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

Date: January 31, 2018
Location: Fujitsu Headquarters, Tokyo
Presenters: Hidehiro Tsukano, Senior Executive Vice President & CFO

<u>Questioner A</u>

Q1: *How large were the unprofitable projects in Japan and outside of Japan? If we exclude the impact of the unprofitable projects, would your operating income still have deteriorated compared to that of last year's third quarter? You also mentioned that the effects of the business model transformation in your infrastructure services business have been lower than you anticipated, but I would like your views on whether you expect them to eventually materialize, or whether we should not expect anything more.*

A1: Regarding the unprofitable projects, both in Japan and outside of Japan, these were large projects that had not been subject to quality assurance monitoring. In both cases, the size amounts to single-digit billions of yen. However, these are only transitory losses. We have confirmed the losses on all existing projects and have already stemmed the flow of further hemorrhaging. .

Regarding the effects of the business model transformation, there are two reasons why we can expect results. The first is from the reduction in fixed costs that, to a certain extent, we can achieve through the reshuffling of our resources. The other reason is that, by changing our skillset, we will shift our business toward digital services, which are newer services with higher margins. We are seeing real benefits from the use of offshoring, although they are not yet at a level that is entirely satisfactory. At the same time, while we are changing our skillset to win new business in digital services, the uptake has been much slower than we anticipated. For the unforeseen losses in the first quarter incurred from a legal dispute, we had projected an overall rebound in operating profit, including in our business outside of Japan. Please understand, however, because the business overall has been slow, making any rebound difficult, we had to revise our full-year projections in service businesses outside Japan downward in the third quarter.

Q2: *Are we correct to assume that fixed costs are being reduced just as you anticipated?*

A2: From my perspective, there are areas in which we performed insufficiently, but we have achieved some reductions almost exactly as we had anticipated.

Q3: *Can you quantify how many billions of yen in reductions you have achieved?*

A3: The cumulative impact over the first nine months of fiscal 2017 is about 10 billion yen.

Q4: *For the business model transformation expenses, originally you had talked about 140.0 billion yen in costs, offset by 110.0 billion yen in gains. Please tell us what the current status is. With regard to gains from future asset sales, how much do you expect those to be?*

A4: The original 140.0 billion yen in costs and 110.0 billion yen in gains were fairly rough projections, but we put those figures forth to give you some guidance on future developments. While thinking through the overall plan, in fiscal 2015 we started to implement various measures, first incurring expenses through fiscal 2016, and now, in fiscal 2017, we have generated gains from the sales of Nifty as well as from the mobile phone business announced today. When we formulated our management direction in fiscal 2015, we said we would devote all of our management resources into changing our portfolio, with an emphasis on connected services, namely Technology Solutions, as our core business areas. We explained that the Ubiquitous Solutions and Device Solutions areas were being positioned as non-core business areas. At the present time, we have not used up all of the expenses we had budgeted, nor have we yet generated all of the gains we anticipate making. Please understand that, if anything, the gains remaining are larger than the expenses.

Questioner B

Q1: *Regarding your full-year projections for operating profit, when I look at your operating profit targets for the fourth quarter for each segment, it appears that operating profit for Services and System Platforms, which you have just revised downward, must reach a fairly high level if you are to meet your targets. What circumstances make you think you will be able to generate such high operating profit in the fourth quarter? On the other hand, for the "Other/Elimination and Corporate" segment, it appears that you have factored in a fairly large operating loss for the fourth* *quarter. It looks like a loss of around 10 billion yen. Are you anticipating the emergence of certain risk factors?*

A1: Originally we anticipated that operating profit from our core business would be 185.0 billion yen, and that the gains from the sales of businesses would be added on top of that. For the reasons I just explained, however, results from our core businesses have started to deviate from our projections. Still, orders are increasing, and we expect revenue to increase accordingly. If you ask what went wrong, one factor is that we were not able to make up for the losses on unprofitable projects, and another factor is that our network products business has underperformed relative to what were already very low expectations.

If you look at quarterly earnings in our network products business in fiscal 2016, the first quarter was weak, the second and third quarters were very strong, and our expectations for the fourth quarter were way off the mark, with operating profit actually falling. This year, the structure of earnings is almost the complete opposite, and, moreover, the overall scale of the business is below that of fiscal 2016. We expected a big rebound in the fourth quarter of fiscal 2017, but now those expectations have completely fallen apart. Because we were not able to make up for this elsewhere, we decided we needed to revise our full-year projections.

For our Services sub-segment, orders in our core businesses are clearly rising, as are revenues, so we feel confident about being able to generate the over 100.0 billion yen in operating profit and are projecting from Services in the fourth quarter. We realized the need to lower our expectations for network products, and have factored that into our projections. In addition, we have already taken care of the losses from unprofitable projects in Services, so do not anticipate any large impact in the fourth quarter. Our feeling is that 185.0 billion yen in operating profit represents an absolute lower boundary to which we must be faithful.

