9.5 billion, or 8.0%, to ¥108.7 billion ($929 million) for the fiscal year ended March 31, 2006, from ¥118.2 billion for the previous fiscal year. The decrease was mainly due to a decline in sales of discrete devices, reflecting a decrease in demand resulting from customers' inventory adjustments, and a decline in sales of optical and microwave devices.

Other

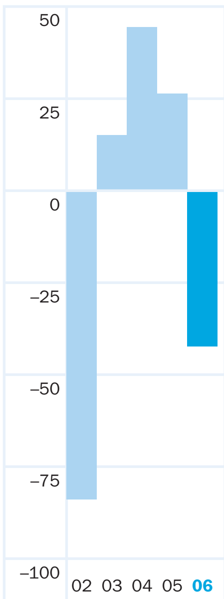
Other net sales consist of sales of color LCD panels, printed circuit boards, and other non-semiconductor products and services. Our other net sales decreased ¥1.4 billion, or 5.1%, to ¥26.8 billion ($229 million) for the fiscal year ended March 31, 2006, from ¥28.3 billion for the previous fiscal year. The business operations in this category are not part of our core operations and have an insignificant impact on overall profit or loss.

Cost of Sales

Cost of sales decreased ¥8.4 billion, or 1.7%, to ¥477.5 billion ($4,081 million) for the fiscal year ended March 31, 2006, from ¥485.9 billion for the previous fiscal year. While measures were enacted to enhance productivity and cost efficiency, declining costs nevertheless were unable to keep pace with falls in product prices. Consequently, the cost of sales as a percentage of net sales rose from 68.6% to 73.9%.

INCOME (LOSS) BEFORE INCOME TAXES

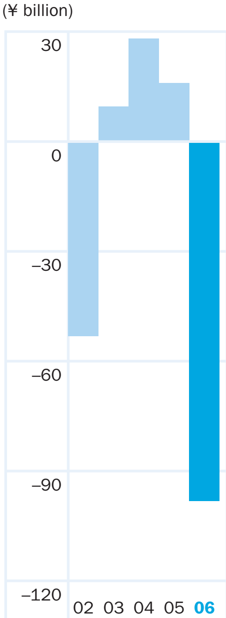
(¥ billion)



Years ended March 31

NET INCOME (LOSS)

(¥ billion)



Years ended March 31

Research and Development Expenses

Research and development expenses increased ¥12.9 billion, or 12.0%, to ¥120.9 billion ($1,033 million) for the fiscal year ended March 31, 2006, from ¥107.9 billion for the previous fiscal year. The increase was primarily a result of increased investment in research and development into advanced technologies. As a percentage of net sales, research and development expenses increased from 15.2% for the fiscal year ended March 31, 2005 to 18.7%. Research and development expenses included fees of ¥8.7 billion and ¥6.3 billion ($54 million) for the fiscal years ended March 31, 2005 and 2006, respectively, paid to NEC in connection with research provided by NEC's laboratories.

Selling, General and Administrative Expenses

Selling, general and administrative expenses increased ¥2.3 billion, or 2.8%, to ¥83.3 billion ($712 million) for the fiscal year ended March 31, 2006, from ¥81.0 billion for the previous fiscal year. As a percentage of net sales, selling, general and administrative expenses increased from 11.5% for the fiscal year ended March 31, 2005 to 12.9%.

Provision for Income Taxes

NEC Electronics' income (loss) before income taxes, provision for income taxes, and effective tax rate for the fiscal years ended March 31, 2005 and 2006 were as follows:

	Billions of yen		Millions of U.S. dollars
Year ended March 31	2005	**2006**	**2006**
Income (loss) before income taxes	¥26.4	**¥(42.4)**	**$(362)**
Provision for income taxes			
Current	10.3	**9.5**	**81**
Deferred	0.4	**46.6**	**399**
Effective tax rate (%)	40.6%	**—**	**—**

Major fluctuations in the effective tax rate reflect the recording of valuation allowances for deferred tax assets.

Minority Interest in Losses of Consolidated Subsidiaries

NEC Electronics recorded minority interest in losses of consolidated subsidiaries, primarily minority interest in losses at our subsidiary in China, of ¥0.4 billion ($3 million) for the fiscal year ended March 31, 2006, compared to ¥0.3 billion for the fiscal year ended March 31, 2005.

Net Income (Loss)

NEC Electronics recorded net loss of ¥98.2 billion ($839 million), representing minus 15.2% of net sales, for the fiscal year ended March 31, 2006, compared to net income of ¥16.0 billion for the previous fiscal year.

Geographical Segment Analysis

Our net sales on a geographic basis were as follows:

Japan

Net sales in Japan decreased ¥54.8 billion, or 13.4%, to ¥352.9 billion ($3,016 million) for the fiscal year ended March 31, 2006, from ¥407.6 billion for the previous fiscal year. The decrease was primarily due to a decline in sales of semiconductors for mobile phones.

United States of America

Net sales in the United States of America decreased ¥2.6 billion, or 3.3%, to ¥76.9 billion ($657 million) for the fiscal year ended March 31, 2006, from ¥79.5 billion for the previous fiscal year. The decrease was primarily due to a decline in sales of system LSIs for servers, among others.

Europe

Net sales in Europe decreased ¥7.0 billion, or 8.7%, to ¥73.0 billion ($624 million) for the fiscal year ended March 31, 2006, from ¥79.9 billion for the previous fiscal year. The decrease was primarily due to a decline in sales of microcontrollers for automobiles.

Asia

Net sales in Asia, excluding Japan, increased ¥2.3 billion, or 1.6%, to ¥143.3 billion ($1,225 million) for the fiscal year ended March 31, 2006, from ¥141.0 billion for the previous fiscal year. The increase was primarily due to a steady growth in sales of products such as LCD driver ICs.

Seasonality

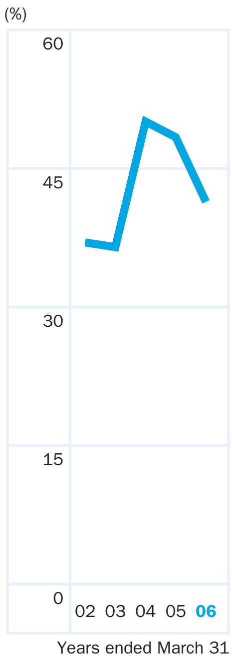
NEC Electronics' main customers for semiconductor products are manufacturers of consumer electronic products.

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 shipments to customers that manufacture consumer products for the year-end holiday season.

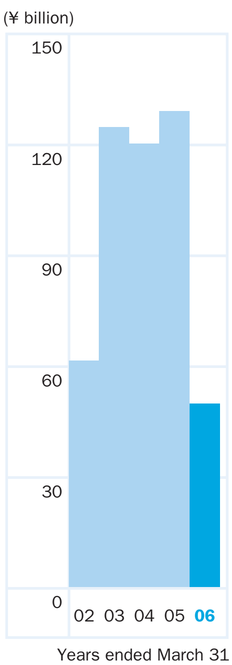
Effect of Change in Exchange Rates on Foreign Currency

The average annual exchange rate of the Japanese yen against the U.S. dollar during the fiscal year ended March 31, 2006 was approximately ¥4 lower compared to the fiscal year ended March 31, 2005. This increased the yen-denominated amount of U.S. dollar-denominated sales, thereby contributing to increased 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 have recorded a net foreign exchange loss of ¥0.5 billion ($4 million) for the fiscal year ended March 31, 2006. 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.

EQUITY RATIO



NET CASH PROVIDED BY OPERATING ACTIVITIES



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 bond 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, as of March 31, 2006. 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, 2006, our total amount of long-term debt was ¥23.7 billion ($202 million) and the outstanding balance of convertible bonds was ¥110.0 billion ($940 million). In addition, we also have a revolving credit facility under which an aggregate of up to ¥20.0 billion ($171 million) in short-term loans is available to meet unforeseen short-term financing needs.

As of March 31, 2006, the total amount of interest-bearing debt, including convertible bonds, borrowings, and obligations under certain capital leases, was ¥148.3 billion ($1,268 million). As of March 31, 2006, we had ¥211.1 billion ($1,804 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 operations, are sufficient to meet its current cash requirements, including working capital, capital expenditures and debt service, for the foreseeable future. In order to facilitate access to global capital markets, the Company has obtained credit ratings from Rating and Investment Information, Inc. (R&I), one of Japan's major credit rating agencies. The Company's current senior long-term credit rating from R&I is A- and current short-term debt rating from R&I is a-1.

Financial Condition

Total Assets and Shareholders' Equity

Total assets at March 31, 2006 totaled ¥745.3 billion ($6,370 million), a ¥68.9 billion decrease from ¥814.2 billion as of March 31, 2005. This was mainly due to the sale and lease back transactions of machinery and equipment, which led to a ¥41.4 billion decrease in property, plant and equipment, as well as the recording of a valuation allowance against deferred tax assets, which resulted in a ¥27.2 billion decrease in other assets.

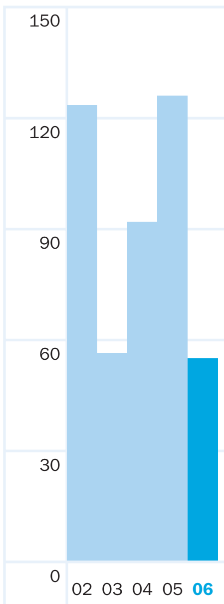
Shareholders' equity was ¥308.3 billion ($2,635 million), decreasing ¥85.6 billion from ¥393.9 billion as of March 31, 2005. This decrease was mainly due to net loss in the amount of ¥98.2 billion ($839 million).

Cash Flow

Net cash provided by operating activities decreased ¥79.3 billion to ¥49.9 billion ($426 million) for the fiscal year ended March 31, 2006, from ¥129.2 billion for the previous fiscal year. The decrease was primarily due to ¥98.2 billion ($839 million) in net loss and an increase in accounts receivable, as well as depreciation and amortization in the amount of ¥89.3 billion ($764 million).

