Summary Translation of Question & Answer Session at
FY 2017 First Quarter Financial Results Briefing for Analysts

Date: July 27, 2017
Location: Fujitsu Headquarters, Tokyo
Presenters: Hidehiro Tsukano, Senior Executive Vice President & CFO

Questioner A

Q1: *You stated that operating profit in the Services sub-segment had actually increased compared to the same period in the previous year, excluding the impact of the legal dispute. However I think that, in your predictions at the beginning of the year, you thought it would fall significantly due in part to a reduction in deals with major banks. How much have you exceeded your internal projections?*

A1: The results are more or less in line with internal projections.

Q2: *I understand you are undertaking such measures as reallocating personnel, particularly in Europe, but could you please tell us why there was no effect on your first quarter results? Also, could you please tell us when and in what form these effects will appear?*

A2: The expenses associated with this reallocation were recorded in the fourth quarter of fiscal 2016, but the actual resource shift is proceeding gradually. At the same time, when it comes to acquiring new skillsets, it is not simply a matter of gathering together the requisite number of people, so we are carefully selecting people with high capabilities after due deliberation for hiring. Thinking simply just about the numbers of people, we have completed about half of the resource shift. We expect that a little more time will be required before we actually enter full operation and begin to see results. We think that completing the entire resource shift will take until the end of this year. Our expectation for when the effects will be visible in the numbers is in the second half of the year and beyond.

Q3: *How large will the cost improvement effects be in the second half?*

A3: On an operating profit basis, the effects of the improvements will be on the order of 10 billion yen or more, compared to the previous year.

Questioner B

Q1: *Please tell us more about the progress of your business model transformation. What measures have been taken and how much progress have you made in the last three months? Do you expect that you will be able to complete what you planned to achieve by the end of fiscal 2017?*

A1: In the business structure transformation, we are beginning to see the gap between expectations and reality. Our plans for commoditized hardware are about a half a year behind schedule. Our plans for devices are about a year behind. We are working to move ahead as soon as possible, with the goal of finishing by the end of fiscal 2017.

As for the growth strategy transformation, we are taking a variety of measures. We are transforming the organization and changing the skillsets of our engineers both inside and outside Japan, and are working to expand offshoring capability. We feel that the effects of these changes are gradually materializing.

Q2: *On page 27 of the presentation materials, it seems that your operating profit outside Japan has deteriorated significantly compared with the first quarter of 2016. Within that, could you please tell us about the reasons for the deterioration in profit in EMEIA, relating the impact of foreign exchange?*

A2: Our results for EMEIA for the first quarter were down 11.4 billion yen compared with the previous year. This includes the approximately 7.0 billion yen loss associated with the legal dispute, so on a core business basis, it is actually a decline of 4.4 billion yen. We are currently in the midst of reshuffling our skillset, so, from a business perspective, we cannot deny that there have been a few struggles along the way, and that is reflected in that fall of 4.4 billion yen.

Q3: *At the same time, your operating profit has improved significantly in Japan. Could you please explain the background on that?*

A3: Our overall operating profit, both inside and outside Japan, has improved by 18.6 billion yen over the previous year, of which a bit less than 10.0 billion was from inside Japan. For the first quarter, there was a major improvement over the previous year due to Ubiquitous Solutions and LSI devices.

Q4: *Are the effects of changing your skillset in Europe increase in costs, looking only at the first quarter? Is it the plan that it will all turn into increased profits in the second half?*

A4: Ultimately, because we are eliminating 3,200 roles and adding 1,200 roles, at the current stage we expect that, in terms of costs, things will either be flat or go down somewhat. The issue is that, on the earnings side, switching out skills and then immediately contributing to business is difficult. Our current expectation is that it is in the second half that we will overcome this difficulty and start to improve our operations, when this will be reflected in actual numbers such as revenue.

Questioner C

Q1: *You have said that the 7.0 billion yen loss associated with the legal dispute was not part of your forecast, but as you have not changed your target operating profit for the year from 185.0 billion yen, are we right in assuming that this is actually an increase in your operating profit target to 192.0 billion yen? Also, as you have said that this incident was not related to your business model transformation, are we correct in understanding that the difference of your planned 140.0 billion yen in costs and 110.0 billion yen in returns will still be seen going forward?*

A1: This 7.0 billion yen was a special loss. With regard to the forecast of 185.0 billion yen, we are not changing it at present, but we are seeing things somewhat more positively, so we think that for something like this charge of 7.0 billion yen, we believe we will have plenty of chances to make up for it in our core business. Our expectations for returns from our business model transformation are not included in these numbers. We have used more than 80.0 billion yen in expenses up to this point, but as we expect that returns will outweigh expenses going forward, we believe we can sufficiently cover our loss.