Q2: *When thinking about your target of achieving an operating profit margin in the 6% zone in fiscal 2018, we have taken into account your operating profit guidance for the full year for fiscal 2017, but when looking ahead to fiscal 2018, I think we need to subtract the roughly 30.0 billion yen in gains you made from the sale of businesses this year. When we do that, for fiscal 2017 your real operating profit margin appears to be* *rather low—around 3.5%-4.0%. Please explain how you plan to get that up to 5.5%-6.0% in fiscal 2018.*

A2: This is something that should be explained by President Tanaka at a review briefing of our management direction, but as I mentioned earlier, the IT market is strong, and we expect it to remain strong over the long term. We have data that supports this view. In this environment, our revenues are steadily rising, and when we consider that the number of vendors able to handle large-scale projects is slightly decreasing, we think our Services business is in a solid position. Furthermore, we need to strictly manage so that no unprofitable projects emerge, but, in any case, we do not intend to take overly optimistic views regarding the risks of any projects, so our understanding is that there is no need to change our basic profit plan.

<u>Questioner C</u>

Q1: *For your financial forecast for the year, you increased operating profit in Other/Elimination and Corporate by 30.0 billion yen, but what does that consist of? If this includes the profit from the sale of your mobile phone business, then if we simply add back in the taxes and expenses to the 30.0 billion yen impact on profit for the period, I believe that would be forty-some-odd billion yen, so it seems to me it must also include some other negative factors. Could you break that down for us? Also, for both Services and System Platforms you have reduced your forecasts by 15.0 billion yen each. In your explanation of your operating profit for the third quarter, you explained that they had each fallen short of their targets single-digit billions of yen, so could you please explain how this15.0 billion yen breaks down between the amount these two sub-segments fell short in the third quarter and the amount you have revised their forecast for the fourth quarter?*

A1: First, we consider 185.0 billion yen to be the bare minimum. Within that, we have announced that the impact of the sale of the mobile phone business on our profit for the period will amount to about 30.0 billion yen. I am sure you can reverse the math and imagine for yourselves the impact on operating profit. In addition to that, we have factored in 30 billion yen in operating losses from the unprofitable projects and other anticipated losses from business risks. Therefore, I want you to understand that this is a stance we are taking to protect our bare minimum forecast for operating profit, no matter what. We also had planned to recover in the fourth quarter some losses we had foreseen in the third quarter, but we determined that this would be difficult, and so we took the view that we should lower the numbers for the fourth quarter by 15.0 billion yen for each sub-segment.

Q2: *What sort of schedule do you envision for the launch of a 5G business at Fujitsu?*

A2: As far as my understanding goes, investments in 5G will begin in the second half of 2019, probably sometime around the end of that year. Also, the initial deployment will be aimed at the Tokyo Olympics, so as we move toward that, any deployment will basically be limited to major metropolitan areas. As we think overall investment will expand gradually over a long period, we do not think we can expect anything major in 2019 and 2020. Moreover, we are bearing in mind that 5G will break down the barriers between industries, and that we will not only have our carrier-focused business, but that we will also have to work on our network integration and network services businesses in non-carrier areas as well.

Questioner D

Q1: *You said that digital services outside Japan did not make the sort of progress you expected in the third quarter, but could you give us some more specific numbers for the scale and growth of digital orders outside Japan?*

A1: Services outside Japan consist of infrastructure services, which we consider a legacy business, Business Application Services (BAS), which is a core business for us in Japan, and digital services, which we are trying to expand on top of these other businesses. We had been trying to expand this new area of digital services, even at the cost of existing legacy business, but the scale of individual deals in this field is extremely small compared to our existing infrastructure services business. The number of deals is starting to increase, but I believe we need just somewhat more time before it becomes something for which we can discuss trends on a quarterly basis.

Q2: *You have reduced your operating profit forecast for your business outside Japan by 15.0 billion yen, but if we understand correctly that about half of that is the impact of the legal dispute that happened in the first quarter, then it sounds like the remaining* *portion of that reduction is due to reasons other than a delay in the startup of this new business. What are your thoughts on that?*

A2: As I said a moment ago, we would like to expand into new areas, even at the expense of existing areas, but when we have a major deal in infrastructure services, we record the total amount of the deal all at once. For major projects, that could be in the double digit billions of yen. We are allowing these legacy deals to become victims, to a certain extent, in order to win market share in new areas with higher profit margins, so if you look just at the immediate situation, the impact of the parts of our business we have sacrificed stand out quite a bit, as we have not been able to cover the gap with business in the new area.

We had planned to also cover the one-time losses that occurred in the first quarter by accelerating business in this new field in the second quarter and beyond, but we were not able to build up to that point.