NET CASH USED IN INVESTING ACTIVITIES

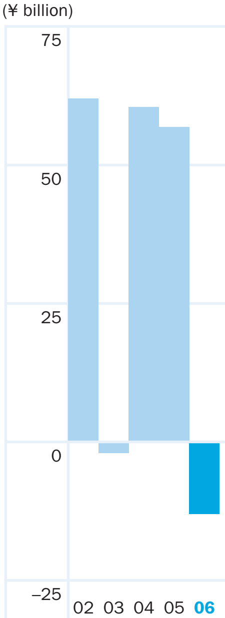
(¥ billion)



Years ended March 31

NET CASH PROVIDED BY FINANCING ACTIVITIES

(¥ billion)



Years ended March 31

Net cash used in investing activities decreased ¥71.4 billion to ¥54.7 billion ($467 million) for the fiscal year ended March 31, 2006, from ¥126.1 billion for the previous fiscal year. This was the result of ¥106.6 billion ($911 million) paid for property, plant and equipment, combined with ¥56.5 billion ($483 million) received from the sale of equipment for leasing.

Net cash used in financing activities was ¥12.5 billion ($107 million) for the fiscal year ended March 31, 2006, as a result of repayment of debt and dividend payments. This was ¥69.4 billion more than the fiscal year ended March 31, 2005, in which net cash of ¥56.9 billion was provided by financing activities such as the issuance of convertible bonds.

Capital Expenditures

NEC Electronics' capital expenditures for the fiscal years ended March 31, 2005 and 2006 were ¥163.2 billion and ¥83.0 billion ($710 million), respectively. The capital expenditures for the fiscal year ending March 31, 2007 are estimated at ¥100.0 billion ($855 million). For the fiscal year ended March 31, 2006, the capital expenditures were largely devoted to the upgrade and expansion of our 300mm wafer line and assembly and testing lines. Current plans call for capital expenditures for the fiscal year ending March 31, 2007 to be primarily earmarked for the same tasks.

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 of ¥67.4 billion and ¥46.0 billion ($393 million) for the fiscal years ended March 31, 2005 and 2006, respectively.

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 the Company in the fiscal years ended March 31, 2005 and 2006 was ¥44.5 billion and ¥52.2 billion ($447 million), respectively.

Risk Factors

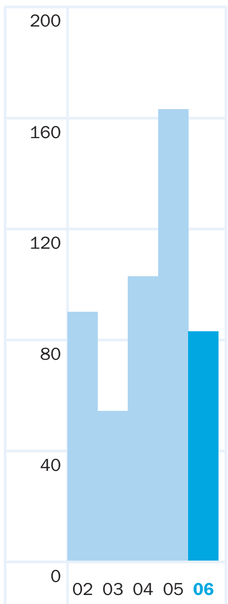
NEC Electronics recognizes the following as some of the most significant risk factors faced in its business operations.

Impact of Market Fluctuations (Silicon Cycle)

The semiconductor industry is known to be subject to cyclical market fluctuations, a phenomenon known as the "silicon cycle." Although we operate on the basis of careful monitoring of 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 and lower fab utilization rates, which may in turn result in diminished cost ratios and a significant deterioration in profits.

CAPITAL EXPENDITURES

(¥ billion)



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 avert or reduce risks relating to fluctuations in the foreign currency exchange markets, such as forward exchange contracts. However, these fluctuations may impact the costs and sales of various products denominated in foreign currencies, as well as the production cost of overseas manufacturing facilities. In addition, conversion of the Company's assets and liabilities denominated in foreign currencies and the financial statements of our overseas subsidiaries into Japanese yen, may also affect our assets and liabilities, as well as earnings and expenses.

Natural Disasters

Natural disasters such as earthquakes, typhoons, and floods, as well as accidents, acts of terror and other factors beyond the control of 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. The company takes various measures, such as enhancing the resistance of buildings at manufacturing and other sites against earthquakes, in order to minimize losses and damages. Additionally, NEC Electronics is 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, NEC Electronics takes various measures including development of leading-edge technologies and cost reduction, but in the event that we are not competitive, our market share may decline, which may negatively impact our financial results. Severe price competition 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.

Poor Decision-making Concerning Investments in Capital and R&D

As an integrated device manufacturer (IDM), many of the semiconductor products sold by us are developed and produced by ourselves. As such, substantial capital expenditures are made annually to stay ahead in technological innovation and to boost production. While we constantly strive to invest the appropriate amount at the appropriate time, poor decisions concerning either timing or amount could cause us to lose substantial business opportunities or suffer operational losses.

NEC Electronics also invests heavily in R&D for leading-edge technologies. However, errors in selecting R&D subjects, delays in development and other factors could prevent such investments from helping sales and earnings, essentially nullifying the investments.

Product Defects, Anomalies and Malfunctions

Although we make 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 diversity of ways in which our products are used by customers. These defects, anomalies or malfunctions could be discovered after our 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 our profits and operating results. To prepare for such events, we have product liability insurance and recall insurance, but it is not guaranteed that the full costs of reimbursements would be covered by these.

Impairment of Long-lived Assets

NEC Electronics has recorded tangible fixed assets and many other long-lived assets in its consolidated balance sheets, 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 an impairment in their value.

Legal Issues

NEC Electronics' products utilize a wide range of technologies, and it is possible that a third party may claim that our certain technologies infringe upon its intellectual property rights. In the event of such claims, we may incur substantial costs related to legal actions and other expenses in defense of us and/or our customers. Depending on the outcome of these claims, we could be ordered to pay substantial amounts in damages or be forced to cease use of such technology due to the demand for excessive license fees which are not economically feasible.

Our operations are subject to various laws and regulations in Japan and other countries around the world pertaining to the environment, safety, fair business practices and other matters. We strive to comply fully with these laws and regulations. However, in the event of a lawsuit or legal proceeding based on violations of such laws and regulations, a ruling against us could negatively impact our earnings and operating results.

The investigation conducted by the United States Department of Justice ("DOJ") in regard to potential antitrust violations in the U.S. DRAM industry was resolved with respect to NEC Corporation and its subsidiaries, including NEC Electronics, by a cooperation and non-prosecution agreement which was entered into between NEC Corporation and the DOJ. However, NEC Electronics America, Inc. is currently subject to the investigations being conducted by the Attorneys General of several states in the U.S. in connection with alleged antitrust violations among DRAM suppliers. Further, NEC Electronics America, Inc. has also been named as one of the defendants in a number of class action civil antitrust lawsuits seeking damages for alleged antitrust violations, and it, along with NEC Corporation, has commenced settlement negotiations with certain customers to which it has sold DRAM in the past.

In addition, NEC Electronics, together with NEC Corporation, is fully cooperating with the European Commission in an investigation of potential violations of European competition laws in the DRAM industry.

Although the outcome of the investigations by the several state Attorneys General and the European Commission, civil lawsuits or the settlement negotiations is not known at this time, NEC Electronics has recorded probable and reasonably estimable losses for the civil lawsuits and settlements with the customers in the fiscal year ended March 31, 2006.

CONSOLIDATED BALANCE SHEETS

NEC Electronics Corporation and Consolidated Subsidiaries
As of March 31, 2005 and 2006

	Millions of yen		Thousands of U.S. dollars
ASSETS	2005	**2006**	**2006**
Current assets:			
Cash and cash equivalents	¥ 225,691	**¥ 211,060**	**$ 1,803,932**
Notes and accounts receivable, trade:			
Related party	18,512	**13,604**	**116,274**
Other	82,283	**100,975**	**863,034**
Allowance for doubtful notes and accounts	(508)	**(729)**	**(6,231)**
Loans receivable from related party	—	**228**	**1,949**
Inventories	67,718	**72,525**	**619,872**
Deferred tax assets	16,028	**6,178**	**52,803**
Prepaid expenses and other current assets	8,917	**9,529**	**81,444**
Total current assets	418,641	**413,370**	**3,533,077**
Investments:			
Marketable securities	9,774	**13,901**	**118,812**
Investments, other	899	**1,696**	**14,496**
	10,673	**15,597**	**133,308**
Property, plant and equipment:			
Land	17,270	**17,365**	**148,419**
Buildings	239,582	**243,976**	**2,085,265**
Machinery and equipment	939,768	**954,969**	**8,162,128**
Construction in progress	37,410	**19,189**	**164,009**
	1,234,030	**1,235,499**	**10,559,821**
Accumulated depreciation	(890,539)	**(933,374)**	**(7,977,556)**
	343,491	**302,125**	**2,582,265**
Other assets:			
Deferred tax assets	29,774	**1,739**	**14,863**
License fees and other intangibles	10,646	**11,596**	**99,111**
Other	997	**854**	**7,299**
	41,417	**14,189**	**121,273**
	¥ 814,222	**¥ 745,281**	**$ 6,369,923**

See notes to consolidated financial statements.

LIABILITIES AND SHAREHOLDERS' EQUITY	Millions of yen 2005	Millions of yen 2006	Thousands of U.S. dollars 2006
Current liabilities:			
Short-term borrowings	¥ 6,257	**¥ 7,201**	**$ 61,547**
Current portion of long-term debt	8,449	**6,471**	**55,308**
Current portion of obligation under capital leases to related party	828	**1,402**	**11,983**
Notes and accounts payable, trade:			
Related party	41,973	**27,705**	**236,795**
Other	81,123	**95,234**	**813,966**
Accounts payable, other and accrued expenses:			
Related party	4,404	**4,201**	**35,906**
Other	45,168	**56,972**	**486,940**
Accrued income taxes	5,576	**3,770**	**32,222**
Other current liabilities	8,948	**11,071**	**94,623**
Total current liabilities	202,726	**214,027**	**1,829,290**
Long-term liabilities:			
Long-term debt	133,067	**127,185**	**1,087,051**
Obligation under capital leases to related party	4,368	**6,050**	**51,709**
Accrued pension and severance costs	76,254	**75,761**	**647,530**
Deferred tax liabilities	—	**9,559**	**81,701**
Other	—	**326**	**2,787**
	213,689	**218,881**	**1,870,778**
Minority shareholders' equity in consolidated subsidiaries	3,944	**4,122**	**35,231**
Commitments and contingent liabilities			
Shareholders' equity:			
Common stock:			
Authorized —400,000,000 shares			
Issued and outstanding—123,500,000 shares	85,955	**85,955**	**734,658**
Additional paid-in capital	276,693	**281,014**	**2,401,829**
Retained earnings (Accumulated deficit)	40,829	**(57,369)**	**(490,333)**
Accumulated other comprehensive income (loss)	(9,608)	**(1,342)**	**(11,470)**
Treasury stock, at cost:			
2005— 889 shares	(6)		
2006—1,020 shares		**(7)**	**(60)**
	393,863	**308,251**	**2,634,624**
	¥814,222	**¥745,281**	**$6,369,923**