Q2: *According to the Fujitsu Data Book, revenue from your cloud business was 315.0 billion yen in the results for fiscal 2016, and your goal for fiscal 2017 is 380.0 billion yen, an increase of about 20%, but what is your current outlook? On the other hand, in your full-year forecasts, you project reduced revenue in infrastructure services. How will the mix of products and services in infrastructure services change? Also, is the profitability of cloud services having a positive effect?*

A2: Fujitsu is using a multi-cloud strategy, where we are able to provide not only Fujitsu's K5, but also cloud services from other companies. The cloud business revenue listed in the Data Book is not only from pure cloud services, but also includes related businesses. The projections for this fiscal year are not bad. It is the case that revenue is forecasted to fall in infrastructure services, but going forward we have the 2020 Tokyo Olympics and the events after that, so we expect that business in Japan will see a steady upward trend of growth. The cloud is like a vessel and we expect to build business applications on top of it, and then digital services on top of those, raising our profit margin.

<u>Questioner D</u>

Q1: *I recall reports in the media that your operating profit forecast for locations outside Japan for fiscal 2017 was 40.0 billion yen. If this was a loss of 11.0 billion yen in the first quarter, what can you do in the second, third, and fourth quarters to achieve this forecast? On top of that, you said that you would be eliminating 2,000 roles, with a positive effect on profits of 10 billion yen or more over the course of the year, but the effect on the first quarter seems small. What are your thoughts on this point?*

A1: With regard to the loss of 7.0 billion yen from the legal dispute, we plan to make up for it as much as possible, and we are considering a variety of measures, including replacing resources and expanding offshoring. As for the point that the effects might be too small, this is not a case where work we already had suddenly disappeared one day and resources were suddenly no longer necessary, so the impact of cost reductions will emerge later. Please consider that it might actually be until fiscal 2018 that we see the full benefit of these changes.

Q2: *What do you currently expect the potential figure for operating profit outside Japan will be for fiscal 2018?*

A2: I think it is really too early to give figures, but I think we will be able to count on beneficial effects, and we expect that the effects of expanding into new business areas with our shifted skillset, as well as the effects of further offshoring, will be even greater.

Q3: *With regard to your network business, how do your first quarter results, particularly in base stations in Japan, compare with your initial expectations? In addition, it is only the end of July, but how are results for the second quarter trending compared to the first quarter?*

A3: The numbers for our network products business by quarter last fiscal year were a significant loss in the first quarter, a more or less equivalent gain in the second quarter, a peak of over 10 billion yen in the third quarter, and an unexpected fall down to about 1.0 billion yen in the fourth quarter. On the other hand, I think the numbers for each quarter in fiscal 2017 will be more or less flat, so compared to the previous year, the first quarter was a significant gain compared to the loss in fiscal 2016, but I expect that there will not be such a huge gap in the second quarter. The third quarter was quite high last fiscal year, so this year's results will probably be down from that, while the fourth quarter was a little low last year, so it is likely to be higher this year. This is how I see things moving. Overall, we do not have very high expectations.

Questioner E

Q1: *Regarding the loss associated with the legal dispute, are we correct in understanding that there will be no new cash outflows associated with it?*

A1: Yes, that is correct. There will be no more cash outflows.

Q2: *In your services business outside Japan, once you have completed the skillset changeover and have the right skills in place, when in fiscal 2018 can we expect to see a stable increase in revenue?*

A2: We are now implementing a changeover in the skillsets of employees, and in order to shift into high-margin services, even if it means the volume of our business in low-margin managed infrastructure services (MIS) slips a bit, we would like to shift our business toward business application services (BAS). It has not yet led to any contribution to profits, but we think revenue should bottom-out in the first half of this fiscal year. It would go against expectations if we did not see an increase in revenue in the second half.

Q3: *Looking at the different regions, do you expect the effects to materialize first in the UK?*

A3: Yes, we expect the UK to lead the way. Still, where we really need to see an improvement is in continental Europe.

Questioner F

Q1: *According to media reports about your Deep Learning Unit (DLU), you plan to use an advanced process node and start shipments in fiscal 2018, but outside of shipments with K5 and*

MetaArc, if outside sales are included, how big a business do you expect this to be, what sales channels will you use, and in which business segments will you book the sales?

A1: We think it is not an exaggeration to say that the DLU's CPU performance itself could achieve the world's most advanced levels of performance. I think its actual performance would be very advanced. We think it would be used in the same way as accelerators from other vendors. In other words, it would be a so-called "co-processor". As for sales channels, we think it would mainly be direct sales, but there are various ways it could be sold. It could be sold as a CPU, it could be sold as an attachment that can be combined with a main CPU, or it could be incorporated into servers, with cloud or other services layered on top, so I think there are a variety of forms the offering could take. We have not yet decided the specifics, but we expect it would mainly be direct sales.