Q3: *With regard to your business transformation, you undertook that transformation two years ago because your hardware business was in a difficult position, but now after two years it seems your network products business, as well as those of other companies, is also in a difficult position. Could you please tell us about your response to the significant ongoing changes in the business environment for network products, including outside Japan, what the timeframe is for that response, what sort of expenses will be incurred, and what results we should expect?*

A3: In our management direction presentation in fiscal 2015, we had a graphic that showed our vision of Connected Services, with lines labeled Services, Software, and a third line labeled SDx Core Hardware. We have been working along the two major axes of transforming our business structure and transforming our growth strategy, but with regard to structure, our primary efforts have in the areas of Ubiquitous Solutions and Device Solutions. We think of network products not in terms of transforming the business structure, but in terms of taking on the challenge of transforming how we do things and the quality of our growth. We are proceeding with efforts to break free from reliance on hardware in our network products business, and shifting to services and software, but I think the results show that the speed of our progress has been insufficient.

Q4: *Then are you considering incurring expenses to accelerate that process?*

A4: We are taking a wide variety of measures, including some that will incur expenses.

<u>Questioner E</u>
Q1: *Could you please tell us about the degree of progress in your structural transformation at the present time? Should we think of the process as being more or less finished, or should we envision supplemental efforts in fiscal 2017 or even in fiscal 2018?*

A1: In President Tanaka's management direction presentation in fiscal 2015, he spoke about incurring 140.0 billion yen in expenses, with 110.0 billion yen in offsetting gains. These were just rough numbers, but we take the opinion that, in terms of a sense of scale, things have not changed significantly. We frontloaded a significant amount of these expenses in fiscal 2015 and 2016, and while a portion remains, I think I can say that we have passed the halfway point with regard to expenses. At the same time, the offsetting gains for the most part were not realized in fiscal 2015 and 2016. The gain from the sale of Nifty that was realized at the beginning of fiscal 2017 was the first of these offsetting gains. Going forward, we will also have a gain from the sale of our mobile phone business, so I think it is fair to say that we have moved beyond the halfway point.

Q2: *It may be too early to say, but do you have a sense of your forecast for fiscal 2018? In fiscal 2017, given conditions in telecommunications, and also factors such as the gains from the sale of your businesses, it seems like you will not see much of an increase in operating profit in fiscal 2018. Could you tell us about what will contribute to your operating profit for fiscal 2018?*

A2: To begin with, for major projects in Services, fiscal 2017 has been a slack period in the development cycle. In particular, major public sector deals and a major deal in the financial sector passed their peak in fiscal 2016. For the financial sector, the public sector, and for social infrastructure-related deals, excluding network products, major projects will return in fiscal 2018 and beyond, and we have already begun receiving orders, so you could say we are starting to climb the mountain. I think that the market environment supporting these deals is also very strong. Looking at the longer term, 2020 and even 2025, things are definitely trending upwards, so our orders will also certainly trend upwards. In that sense, I think we have a good baseline from which to build.

These details are really something that President Tanaka should address, but with regard to our overall plan, nothing has changed. We are steadily building toward our management goal of achieving an operating profit margin of 10%, with fiscal 2018 in the 6% zone. There is nothing that seems weak, in terms of our core business.

<u>Questioner F</u>

Q1: *In your presentation today, you spoke of being conservative, but could you explain in which areas you are being conservative?*

A1: We are being conservative in our estimates for network products, to the point that we lowered expectations to a level to which we did not actually think things could fall. We are taking the view that, if we see even a small recovery, then even if it is very small it should still raise our operating income beyond our projected level. In addition, we are undertaking measures to rebound in various businesses, and we expect further improvement in our results if we can build something out of those efforts. It is in these sorts of areas that we are taking a more conservative viewpoint.

Q2: *Could you tell us more about the background to the unprofitable projects you mentioned? In your earlier response, you said things about them being outside your quality assurance processes or about them being past projects, but when unprofitable projects are clearly decreasing across the industry as a whole, why have they become so visible at Fujitsu? In addition, for the deals currently on the horizon in Japan, what sort of revenue increases do you expect next year?*

A2: We previously had unprofitable projects in our solutions and system integration business, but our quality assurance capabilities enabled us to limit the losses to a fairly low level. This time, however, we had a significant unprofitable project in infrastructure services, which had previously not been subject to our quality assurance process. I do not remember us ever seeing this sort of significant loss in this area in the past, and this instance was something truly unforeseen, so I would like you to understand that this was an area that was not under careful monitoring. We have extended the reach of our quality assurance process outside Japan, but this was a situation in which we realized that a project we had undertaken some time ago had turned out to be unprofitable. We will be further strengthening our quality assurance capabilities, and the basis for that process will be our way of thinking about profits when the deal is being discussed, so we plan to further strengthen this way of thinking at the review stage. As for Japan, we are still formulating numbers for fiscal 2018 and beyond. Our thought is that if the market grows by around 2%, plus or minus 1% or so, then we would like to produce results 1% above that level. In terms of orders, fiscal 2017 was a slow period for large-scale projects, but significant growth from customers in the manufacturing sector as well as the retailing and distribution sector is partially compensating for that slowdown. If orders from the public sector, financial services sector, and social infrastructure sector pick back up, and if orders from the manufacturing sector and retailing and distribution sector continue their current growth, then I do not think there is any need to be worried about revenue for fiscal 2018.