CONSOLIDATED STATEMENTS OF OPERATIONS

NEC Electronics Corporation and Consolidated Subsidiaries
For the years ended March 31, 2004, 2005 and 2006

	Millions of yen			Thousands of U.S. dollars
	2004	2005	**2006**	**2006**
Sales and other income:				
Net sales	¥711,986	¥708,014	**¥645,963**	**$5,521,051**
Gain on sales of property, plant and equipment and other	2,201	2,443	**1,917**	**16,384**
Interest and dividend income	364	489	**1,078**	**9,214**
Gain on sales of investments in securities	863	112	**1,365**	**11,667**
Subsidy related to transfer of the substitutional portion of employee pension fund liabilities, net of settlement loss of ¥26,622 million in 2004	1,874	—	**—**	**—**
	717,288	711,058	**650,323**	**5,558,316**
Costs and expenses:				
Cost of sales	476,069	485,871	**477,476**	**4,080,991**
Research and development	99,450	107,942	**120,874**	**1,033,111**
Selling, general and administrative	81,870	81,025	**83,302**	**711,983**
Litigation and settlement expense	—	—	**3,413**	**29,171**
Restructuring charges	—	—	**1,683**	**14,385**
Loss on sales or disposal of property, plant and equipment and other	8,818	7,483	**4,132**	**35,316**
Interest	1,366	749	**874**	**7,470**
Net foreign exchange loss	3,193	913	**519**	**4,436**
Loss on investments in securities	2,133	666	**436**	**3,727**
	672,899	684,649	**692,709**	**5,920,590**
Income (loss) before income taxes and minority interest in losses of consolidated subsidiaries	44,389	26,409	**(42,386)**	**(362,274)**
Provision for income taxes	17,281	10,714	**56,166**	**480,051**
Income (loss) before minority interest in losses of consolidated subsidiaries	27,108	15,695	**(98,552)**	**(842,325)**
Minority interest in losses of consolidated subsidiaries	(958)	(336)	**(354)**	**(3,026)**
Net income (loss)	¥ 28,066	¥ 16,031	**¥(98,198)**	**$ (839,299)**

	Yen			U.S. dollars
	2004	2005	**2006**	**2006**
Basic net income (loss) per share	¥ 240.61	¥ 129.81	**¥(795.13)**	**$ (6.80)**
Diluted net income (loss) per share	¥ 240.61	¥ 120.30	**¥(795.13)**	**$ (6.80)**
Cash dividends per share	¥ 20.00	¥ 20.00	**¥ —**	**$ —**

See notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

NEC Electronics Corporation and Consolidated Subsidiaries
For the years ended March 31, 2004, 2005 and 2006

						Millions of yen		Thousands of U.S. dollars
		2004		2005		**2006**		**2006**
Common stock:								
Balance at beginning of year	¥ 50,000		¥ 85,955		**¥ 85,955**		**$ 734,658**	
Public stock offering, net	35,955		—		**—**		**—**	
Balance at end of year	¥ 85,955		¥ 85,955		**¥ 85,955**		**$ 734,658**	
Additional paid-in capital:								
Balance at beginning of year	¥216,744		¥275,667		**¥276,693**		**$2,364,898**	
Contribution to capital	—		558		**6,092**		**52,068**	
Transaction under common control	—		—		**(1,974)**		**(16,872)**	
Public stock offering, net	57,810		—		**—**		**—**	
Stock issue costs, net of tax	(817)		—		**—**		**—**	
Settlement for transfer of subsidiaries	1,683		—		**—**		**—**	
Compensation expense for stock options	247		468		**203**		**1,735**	
Balance at end of year	¥275,667		¥276,693		**¥281,014**		**$2,401,829**	
Retained earnings (Accumulated deficit):								
Balance at beginning of year	¥ 1,672		¥ 27,268		**¥ 40,829**		**$ 348,966**	
Net income (loss)	28,066	28,066	16,031	16,031	**(98,198)**	**(98,198)**	**(839,299)**	**(839,299)**
Dividends	(2,470)		(2,470)		**—**		**—**	
Balance at end of year	¥ 27,268		¥ 40,829		**¥(57,369)**		**$ (490,333)**	
Accumulated other comprehensive income (loss):								
Balance at beginning of year	¥ (29,489)		¥ (17,147)		**¥ (9,608)**		**$ (82,119)**	
Foreign currency translation adjustments		(3,248)		1,260		**4,757**		**40,658**
Minimum pension liability adjustment, net of tax		13,088		5,791		**1,243**		**10,624**
Unrealized gains on marketable securities, net of tax		2,471		493		**2,304**		**19,692**
Unrealized gains (losses) on derivative financial instruments, net of tax		31		(5)		**(38)**		**(325)**
Other comprehensive income (loss)	12,342	12,342	7,539	7,539	**8,266**	**8,266**	**70,649**	**70,649**
Comprehensive income (loss)		¥40,408		¥23,570		**¥(89,932)**		**$(768,650)**
Balance at end of year	¥ (17,147)		¥ (9,608)		**¥ (1,342)**		**$ (11,470)**	
Treasury stock, at cost:								
Balance at beginning of year	¥ —		¥ (4)		**¥ (6)**		**$ (51)**	
Purchase	(4)		(2)		**(1)**		**(9)**	
Balance at end of year	¥ (4)		¥ (6)		**¥ (7)**		**$ (60)**	

See notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

NEC Electronics Corporation and Consolidated Subsidiaries
For the years ended March 31, 2004, 2005 and 2006

	Millions of yen			Thousands of U.S. dollars
	2004	2005	**2006**	**2006**
Cash flows from operating activities:				
Net income (loss)	¥ 28,066	¥ 16,031	**¥ (98,198)**	**$ (839,299)**
Adjustments to reconcile net income (loss) to net cash provided by operating activities:				
Depreciation and amortization	82,392	95,999	**89,342**	**763,607**
Deferred income taxes	369	384	**46,637**	**398,607**
Loss on property, plant and equipment, net	7,023	2,544	**2,817**	**24,077**
Realized (gain) loss on marketable securities	(863)	376	**178**	**1,521**
Provision for pension and severance costs, less payments	1,597	2,708	**1,072**	**9,162**
Minority interest in losses of consolidated subsidiaries	(958)	(336)	**(354)**	**(3,026)**
(Increase) decrease in notes and accounts receivable	10,381	9,975	**(7,928)**	**(67,761)**
(Increase) decrease in inventories	2,323	5,024	**(3,062)**	**(26,171)**
Increase (decrease) in notes and accounts payable	(16,634)	(9,417)	**5,675**	**48,504**
Increase in other current liabilities	4,295	5,134	**6,605**	**56,453**
Other, net	2,330	731	**7,106**	**60,736**
Net cash provided by operating activities	120,321	129,153	**49,890**	**426,410**
Cash flows from investing activities:				
Proceeds from sales of property, plant and equipment	1,685	45,544	**56,474**	**482,684**
Additions to property, plant and equipment	(86,764)	(176,391)	**(106,642)**	**(911,470)**
Proceeds from sales of marketable securities	1,765	150	**395**	**3,376**
Purchase of marketable securities	(873)	—	**(816)**	**(6,974)**
Acquisition of minority interest	(974)	(67)	**—**	**—**
(Increase) decrease in loans receivable from related party	(3,970)	6,669	**(223)**	**(1,906)**
Increase in other investment securities	—	(221)	**(1,021)**	**(8,726)**
Other, net	(2,845)	(1,780)	**(2,840)**	**(24,274)**
Net cash used in investing activities	(91,976)	(126,096)	**(54,673)**	**(467,290)**
Cash flows from financing activities:				
Proceeds from long-term debt	1,857	111,894	**2,335**	**19,957**
Repayments of long-term debt	(15,252)	(49,927)	**(10,581)**	**(90,436)**
Increase (decrease) in short-term borrowings, net	(12,878)	(380)	**124**	**1,060**
Repayments of lease obligation to related party	(1,122)	(1,004)	**(1,198)**	**(10,239)**
Dividends paid	—	(3,703)	**(1,235)**	**(10,556)**
Transaction under common control	—	—	**(1,974)**	**(16,872)**
Public stock offering, net	92,885	—	**—**	**—**
Settlement for transfer of subsidiaries	(6,041)	—	**—**	**—**
Other, net	1,021	(2)	**(1)**	**(8)**
Net cash provided by (used in) financing activities	60,470	56,878	**(12,530)**	**(107,094)**
Effect of exchange rate changes on cash and cash equivalents	(1,571)	296	**2,682**	**22,923**
Net increase (decrease) in cash and cash equivalents	87,244	60,231	**(14,631)**	**(125,051)**
Cash and cash equivalents at beginning of year	78,216	165,460	**225,691**	**1,928,983**
Cash and cash equivalents at end of year	¥165,460	¥ 225,691	**¥ 211,060**	**$1,803,932**
Supplemental disclosures of cash flow information:				
Cash paid during the year for:				
Interest	¥ 1,415	¥ 710	**¥ 927**	**$ 7,923**
Income taxes	15,756	11,460	**8,217**	**70,231**
Non-cash investing and financing transaction:				
Settlement for transfer of subsidiaries	1,683	—	**—**	**—**
Contribution to capital	—	558	**6,092**	**52,068**
Machinery and equipment obtained by capital leases	456	392	**3,337**	**28,521**

See notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NEC Electronics Corporation and Consolidated Subsidiaries

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 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.

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, certain foreign subsidiaries have a December 31 fiscal year end. Therefore, the Company recognizes the results of operations and financial position of such subsidiaries on a basis of a three-month lag. There have been no significant transactions with such subsidiaries during the periods from January 1 to March 31.

Cash equivalents

All highly liquid investments with a maturity at their date of acquisition 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 notes and accounts

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

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.

Other investment securities are stated at cost. The Company periodically evaluates whether the value of 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 condition 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 an impairment loss to the extent of the decline.

Inventories

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

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 are 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 5 to 7 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.

License fees and other intangibles

License fees and other intangibles principally consist of prepaid license fees which are amortized on a straight-line basis over the contract term.