Q2: *With the migration of your internal systems to K5, I think we were told there would be a cumulative reduction in costs of 35.0 billion yen over five years, but in the explanatory materials we received at your presentation last fall, there was little evidence that the cost savings had materialized. When do you expect to start seeing the effects?*

A2: I think there are two components: our own internal usage, and what is delivered to customers. For our own internal usage, the consolidation of our existing system is progressing smoothly, with about 60% of the switchover completed. This will lead to efficiencies, and the effects will ultimately materialize in the form of lower overhead costs.

As for what is delivered to customers, of course we have made progress in Japan, but we have also started expanding sales outside of Japan, as well, although we are still only midway through this process. I think I will be able to talk in terms of numbers starting in the second half of this fiscal year.

<u>Questioner G</u>

Q1: *In your explanation on the "Other/Elimination and Corporate" segment, you said that your next-generation cloud investments have increased, but you have been making these upfront investments continuously for years. When do you expect these investments will peak?*

A1: This year, in particular, we are expanding outside of Japan, and that is the part where costs have increased. Looking ahead, we expect them to gradually come to a peak, and then flatten out, or possibly decline a bit. Looking just at this year, we had to factor in an increase in expenses because of the expansion outside Japan. Still, most of that spending will be finished by the end of this fiscal year.

Q2: *In your network business in North America, you mentioned that there was a delay in launching a new product, but is the delay because of a technical problem, or is it because it is taking time to line up customers? Please tell us the current status and what you expect in the future.*

A2: The new product needs to be somewhat customized for each customer, and it is only after we receive a positive evaluation from a customer that we begin volume production, but there have been cases in which we have not been able to receive approval from customers, causing the schedule to slip. The timing of the launch will depend on whether we can get back on schedule. From a longer-term perspective, we need to shift away from hardware to services or software. The sales of our software-defined networking software products are not yet near a level where we can be satisfied, but the software has been accepted by some major telecom carriers, and we would like to leverage sales of software into a broader business with peripheral services.

Questioner H

Q1: *Please tell us about business conditions in the first quarter in your IT business in Japan's vertical markets, as well as your projections. What are your thoughts about the IT business in Japan in the future?*

A1: Overall, revenue continued unchanged at the same high level as the first quarter of fiscal 2016. Broken out by industry, sales to customers in the manufacturing sector rose 2%, declined 2% in retailing and distribution, declined 2% in financial services, and in Japan, increased significantly in social infrastructure, by 12%, with growth in fixed-line business. Sales to customers in the public and regional sector declined by 5% as a big project in last fiscal year's first quarter ended. Overall, revenue was on par with last year.

Overall, I think our IT business in Japan will remain solid, but it might only grow at a rate of 1-2%. We cannot expect big increases of 3-5%, but up until 2020, or even 2025, we expect our business in Japan to be firm and to grow briskly.

Q2: *In your recent Management Direction Progress Review, we got the impression that you would soon be wrapping up negotiations with Lenovo on PCs, but when do you expect that to happen?*

A2: Originally, completing the entire business structure transformation during fiscal 2016 was the plan in its most ideal form. At present, our plans for commodity hardware are six months behind schedule. One timeline would be to have this completed by the end of the first half of this fiscal year. For LSI devices, one rough estimate would be by the end of March 2018.

Questioner I

Q1: *Earlier you talked about two risk factors, but were you just talking in general terms, or was there something that happened, now that the first quarter is over, to cause circumstances to change?*

A1: I was simply talking in general terms. In addition, we need the self-discipline not to depend on conditions in those markets remaining favorable to us, and that is why we need to solidly raise profits in our core business of Technology Solutions.

Q2: *In your recent Management Direction Progress Review briefing you announced that your operating profit margin would be in the 6% zone in fiscal 2018. I think it was relatively early timing to be making such an announcement, but you have a medium-term target of achieving a 10% operating profit margin, so was this simply a case of working backwards and calculating that you would need to achieve a level of around 6% next fiscal year if you are to reach your medium-term target? Or was it the case that, amid a variety of uncertain factors, you made the announcement to demonstrate management's commitment, including a commitment to reducing expenses?*

A2: By restructuring our business portfolio and implementing various moves, we think we can achieve a margin of around 6%. We can see the scenario, so what is left is the issue of timing. If the operating profit margin remains at 6-7%, we will not suddenly be able to achieve a 10% margin, so we need to formulate further specific measures.