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.

Stock-based compensation

The Company accounts for its stock-based compensation plans under the fair value recognition provisions of Statement of Financial Accounting Standards ("SFAS") No. 123, *Accounting for Stock-Based Compensation.*

Net income per share

Basic net income per share is computed by dividing net income by the weighted-average number of shares of common stock outstanding for the period. Diluted net income 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 the 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 revenue based on each of the underlying revenue 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 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 other comprehensive income (loss), net of tax. Amounts recorded to 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.

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. Simultaneously, the SPEs and others sell an interest in those receivables to a financial institution. 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.

Reclassifications

Certain amounts in the consolidated financial statements for the years ended March 31, 2004 and 2005 have been reclassified to conform to the 2006 presentation.

New Accounting Standards

In November 2004, the Financial Accounting Standards Board ("FASB") issued SFAS No. 151, *Inventory Costs – an amendment of Accounting Research Bulletins ("ARB") No. 43, Chapter 4* ("SFAS No. 151"). SFAS No. 151 amends the guidance in ARB No. 43, Chapter 4, *Inventory Pricing*, to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage). Among other provisions, the new rule requires that items such as idle facility expense, excessive spoilage, double freight, and rehandling costs be recognized as current-period charges regardless of whether they meet the criterion of "so abnormal" as stated in ARB No. 43. Additionally, SFAS No. 151 requires that the allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. This standard has been effective for inventory costs incurred during fiscal years beginning after June 15, 2005 and applied on a prospective basis. The Company adopted SFAS No. 151 effective on April 1, 2006. The adoption of SFAS No. 151 is not expected to have a material effect on its results of operations and financial position.

In December 2004, the FASB issued SFAS No. 123 (revised 2004), *Share-Based Payment* ("SFAS No. 123(R)"). This statement requires all share-based payments to employees, including grants of employee stock options, to be recognized in the consolidated financial statements based on fair values. SFAS No. 123(R) has been effective for the first fiscal year beginning after June 15, 2005. The Company adopted SFAS No. 123(R) effective April 1, 2006. The Company does not expect SFAS No. 123(R) to have a significant effect on its financial position or results of operations.

In May 2005, the FASB issued SFAS No. 154, *Accounting Changes and Error Corrections – a replacement of Opinion of the Accounting Principles Board ("APB") No. 20 and FASB Statement No. 3* ("SFAS No. 154"). SFAS No. 154 replaces APB Opinion No. 20, *Accounting Changes,* and SFAS No. 3, *Reporting Accounting Changes in Interim Financial Statements,* and changes the requirements for the accounting for and reporting of accounting changes and error corrections. SFAS 154 establishes retrospective application, or the latest practicable date, as the required method for reporting a change in accounting principle and the reporting of a correction of an error. SFAS No. 154 has been effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The Company adopted SFAS No. 154 effective April 1, 2006. The Company's results of operations and financial condition is only impacted following the adoption of SFAS No. 154 if and when circumstances exist that requires the application of the standard's principles.

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 ¥117= U.S.$1, the approximate current rate at March 31, 2006, has been used for the purpose of presentation of the U.S. dollar amounts in the accompanying consolidated financial statements.

4. Investments

The summary of marketable equity securities at March 31, 2005 and 2006 which were classified as available-for-sale was as follows:

	Millions of yen			
	Cost	Gross unrealized holding gains	Gross unrealized holding losses	Fair value
March 31, 2005	¥3,976	¥5,908	¥(110)	¥ 9,774
March 31, 2006	**4,231**	**9,670**	**—**	**13,901**

	Thousands of U.S. dollars			
	Cost	Gross unrealized holding gains	Gross unrealized holding losses	Fair value
March 31, 2006	**$36,162**	**$82,650**	**—**	**$118,812**

Proceeds from sales of available-for-sale securities were ¥1,765 million, ¥150 million and ¥395 million ($3,376 thousand) for the years ended March 31, 2004, 2005 and 2006, respectively. Gross realized gains were ¥863 million, ¥112 million and ¥54 million ($462 thousand) for the years ended March 31, 2004, 2005 and 2006, respectively. Gross realized losses, including impairments, were ¥488 million and ¥232 million ($1,983 thousand) for the years ended March 31, 2005 and 2006, respectively.

Investments in equity securities, included in investments, other, with an aggregate carrying amount of ¥462 million and ¥1,277 million ($10,915 thousand) at March 31, 2005 and 2006, respectively, consist of numerous investments in securities of non-public companies. Investments with an aggregate cost of ¥1,277 million ($10,915 thousand) were not evaluated for impairment because it was not practicable to estimate the fair value of these investments and 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.

5. Inventories

Inventories at March 31, 2005 and 2006 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
March 31	2005	**2006**	**2006**
Finished products	¥20,196	**¥18,406**	**$157,316**
Work in process and semifinished components	33,358	**36,472**	**311,727**
Raw materials and purchased components	14,164	**17,647**	**150,829**
	¥67,718	**¥72,525**	**$619,872**

6. License Fees and Other Intangibles

Intangible assets acquired during the year ended March 31, 2006 totaled ¥10,211 million ($87,274 thousand), which are subject to amortization and primarily consist of license fees of ¥9,810 million ($83,846 thousand). The weighted-average amortization period for license fees is approximately 5 years.

License fees and other intangibles subject to amortization at March 31, 2005 and 2006 consisted of the following:

	Millions of yen				Thousands of U.S. dollars	
	2005		**2006**		**2006**	
March 31	Gross carrying amount	Accumulated amortization	Gross carrying amount	Accumulated amortization	Gross carrying amount	Accumulated amortization
License fees	¥19,586	¥(11,322)	**¥13,732**	**¥(4,443)**	**$117,368**	**$(37,974)**
Other	8,571	(6,189)	**6,602**	**(4,295)**	**56,427**	**(36,710)**
	¥28,157	¥(17,511)	**¥20,334**	**¥(8,738)**	**$173,795**	**$(74,684)**

The aggregate amortization expense for the years ended March 31, 2004, 2005 and 2006 was ¥3,861 million, ¥4,403 million and ¥5,560 million ($47,521 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
2007	¥4,103	$35,068
2008	3,649	31,188
2009	1,814	15,504
2010	791	6,761
2011	355	3,034

Intangibles with indefinite useful lives at March 31, 2005 and 2006 were insignificant.

7. Short-Term Borrowings and Long-Term Debt

Short-term borrowings at March 31, 2005 and 2006 were as follows:

	Millions of yen		Thousands of U.S. dollars
March 31	2005	**2006**	**2006**
Unsecured loans, principally from banks, including bank overdrafts (average interest rate of 1.99% in 2005 and 2.43% in 2006)	¥6,257	**¥7,201**	**$61,547**

At March 31, 2006, the Company had unused lines of credit for short-term financing aggregating ¥20,000 million ($170,940 thousand) subject to an annual renewal with commitment fees on the unused portion ranging from 0.13% to 0.14% and ¥12,625 million ($107,906 thousand) with no commitment fees generally with maturities within one year.

Long-term debt at March 31, 2005 and 2006 was as follows:

	Millions of yen		Thousands of U.S. dollars
March 31	2005	**2006**	**2006**
Loans, principally from banks and insurance companies, due through 2008, with interest rates of 0.62% to 4.00% at March 31, 2005 and with interest rates of 0.72% to 5.00% at March 31, 2006:			
Secured	¥ 1,411	**¥ 221**	**$ 1,889**
Unsecured	30,105	**23,435**	**200,299**
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**	**940,171**
	141,516	**133,656**	**1,142,359**
Less – portion due within one year	(8,449)	**(6,471)**	**(55,308)**
	¥133,067	**¥127,185**	**$1,087,051**

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 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 is 130% or more of the conversion price for 30 consecutive trading days.

The Company is required to repay certain medium-term loans, the balance of which was ¥20,000 million ($170,940 thousand) at March 31, 2006, if; net assets fall below ¥150,000 million ($1,282,051 thousand), operating cash flow in the consolidated statements of cash flows would be negative for two consecutive half year periods, or NEC's ownership interest in NEC Electronics Corporation falls to 50% or less or NEC Electronics Corporation no longer is a consolidated subsidiary of NEC. None of the above had occurred as of March 31, 2006.

Property, plant and equipment with a net book value of ¥6,168 million ($52,718 thousand) was pledged as security for long-term debt at March 31, 2006.

The Company has agreements with its banks to the effect that, with respect to all present or future loans with such banks, the Company shall provide collateral (including sums on deposit with such banks) or guarantors immediately upon the bank's request and that any collateral furnished, pursuant to such agreements or otherwise, will be applicable to all indebtedness to such banks.

At March 31, 2006, 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
2007	¥ 6,471	$ 55,308
2008	16,564	141,573
2009	637	5,444
2010	—	—
2011	—	—

8. Pension and Severance Plans

NEC Electronics Corporation and its subsidiaries in Japan have severance indemnity plans and non-contributory defined benefit pension plans, including cash balance pension plans. NEC Electronics Corporation and certain subsidiaries in Japan 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.

In the year ended March 31, 2003, NEC and certain subsidiaries in Japan received the approval of the Japanese government to eliminate future benefit obligations related to the governmental welfare component, or substitutional portion, of the contributory defined benefit pension plans, over which the Japanese government would take responsibility. During the year ended March 31, 2004, final approval was received. The Company accounted for the elimination of future benefits and relief of past obligations with the transfer of assets as the culmination of a series of steps in a single settlement transaction and recognized a net gain of ¥1,874 million. Details of the net gain related to transfer of substitutional portion of employee pension fund liabilities for the year ended March 31, 2004 were as follows:

Year ended March 31, 2004	Millions of yen
Subsidy from government	¥ 28,496
Less: Settlement loss	
Derecognition of accrued salary progression	7,578
Recognition of unrealized actuarial loss	(34,200)
Net gain	¥ 1,874

Since year ended March 31, 2004, NEC Electronics Corporation and certain subsidiaries in Japan have amended the severance indemnity plan by introducing 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. These amendments resulted in decreases in the Company's benefit obligation.

In addition, NEC Electronics Corporation and certain subsidiaries in Japan have amended their defined benefit pension plans and established 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. These amendments resulted in decreases in the Company's benefit obligation.

Most subsidiaries outside Japan 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.

March 31 is the measurement date for the determination of the Company's benefit obligation. Reconciliations of beginning and ending balances of the benefit obligations and the fair value of the plan assets were as follows:

	Millions of yen		Thousands of U.S. dollars
March 31	2005	**2006**	**2006**
Change in benefit obligations:			
Benefit obligations at beginning of year	¥133,320	**¥132,343**	**$1,131,137**
Service cost	6,987	**7,363**	**62,932**
Interest cost	3,333	**3,243**	**27,718**
Actuarial (gain) loss	(2,157)	**1,390**	**11,880**
Benefits paid	(9,140)	**(3,500)**	**(29,915)**
Plan amendment	—	**(3,169)**	**(27,085)**
Benefit obligations at end of year	132,343	**137,670**	**1,176,667**
Change in plan assets:			
Fair value of plan assets at beginning of year	46,836	**53,879**	**460,504**
Actual return on plan assets	4,699	**1,369**	**11,701**
Employer's contributions	5,759	**7,479**	**63,923**
Benefits paid	(3,415)	**(1,156)**	**(9,880)**
Fair value of plan assets at end of year	53,879	**61,571**	**526,248**
Funded status	(78,464)	**(76,099)**	**(650,419)**
Unrecognized prior service cost*	(22,494)	**(23,917)**	**(204,419)**
Unrecognized actuarial loss*	47,461	**45,708**	**390,667**
Unrecognized net obligation at April 1, 1989 being recognized over 17 years	261	**—**	**—**
Net amounts recognized	¥ (53,236)	**¥ (54,308)**	**$ (464,171)**
Amounts recognized in the consolidated balance sheets consist of:			
Accrued pension and severance costs	¥ (76,254)	**¥ (75,761)**	**$ (647,530)**
Accumulated other comprehensive (income) loss, pretax	23,018	**21,453**	**183,359**
Net amounts recognized	¥ (53,236)	**¥ (54,308)**	**$ (464,171)**

(*) Unrecognized prior service cost and actuarial loss are amortized on the straight-line method over the average remaining service period of employees expected to receive benefits under the plan, which is currently 17 years.

The accumulated benefit obligation for all defined benefit pension plans was ¥130,133 million and ¥137,332 million ($1,173,778 thousand) as of March 31, 2005 and 2006, respectively.

The weighted-average assumptions used to determine benefit obligations at March 31, 2005 and 2006 were as follows:

March 31	2005	**2006**
Discount rate	2.5%	**2.5%**
Rate of increase in future compensation level	1.7%–3.8%	**1.7%–3.8%**

The weighted-average assumptions used to determine net pension and severance cost for the years ended March 31, 2004, 2005 and 2006 were as follows:

Year ended March 31	2004	2005	**2006**
Discount rate	3.0%	2.5%	**2.5%**
Rate of increase in future compensation level	1.7%–3.8%	1.7%–3.8%	**1.7%–3.8%**
Expected long-term rate of return on plan assets	4.0%	2.5%	**2.5%**

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

The allocation for the plan assets at March 31, 2005 and 2006 was as follows:

March 31	2005	**2006**
Asset category		
Equity securities	38%	**41%**
Debt securities	41%	**36%**
Short term investments	21%	**23%**

Target allocation of equity securities, debt securities and short term investments is 35%, 45% and 20%, 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, 2004, 2005 and 2006 were as follows:

		Millions of yen		Thousands of U.S. dollars
Year ended March 31	2004	2005	**2006**	**2006**
Service cost	¥ 6,419	¥ 6,987	**¥ 7,363**	**$ 62,932**
Interest cost	5,669	3,333	**3,243**	**27,718**
Expected return on plan assets	(3,098)	(1,200)	**(1,426)**	**(12,188)**
Amortization of unrecognized prior service cost	(782)	(1,759)	**(1,746)**	**(14,923)**
Amortization of actuarial loss	4,678	3,734	**3,200**	**27,350**
Amortization of unrecognized net obligation at April 1, 1989 being recognized over 17 years	259	261	**261**	**2,231**
Settlement loss	26,622	—	**—**	**—**
Net pension and severance cost for all defined benefit plans	¥39,767	¥11,356	**¥10,895**	**$ 93,120**

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

		Millions of yen		Thousands of U.S. dollars
Year ended March 31	2004	2005	**2006**	**2006**
Net pension and severance cost for all defined benefit plans	¥39,767	¥11,356	**¥10,895**	**$ 93,120**
Employees' contributions to the contributory defined benefit pension plans	(553)	—	**—**	**—**
Cost for defined contribution plans	434	704	**975**	**8,333**
Total cost for all defined benefit and defined contribution plans	¥39,648	¥12,060	**¥11,870**	**$101,453**

The Company expects to contribute approximately ¥7,500 million ($64,103 thousand) to its pension plans in fiscal year ending March 31, 2007.

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
2007	¥ 3,600	$ 30,769
2008	4,500	38,462
2009	4,600	39,316
2010	4,700	40,171
2011	4,800	41,026
2012 – 2016	23,500	200,855

9. Income Taxes

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

	Millions of yen			Thousands of U.S. dollars
Year ended March 31	2004	2005	**2006**	**2006**
Income (loss) before income taxes:				
NEC Electronics Corporation and domestic subsidiaries	¥32,083	¥ 8,864	**¥(54,165)**	**$(462,949)**
Foreign subsidiaries	12,306	17,545	**11,779**	**100,675**
	¥44,389	¥26,409	**¥(42,386)**	**$(362,274)**
Provision for income taxes:				
Current:				
NEC Electronics Corporation and domestic subsidiaries	¥15,163	¥ 7,461	**¥ 3,732**	**$ 31,897**
Foreign subsidiaries	1,749	2,869	**5,797**	**49,547**
	16,912	10,330	**9,529**	**81,444**
Deferred:				
NEC Electronics Corporation and domestic subsidiaries	(1,246)	(1,330)	**50,186**	**428,940**
Foreign subsidiaries	1,615	1,714	**(3,549)**	**(30,333)**
	369	384	**46,637**	**398,607**
	¥17,281	¥10,714	**¥ 56,166**	**$ 480,051**

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 42.0% for the year ended March 31, 2004. The Japanese government enacted a change in March 2003 and, accordingly, the statutory tax rate was reduced to 40.5% effective April 1, 2004. A reconciliation between the reported total income tax provision and the amount computed by multiplying the income (loss) before income taxes by the statutory tax rate was as follows:

	Millions of yen			Thousands of U.S. dollars
Year ended March 31	2004	2005	**2006**	**2006**
Expected tax provision (benefit)	¥18,643	¥10,696	**¥(17,166)**	**$(146,718)**
Increase (decrease) in taxes resulting from:				
Changes in valuation allowance	(205)	(1,209)	**72,976**	**623,726**
International tax rate differences	(926)	(392)	**834**	**7,128**
Tax credit for research and development	(1,045)	(373)	**—**	**—**
Undistributed earnings of foreign subsidiaries	1,422	(271)	**(381)**	**(3,256)**
Effect of change in statutory tax rate on deferred tax balances	455	—	**—**	**—**
Non-deductible expenses for tax purposes	109	1,503	**259**	**2,214**
Other	(1,172)	760	**(356)**	**(3,043)**
Income tax provision	¥17,281	¥10,714	**¥ 56,166**	**$ 480,051**

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

	Millions of yen		Thousands of U.S. dollars
March 31	2005	**2006**	**2006**
Deferred tax assets:			
Accrued pension and severance costs	¥29,371	**¥ 29,844**	**$ 255,077**
Research and development costs	6,870	**11,728**	**100,239**
Accrued bonus	5,999	**5,812**	**49,675**
Investments	4,313	**2,073**	**17,718**
Operating loss carryforwards	1,111	**24,760**	**211,624**
Other	9,840	**14,939**	**127,684**
	57,504	**89,156**	**762,017**
Less – valuation allowance	(3,717)	**(74,555)**	**(637,222)**
Total	¥53,787	**¥ 14,601**	**$ 124,795**
Deferred tax liabilities:			
Tax deductible reserves	¥ 2,816	**¥ 7,948**	**$ 67,932**
Marketable securities	2,348	**3,916**	**33,471**
Tax on undistributed earnings	1,780	**3,566**	**30,479**
Other	1,041	**813**	**6,948**
Total	¥ 7,985	**¥ 16,243**	**$ 138,830**

The valuation allowance is primarily related to deferred tax assets of NEC Electronics Corporation and its domestic subsidiaries for which there is uncertainty regarding realization. The net changes in the total valuation allowance for the years ended March 31, 2004 and 2005 were a decrease of ¥2,935 million and ¥1,369 million, respectively. For the year ended March 31, 2006, the net change in the total valuation allowance was an increase of ¥70,838 million ($605,453 thousand) to provide a valuation allowance against all of the NEC Electronics and its domestic subsidiaries' deferred tax assets because of the uncertainty whether it is more likely than not that the deferred tax asset will be realized.

The benefits of operating loss carryforwards for the years ended March 31, 2004, 2005 and 2006 were ¥9,535 million, ¥6,504 million and ¥3,891 million ($33,256 thousand), respectively.

At March 31, 2006, the Company had operating loss carryforwards amounting to ¥76,317 million ($652,282 thousand) of which ¥72,905 million ($623,120 thousand) relate to domestic subsidiaries and will expire during the period from 2009 through 2013. The remainder of ¥3,412 million ($29,162 thousand) relates to a foreign subsidiary with no expiration date.

10. Shareholders' Equity

(1) Retained earnings

The Japanese Commercial Code provides that an amount equal to at least 10% of cash dividends and other distributions from retained earnings paid by NEC Electronics Corporation and its subsidiaries in Japan 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 Commercial Code also provides that to the extent that the sum of the additional paid-in capital and the legal reserve exceed 25% of the stated capital, the amount of the excess (if any) is available for appropriations by the resolution of the shareholders.

The amount of retained earnings available for dividends is based on NEC Electronics Corporation's retained earnings determined in accordance with generally accepted accounting principles in Japan and the Japanese Commercial Code. NEC Electronics Corporation has recorded accumulated deficit and there are no retained earnings available for dividends at March 31, 2006.

(2) Other comprehensive income (loss)

Change in accumulated other comprehensive income (loss) was as follows:

	Millions of yen			Thousands of U.S. dollars
Year ended March 31	2004	2005	**2006**	**2006**
Foreign currency translation adjustments:				
Balance at beginning of year	¥ 4,944	¥ 1,696	**¥ 2,956**	**$ 25,265**
Change in the current period	(3,248)	1,260	**4,757**	**40,658**
Balance at end of year	¥ 1,696	¥ 2,956	**¥ 7,713**	**$65,923**
Minimum pension liability adjustment:				
Balance at beginning of year	¥(34,919)	¥(21,831)	**¥(16,040)**	**$(137,094)**
Change in the current period	13,088	5,791	**1,243**	**10,624**
Balance at end of year	¥(21,831)	¥(16,040)	**¥(14,797)**	**$(126,470)**
Unrealized gains (losses) on marketable securities:				
Balance at beginning of year	¥ 486	¥ 2,957	**¥ 3,450**	**$ 29,487**
Change in the current period	2,471	493	**2,304**	**19,692**
Balance at end of year	¥ 2,957	¥ 3,450	**¥ 5,754**	**$ 49,179**
Unrealized gains (losses) on derivative financial instruments:				
Balance at beginning of year	¥ —	¥ 31	**¥ 26**	**$ 223**
Change in the current period	31	(5)	**(38)**	**(325)**
Balance at end of year	¥ 31	¥ 26	**¥ (12)**	**$ (102)**
Total accumulated other comprehensive income (loss):				
Balance at beginning of year	¥(29,489)	¥(17,147)	**¥ (9,608)**	**$ (82,119)**
Change in the current period	12,342	7,539	**8,266**	**70,649**
Balance at end of year	¥(17,147)	¥ (9,608)	**¥ (1,342)**	**$ (11,470)**

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

	Millions of yen		
Year ended March 31	Before-tax amount	Tax (expense) or benefit	Net-of-tax amount
2004:			
Foreign currency translation adjustments	¥ (3,248)	¥ —	¥ (3,248)
Minimum pension liability adjustment	17,532	(4,444)	13,088
Unrealized gains (losses) on marketable securities:			
Unrealized holding gains arising during period	4,993	(2,021)	2,972
Less: reclassification adjustments for gains realized in net income (loss)	(863)	362	(501)
Unrealized gains (losses) on derivative financial instruments:			
Net changes in fair value of derivative financial instruments	(22)	8	(14)
Less: reclassification adjustments for losses realized in net income (loss)	71	(26)	45
Other comprehensive income (loss)	¥18,463	¥(6,121)	¥12,342

Year ended March 31	Millions of yen Before-tax amount	Tax (expense) or benefit	Net-of-tax amount
2005:			
Foreign currency translation adjustments	¥ 1,260	¥ —	¥ 1,260
Minimum pension liability adjustment	7,713	(1,922)	5,791
Unrealized gains (losses) on marketable securities:			
Unrealized holding gains arising during period	454	(184)	270
Less: reclassification adjustments for losses realized in net income (loss)	376	(153)	223
Unrealized gains (losses) on derivative financial instruments:			
Net changes in fair value of derivative financial instruments	(75)	27	(48)
Less: reclassification adjustments for losses realized in net income (loss)	67	(24)	43
Other comprehensive income (loss)	¥ 9,795	¥ (2,256)	¥ 7,539
2006:			
Foreign currency translation adjustments	**¥ 4,757**	**¥ —**	**¥ 4,757**
Minimum pension liability adjustment	**1,565**	**(322)**	**1,243**
Unrealized gains (losses) on marketable securities:			
Unrealized holding gains arising during period	**3,694**	**(1,496)**	**2,198**
Less: reclassification adjustments for losses realized in net income (loss)	**178**	**(72)**	**106**
Unrealized gains (losses) on derivative financial instruments:			
Net changes in fair value of derivative financial instruments	**30**	**(11)**	**19**
Less: reclassification adjustments for losses realized in net income (loss)	**(89)**	**32**	**(57)**
Other comprehensive income (loss)	**¥10,135**	**¥ (1,869)**	**¥ 8,266**

Year ended March 31	Thousands of U.S. dollars Before-tax amount	Tax (expense) or benefit	Net-of-tax amount
2006:			
Foreign currency translation adjustments	**$40,658**	**$ —**	**$40,658**
Minimum pension liability adjustment	**13,376**	**(2,752)**	**10,624**
Unrealized gains (losses) on marketable securities:			
Unrealized holding gains arising during period	**31,573**	**(12,787)**	**18,786**
Less: reclassification adjustments for losses realized in net income (loss)	**1,521**	**(615)**	**906**
Unrealized gains (losses) on derivative financial instruments:			
Net changes in fair value of derivative financial instruments	**256**	**(94)**	**162**
Less: reclassification adjustments for losses realized in net income (loss)	**(761)**	**274**	**(487)**
Other comprehensive income (loss)	**$86,623**	**$(15,974)**	**$70,649**

11. Stock Compensation Plan

The Company has several stock option plans (the "Plans") approved by the shareholders under which options were granted to directors, corporate officers and certain upper-level employees to purchase shares of common stock. 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, and that the Company achieves certain targets. The options are exercisable over a period of two years commencing two years after the date of grant.

The terms of the options are subject to adjustment if there is a share split or consolidation of shares. The Plans provide 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 stock option activity was as follows:

	2004		2005		2006		
		Weighted-average exercise price		Weighted-average exercise price		Weighted-average exercise price	
Year ended March 31	Number of shares	Yen	Number of shares	Yen	Number of shares	Yen	U.S dollars
Outstanding at beginning of year	—	¥ —	313,500	¥8,990	**302,500**	**¥8,990**	**$76.84**
Granted	316,500	8,990	70,000	7,044	**71,000**	**5,355**	**45.77**
Excised	—	—	—	—	**—**	**—**	**—**
Forfeited	(3,000)	8,990	(11,000)	8,990	**(11,000)**	**8,990**	**76.84**
Expired	—	—	(70,000)	7,044	**(71,000)**	**5,355**	**45.77**
Outstanding at end of year	313,500	¥8,990	302,500	¥8,990	**291,500**	**¥8,990**	**$76.84**
Exercisable at end of year	—	—	—	—	**291,500**	**¥8,990**	**$76.84**

All of the stock options which were granted during the years ended March 31, 2005 and 2006 have expired at the end of each fiscal year because the performance target was not achieved.

The weighted-average remaining contractual life for options outstanding at March 31, 2006 is 1.5 years. The Company recognized ¥247 million, ¥468 million and ¥203 million ($1,735 thousand) of compensation expense for the years ended March 31, 2004, 2005 and 2006, respectively.

The weighted-average fair value per option at the date of grant during the years ended March 31, 2004, 2005 and 2006 was ¥3,150, ¥1,885 and ¥875 ($7.48), respectively. 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	2004	2005	2006
Risk-free interest rate	0.56%	0.34%	**0.16%**
Expected life	3 years	3 years	**3 years**
Expected volatility	52.30%	46.80%	**42.30%**
Expected dividend	0.22%	0.31%	**0.47%**

12. Net Income (Loss) Per Share

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

	Millions of yen			Thousands of U.S. dollars
Year ended March 31	2004	2005	**2006**	**2006**
Net income (loss)	¥28,066	¥16,031	**¥(98,198)**	**$(839,299)**

Year ended March 31	2004	2005	2006
			Number of shares
Weighted-average number of shares of common stock outstanding	116,645,657	123,499,336	**123,499,052**
Effect of dilutive securities:			
Convertible bonds	—	9,761,588	**—**
Weighted-average number of shares of diluted common stock outstanding	116,645,657	133,260,924	**123,499,052**

Year ended March 31	2004	2005	2006	2006
			Yen	U.S. dollars
Net income (loss) per share				
Basic	¥240.61	¥129.81	**¥(795.13)**	**$(6.80)**
Diluted	240.61	120.30	**(795.13)**	**(6.80)**

Certain stock options and convertible bonds are not included in the computation of diluted net income (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 income (loss) per share in the future is as follows.

Year ended March 31	2004	2005	2006
			Number of shares
Convertible bonds	—	—	**11,156,100**
Stock options	313,500	302,500	**291,500**

13. 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. Purchases from and sales to NEC and NEC's affiliates are generally based on market prices. The Company purchases and leases machinery and equipment from NEC and NEC's affiliates based on market prices. 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. 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. The subsidiaries which have an excess of funds provide the funds to NEC's financing subsidiaries and received interest of 0.64% ~ 3.00%, 0.66% ~ 3.75% and 1.75% ~ 4.50% for the years ended March 31, 2004, 2005 and 2006, respectively. The funds provided are included in loans receivable from related party. 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, 2005 and 2006, ¥15,983 million and ¥18,799 million ($160,675 thousand) worth of software and hardware were included in property, plant and equipment, respectively, and ¥2,291 million, ¥1,947 million and ¥2,833 million ($24,214 thousand) of expenses related to the implementation of the system have been charged to income for the years ended March 31, 2004, 2005 and 2006, respectively. Effective April 1, 2003, 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. In addition, NEC Electronics Corporation had forward exchange contracts with NEC. NEC has also provided advertising and other administrative services to the Company. The accompanying consolidated statements of operations included the expenses related to these services.

The Company purchased certain machinery and equipment from a subsidiary of NEC. Since this purchase was a transaction among entities under common control, the Company accounted for this transaction as capital transaction, and recorded a decrease of ¥1,974 million ($16,872 thousand) in additional paid-in capital. As discussed in Note 1, NEC's semiconductor business operations were transferred to the Company. Under the terms of the separation arrangements, any subsequent income tax benefits derived from the assets and liabilities relating to the general-purpose DRAM business (which were not transferred at the corporate separation) are reported as capital transactions. Accordingly, income tax benefits of ¥6,092 million ($52,068 thousand) are reported as an increase of additional paid-in capital for the year ended March 31, 2006.

Transactions with related parties for the years ended March 31, 2004, 2005 and 2006 were as follows:

	Millions of yen		
Year ended March 31, 2004	NEC	NEC's affiliates	Total
Sales	¥10,131	¥95,124	¥105,255
Purchases of components, supplies, and services	2,861	73,025	75,886
Purchases of machinery and equipment	7,609	14,989	22,598
Shipping and handling cost	—	8,896	8,896
Lease payment	4,465	5,326	9,791
Research and development	9,200	3,969	13,169
Advertising cost	—	28	28
Brand fee	2,366	—	2,366
Other selling, general and administrative	9,363	12,090	21,453
Fees for forward exchange contracts	21	—	21
Interest income	—	117	117
Sublease rentals receipt	—	369	369

	Millions of yen		
Year ended March 31, 2005	NEC	NEC's affiliates	Total
Sales	¥ 9,590	¥64,236	¥ 73,826
Purchases of components, supplies, and services	3,056	70,760	73,816
Purchases of machinery and equipment	10,987	25,686	36,673
Shipping and handling cost	—	8,129	8,129
Lease payment	4,036	5,272	9,308
Research and development	8,665	6,579	15,244
Advertising cost	—	32	32
Brand fee	2,682	—	2,682
Other selling, general and administrative	8,840	10,648	19,488
Fees for forward exchange contracts	15	—	15
Interest income	—	48	48
Sublease rentals receipt	—	311	311

	Millions of yen		
Year ended March 31, 2006	NEC	NEC's affiliates	Total
Sales	**¥ 7,201**	**¥54,231**	**¥ 61,432**
Purchases of components, supplies, and services	**3,824**	**59,113**	**62,937**
Purchases of machinery and equipment	**6,972**	**7,965**	**14,937**
Shipping and handling cost	**—**	**7,907**	**7,907**
Lease payment	**4,926**	**4,073**	**8,999**
Research and development	**6,318**	**8,730**	**15,048**
Advertising cost	**—**	**17**	**17**
Brand fee	**4,255**	**—**	**4,255**
Other selling, general and administrative	**9,165**	**10,390**	**19,555**
Interest income	**—**	**76**	**76**
Sublease rentals receipt	**—**	**231**	**231**

Year ended March 31, 2006	NEC	NEC's affiliates	Total
	Thousands of U.S. dollars		
Sales	**$61,547**	**$463,513**	**$525,060**
Purchases of components, supplies, and services	**32,684**	**505,239**	**537,923**
Purchases of machinery and equipment	**59,590**	**68,077**	**127,667**
Shipping and handling cost	**—**	**67,581**	**67,581**
Lease payment	**42,103**	**34,812**	**76,915**
Research and development	**54,000**	**74,615**	**128,615**
Advertising cost	**—**	**145**	**145**
Brand fee	**36,368**	**—**	**36,368**
Other selling, general and administrative	**78,333**	**88,804**	**167,137**
Interest income	**—**	**650**	**650**
Sublease rentals receipt	**—**	**1,974**	**1,974**

14. Financial Instruments

(1) Fair value of financial instruments

The carrying amounts of cash and cash equivalents, notes and accounts receivable, trade, loans receivable from related party, short-term borrowings, notes and accounts payable, trade, accounts payable, other and accrued expenses, accrued income taxes and other current assets and 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, forward exchange contracts and interest rate and currency swap agreements at March 31, 2005 and 2006 were summarized as follows:

March 31	Carrying amount	Estimated fair value	Carrying amount	Estimated fair value	Carrying amount	Estimated fair value
	Millions of yen				Thousands of U.S. dollars	
	2005		**2006**		**2006**	
Long-term debt, including current portion	¥(141,516)	¥(130,156)	**¥(133,656)**	**¥(119,273)**	**$(1,142,359)**	**$(1,019,427)**
Forward exchange contracts	(819)	(819)	**(428)**	**(428)**	**(3,658)**	**(3,658)**
Interest rate and currency swap agreements	175	175	**(16)**	**(16)**	**(137)**	**(137)**

The fair value of long-term debt is estimated using market quotes, or where market quotes are not available, using estimated discounted future cash flows. The carrying amounts and the estimated fair value of investments were disclosed in Note 4. The fair value of forward exchange contracts is estimated by obtaining quotes for futures contracts with similar maturities. The fair value of interest rate and currency swap agreements is estimated based on estimated discounted net future cash flows.

(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.

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.

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, 2006, the forward exchange contracts qualifying as a cash flow hedge will mature within four months.

Interest rate and currency swap agreements

The Company has entered into interest rate swap agreements to manage interest rate risk exposure associated with underlying debt. The Company also entered into currency and interest rate swap agreements to manage both foreign currency and interest rate risk exposures. Certain interest rate swap agreements are designated as a fair value hedge. The interest rate swap agreements utilized by the Company effectively modify the Company's fixed-rate debt to a floating rate for the next two years. These agreements involve 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, 2004, 2005 and 2006.

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. Securitization of Receivables

The Company had several securitization programs under which certain trade receivables were sold, without recourse, to SPEs and others. Simultaneously, the SPEs and others sold an interest in those receivables to a financial institution. In certain securitizations, the Company had retained a subordinated interest.

The Company serviced, administered and collected the securitized trade receivables on behalf of the SPEs and others and the costs and fees of servicing, administrating and collecting were not significant. For the years ended March 31, 2004, 2005 and 2006, the Company had recorded losses of ¥83 million, ¥98 million and ¥18 million ($154 thousand) related to the securitization transactions.

Expected credit loss and discount rate used in measuring the fair value of retained interests at the sale date of the securitization transactions completed during the year ended March 31, 2004, 2005 and 2006 were as follows:

Year ended March 31	2004	2005	**2006**
Expected credit loss	0.0%	0.0%	**0.0%**
Discount rate	1.6%	2.8%	**4.9%**

A summary of cash flows received from SPEs and others for all securitization activities that occurred in the years ended March 31, 2004, 2005 and 2006 was as follows:

		Millions of yen		Thousands of U.S. dollars
Year ended March 31	2004	2005	**2006**	**2006**
Proceeds from new securitization	¥79,093	¥56,699	**¥37,734**	**$322,513**
Cash flows received on retained interests	9,681	10,690	**8,283**	**70,795**

16. Advertising Costs

The Company expenses advertising costs as incurred. Advertising expenses amounted to ¥1,218 million, ¥1,075 million and ¥1,082 million ($9,248 thousand) for the years ended March 31, 2004, 2005 and 2006, respectively.

17. Restructuring Charges

During the year ended March 31, 2006, the Company announced a series of restructuring program consists of closing a prototype line in Japan and a manufacturing plant in Ireland. As a result, the Company recognized restructuring charges of ¥1,683 million ($14,385 thousand). These charges primarily consisted of personnel costs of ¥1,010 million ($8,632 thousand), accelerated depreciation of equipments of ¥669 million ($5,718 thousand), and others of ¥4 million ($35 thousand). Prior to March 31, 2006, the Company had paid other costs of ¥4 million ($35 thousand). At March 31, 2006, personnel costs of ¥1,010 million ($8,632 thousand) are unpaid.

This program is expected to be completed during the year ending March 31, 2007. In connection with this undergoing program, the Company expects to record charges of approximately total ¥6,000 million ($51,282 thousand).

18. 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, were ¥6,581 million and ¥7,207 million ($61,598 thousand) at March 31, 2005 and 2006, respectively. Accumulated depreciation of the leased assets at March 31, 2005 and 2006 was ¥2,431 million and ¥2,761 million ($23,598 thousand), respectively. In addition, the gross amounts of leased assets under capital leases, the majority of which is from NEC Leasing Ltd., included in machinery and equipment, were ¥2,604 million and ¥3,790 million ($32,393 thousand) at March 31, 2005 and 2006, respectively. Accumulated depreciation of the leased assets at March 31, 2005 and 2006 was ¥1,880 million and ¥1,701 million ($14,538 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, 2006:

Year ending March 31	Millions of yen	Thousands of U.S. dollars
2007	¥ 1,858	$ 15,880
2008	1,492	12,752
2009	735	6,282
2010	571	4,880
2011	526	4,496
2012 and thereafter	4,011	34,282
Total minimum lease payments	9,193	78,572
Less – amount representing interest	(1,741)	(14,880)
Present value of net minimum lease payments	7,452	63,692
Less – current obligation	(1,402)	(11,983)
Long-term lease obligation	¥ 6,050	$ 51,709

Rental expense under operating leases was ¥30,471 million, ¥26,598 million and ¥34,798 million ($297,419 thousand) for the years ended March 31, 2004, 2005 and 2006, respectively. The rental expense for the years ended March 31, 2004, 2005 and 2006 included the rental expense of ¥8,598 million, ¥8,416 million and ¥7,799 million ($66,658 thousand) under operating leases with NEC's affiliates, respectively.

Sublease rentals received for the years ended March 31, 2004, 2005 and 2006 were ¥369 million, ¥369 million and ¥363 million ($3,103 thousand), respectively. The sublease rentals received for the years ended March 31, 2004, 2005 and 2006 included the sublease rentals received of ¥369 million, ¥311 million and ¥231 million ($1,974 thousand) with NEC 's affiliates, respectively.

During the years ended March 31, 2005 and 2006, the Company executed sale and lease back agreements for certain machinery and equipment at their net book values. The proceeds were ¥44,480 million and ¥52,247 million ($446,556 thousand), respectively, and the period is 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 ¥128 million and ¥4,251 million ($36,333 thousand) for the years ended March 31, 2005 and 2006, respectively.

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

Year ending March 31:	Millions of yen	Thousands of U.S. dollars
2007	¥19,469	$166,402
2008	14,794	126,444
2009	13,348	114,085
2010	10,946	93,556
2011	1,867	15,957
2012 and thereafter	729	6,231

The Company has several leasing agreements for machinery and equipment which are accounted for as an operating lease. Certain 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 lease term. At March 31, 2006, the maximum amount of the recognized residual value guarantee was approximately ¥22,200 million ($189,744 thousand) and the lease term was one year to five years.

19. Commitments and Contingent Liabilities

Commitments outstanding at March 31, 2006 for the purchase of property, plant and equipment approximated ¥42,200 million ($360,684 thousand).

The Company conducts business activity on a global scale. Such business activities, from time to time, may involve legal actions, claims or other disputes. Although there are various matters pending at any one time, management is of the opinion that settlement of all such matters pending at March 31, 2006 would not have a material effect on the Company's financial position or results of operation, except for the following:

The investigation conducted by the United States Department of Justice ("DOJ") in regard to potential antitrust violations in the U.S. DRAM industry was resolved with respect to NEC Corporation and its subsidiaries, including the Company, by a cooperation and non-prosecution agreement which was entered into between NEC Corporation and the DOJ. However, NEC Electronics America, Inc. is currently subject to the investigations being conducted by the Attorneys General of several states in the U.S. in connection with alleged antitrust violations among the DRAM suppliers. Further, NEC Electronics America, Inc. has also been named as one of the defendants in a number of class action civil antitrust lawsuits seeking damages for alleged antitrust violations, and it, along with NEC Corporation, has commenced settlement negotiations with certain customers to which it has sold DRAM in the past.

In addition, the Company, together with NEC Corporation, is fully cooperating with the European Commission in an investigation of potential violations of European competition laws in the DRAM industry.

Although the outcome of the investigations by the several state Attorneys General and the European Commission, civil lawsuits or the settlement negotiations is not known at this time, the Company has recorded probable and reasonably estimable losses for the civil lawsuits and settlements with the customers in the period ending March 31, 2006.

20. 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, 2004, 2005 and 2006 were as follows:

	Millions of yen			Thousands of U.S. dollars
Year ended March 31	2004	2005	**2006**	**2006**
Communications	¥152,299	¥138,010	**¥107,995**	**$ 923,034**
Computing and Peripherals	138,227	140,941	**126,581**	**1,081,889**
Consumer Electronics	88,294	101,278	**102,639**	**877,256**
Automotive and Industrial	90,707	102,784	**103,780**	**887,009**
Multi-market ICs	79,988	78,575	**69,449**	**593,581**
Discrete, Optical and Microwave Devices	122,095	118,172	**108,701**	**929,068**
Other	40,376	28,254	**26,818**	**229,214**
	¥711,986	¥708,014	**¥645,963**	**$5,521,051**

Sales, which are attributed to geographic areas based on the country location of the Company that transacted the sale with the external customer, geographic profit (loss) for the years ended March 31, 2004, 2005 and 2006 and long-lived assets at March 31, 2005 and 2006 were as follows. 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 of the Japanese Securities and Exchange Law.

	Millions of yen			Thousands of U.S. dollars
March 31	2004	2005	**2006**	**2006**
Net sales:				
Japan	¥426,260	¥407,646	**¥352,875**	**$3,016,026**
United States of America	74,845	79,453	**76,860**	**656,923**
Europe	75,764	79,946	**72,961**	**623,598**
Asia	135,117	140,969	**143,267**	**1,224,504**
Total	¥711,986	¥708,014	**¥645,963**	**$5,521,051**
Geographic profit (loss):				
Japan	¥ 43,266	¥ 12,597	**¥ (51,074)**	**$ (436,530)**
United States of America	4,559	9,650	**7,999**	**68,368**
Europe	2,321	1,851	**20**	**171**
Asia	6,325	9,078	**7,366**	**62,957**
Total	¥ 56,471	¥ 33,176	**¥ (35,689)**	**$ (305,034)**

	Millions of yen		Thousands of U.S. dollars
March 31	2005	**2006**	**2006**
Long-lived assets:			
Japan	¥327,528	**¥283,255**	**$2,420,983**
United States of America	3,852	**4,643**	**39,684**
Europe	3,338	**2,959**	**25,290**
Asia	20,416	**23,718**	**202,718**
Total	¥355,134	**¥314,575**	**$2,688,675**

Transfers between geographic areas are made at arm's-length prices.

Sales to NEC and NEC's affiliates accounted for 15%, 10% and 10% of total sales for the years ended March 31, 2004, 2005 and 2006, 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 42%, 43% and 42% of total sales for the years ended March 31, 2004, 2005 and 2006, respectively. At March 31, 2005 and 2006, the Company had accounts receivable, trade of ¥22,756 million and ¥28,673 million ($245,068 thousand), respectively, from these distributors. In addition, at March 31, 2005 and 2006, the Company had guarantee deposits received of ¥1,502 million and ¥1,530 million ($13,077 thousand), respectively, from these distributors as collateral.

REPORT OF INDEPENDENT AUDITORS

ERNST & YOUNG

ERNST & YOUNG SHINNIHON
Hibiya Kokusai Bldg.
2-2-3, Uchisaiwai-cho
Chiyoda-ku, Tokyo, Japan 100-0011
C.P.O. Box 1196, Tokyo, Japan 100-8641

Tel: 03 3503 1191
Fax: 03 3503 1277

Report of Independent Auditors

The Board of Directors and Shareholders
NEC Electronics Corporation

We have audited the accompanying consolidated balance sheets of NEC Electronics Corporation (the "Company") as of March 31, 2005 and 2006, 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, 2006, all expressed in Japanese 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 the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and 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 at March 31, 2005 and 2006, and the consolidated results of its operations and its cash flows for each of the three years in the period ended March 31, 2006 in conformity with accounting principles generally accepted in the United States of America.

We have also reviewed the translation of the financial statements mentioned above into United States dollars on the basis described in Note 3. In our opinion, such statements have been translated on such basis.

Ernst & Young ShinNihon

June 27, 2006

DIRECTORS, CORPORATE AUDITORS AND CORPORATE OFFICERS

(As of June 27, 2006)

TOSHIO NAKAJIMA
President and CEO

HIDETO GOTO
Executive Vice President and Member of the Board

JUNSHI YAMAGUCHI
Executive Vice President and Member of the Board

YOSHIKAZU INADA
Executive Vice President and Member of the Board

SHUNICHI SUZUKI
Member of the Board

Directors

President and CEO

TOSHIO NAKAJIMA

Executive Vice President and Member of the Board

HIDETO GOTO

JUNSHI YAMAGUCHI

YOSHIKAZU INADA

Member of the Board

SHUNICHI SUZUKI

Corporate Auditors

NORIO TANOUE

KEIJI SUZUKI

YASUYUKI SHIBATA

SHIGEO MATSUMOTO

Corporate Officers

TOSHIO NAKAJIMA

HIDETO GOTO

JUNSHI YAMAGUCHI

YOSHIKAZU INADA

HIROSHI SATO

TOYOZO HOSOYA

KUNIO MORIOKA

MASAO FUKUMA

NOTES

1. Mr. Norio Tanoue and Mr. Yasuyuki Shibata are outside corporate auditors stipulated in Paragraph 16, Article 2 of the Corporation Law.
2. Mr. Shunichi Suzuki, Member of the Board at NEC Electronics Corporation, also serves as Executive Vice President and Member of the Board at NEC. Mr. Shigeo Matsumoto, Corporate Auditor at NEC Electronics Corporation, also serves as Corporate Auditor at NEC.

MAJOR SUBSIDIARIES AND AFFILIATES

(As of March 31, 2006)

Domestic Manufacturing Companies

NEC Yamagata, Ltd.
NEC Fukui, Ltd.
NEC Kansai, Ltd.
NEC Yamaguchi, Ltd.
NEC Kyushu, Ltd.
NEC Semicon Package Solutions, Ltd.
NEC Fabserve, Ltd.

Domestic Sales and Design Companies

NEC Micro Systems, Ltd.
NEC Deviceport, Ltd.

Overseas Manufacturing Companies

NEC Electronics America, Inc.[1]
NEC Semiconductors Ireland Limited
NEC Semiconductors Singapore Pte. Ltd.
NEC Semiconductors (Malaysia) Sdn. Bhd.
P.T. NEC Semiconductors Indonesia
Shougang NEC Electronics Co., Ltd.[2]

Overseas Sales and Design Companies

NEC Electronics America, Inc.[1]
NEC Electronics (Europe) GmbH
NEC Electronics Taiwan, Ltd.
NEC Electronics Singapore Pte. Ltd.
NEC Electronics (China) Co., Ltd.[3]
NEC Electronics Hong Kong Limited
NEC Electronics Shanghai, Ltd.

Semiconductor-related Company

NEC Compound Semiconductor Devices, Ltd.[4]
NEC Compound Semiconductor Devices Hong Kong Limited

1: Manufacturing, sales and design company in the U.S.A.
2: Shougang NEC Electronics Co., Ltd.'s sales division was integrated with NEC Electronics (China) Co., Ltd.
3: NEC Electronics (China) Co., Ltd.'s company name was changed from NEC IC Design Bejing, and sales and design functions were added.
4: NEC Compound Semiconductor Devices was merged with NEC Electronics Corp, effective April 1, 2006.

CORPORATE DATA

(As of March 31, 2006)

Company Name

NEC Electronics Corporation

Established

November 1, 2002

Capital Stock

¥86.0 billion

Major Operations

Research, development, manufacture and sale and servicing of semiconductors, primarily system LSIs.

Employees

23,857 (Consolidated)

Headquarters

1753 Shimonumabe, Nakahara-ku,
Kawasaki, Kanagawa 211-8668, Japan

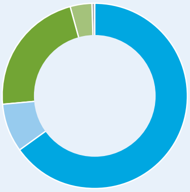
Transfer Agent

The Sumitomo Trust and Banking Company, Limited
Stock Transfer Agency Department:
4-4, Marunouchi 1-chome, Chiyoda-ku,
Tokyo 100-8233, Japan
Postal Address:
1-10 Nikkou-cho, Fuchu-shi, Tokyo 183-8701, Japan
Request forms for change of address, etc.
Toll free (in Japan): 0120-175-417
Other inquiries
Toll free (in Japan): 0120-176-417

Stock Exchange Listing

Tokyo Stock Exchange First Section (code: 6723)

Distribution of Ownership among Shareholders



Other companies	65.2%
Domestic financial institutions	8.5%
Foreign companies, others	22.0%
Individuals, others	3.8%
Securities companies	0.5%

Contact Information

Investor Relations
Corporate Communications Division
NEC Electronics Corporation
Tel: +81 44-435-1664
Fax:+81 44-435-1669
e-mail: ir@necel.com
http://www.necel.com/ir/en/

NEC Electronics Corporation
1753 Shimonumabe, Nakahara-ku,
Kawasaki, Kanagawa 211-8668, Japan
Tel: +81 44-435-5111
http://www.necel.com/

©NEC Electronics Corporation 2006
Printed in Japan

Mixed Sources
Product group from well-managed forests and other controlled sources
www.fsc.org Cert no. SA-COC-1196
© 1996 Forest Stewardship Council
FSC

PRINTED WITH SOY INK™
This annual report is printed with aroma-free soy ink, which has low impact on the environment