Summary Translation of Question & Answer Session at
FY 2016 Third Quarter Financial Results Briefing for Analysts

Date: January 31, 2017
Location: Fujitsu Headquarters, Tokyo
Presenter: Hidehiro Tsukano, *Director, CFO*
SEVP, Head of Global Corporate Functions

Questioner A

Q1: *Regarding your guidance for operating profit in the fourth quarter, you explained that there are specific factors causing you to have a conservative outlook, and I think you are forecasting losses for both Device Solutions and Ubiquitous Solutions. For Other/Elimination and Corporate, as well, it appears there will be a loss of around 75.0 billion yen, but I would like you to explain the background in greater detail. I believe that, for next fiscal year, you have an operating profit margin target of around 5%, but if we see similar developments next fiscal year, I think it will be difficult for you to achieve your target. In addition to explaining how conservative these figures are, please also comment on how you are viewing fiscal 2017.*

A1: Regarding the fourth quarter, there are three main factors affecting the figures. The first is PCs. As I explained earlier, because it has been announced that sales of Windows 7 will be terminated, we expect that demand has been pushed up from the fourth quarter, so we have a cautious outlook on figures for the fourth quarter. In addition, components whose prices are denominated in dollars, including such key components as memory and LCDs, are in short supply, and we expect their prices to rise. Accordingly, when we factor in a rise in fourth quarter expenses, we have no choice but to be cautious. The second is mobile phones, and here, too, as with PCs, we expect to face the impact of higher costs for components, and therefore have a cautious outlook. The third factor is business model transformation expenses. We recorded 7.4 billion yen of the 45.0 billion yen in anticipated expenses in the third quarter. For the remaining expenses of roughly 37.5 billion yen, because we have not yet allocated them to specific segments, we have temporarily included them in Other/Elimination and Corporate, but they will be allocated to specific segments as they are recorded. The combination of these factors is causing us to have a cautious outlook for the fourth quarter, but the figures for the other businesses are solidly increasing. Regarding next fiscal year, we just need to steadily execute the plans we have outlined in our management direction. There may very well be differences in how quickly we achieve our goals in comparison to our plans, but as long as we achieve them, we feel our performance figures are sure to rise.

Q2: *With respect to the transformation of your business model, today you announced a reorganization of Nifty Corporation, but please tell us if you have made progress in other areas, or if there are other initiatives you are considering. In such areas as the degree of progress you are making in the PC business collaboration you already announced, or initiatives you are taking in your services business in North America or Southeast Asia, please tell us how your transformation is progressing.*

A2: For Fujitsu Ten and our PC business, rather than characterizing it as a negotiation process, it is more accurate to say that we have reached the point at which we are steadily tying together some loose ends. We think things will have taken shape by the end of this fiscal year. Other than that, while there are a variety of measures we are considering, we are not in a position to comment on them at the present time.

Q3: *Just to confirm, when you said that the roughly 37.5 billion yen remaining in business model transformation expenses is conservative, does that mean that there is a possibility that these expenses will not materialize?*

A3: We have a fairly cautious outlook on the overall figures for the fourth quarter. On the other hand, for the remaining 37.5 billion yen in business model transformation expenses, we would like to make steady progress in our transformation, and that is why we have included that level of expenses in our full-year forecast.

Questioner B

Q1: *You just talked about how operating profit in the third quarter compared with what you had anticipated when you announced your forecast in October, but please tell us how each sub-segment either outperformed or underperformed relative to your plan.*

A1: Overall, in the third quarter we exceeded plans by about 5.0 billion yen. Operating profit in Technology Solutions fell short of projections by 1.0 billion yen. Conversely, Ubiquitous Solutions exceeded plans by 3.0 billion yen. Device Solutions also rebounded, exceeding expectations by 3.0 billion yen, resulting in overall performance that was 5.0 billion yen higher than our plan.

Q2: *Your results in the third quarter leave me with a good impression, but it seems to me that, rather than the results of a business model transformation, it is more because your existing actual businesses performed well. Originally, your total business model transformation expenses were to be 110.0 billion yen, and so far, you are on your way to spending a total of 85.0 billion yen, with 40.0 billion yen in fiscal 2015 and 45.0 billion yen in fiscal 2016, so please tell us again how far along you are in your business model transformation. Is your business model transformation complete by the measures you have announced so far in the areas of PCs, Fujitsu Ten, and Nifty Corporation? Should we anticipate the risk that there may be additional business model transformation expenses in fiscal 2017?*

A2: At the management direction briefing, we said that there would be business model transformation expenses for fiscal 2015 and 2016 of 140.0 billion yen. In addition, we said that there would be an offsetting amount of gains over the two years of 110.0 billion yen. There has been absolutely no change in our transformation scenario, and we are doing exactly what we think needs to be done. Unfortunately, however, as I mentioned earlier, because a variety of stakeholders are involved, there are areas where we are slightly behind schedule. As we explained in our management direction briefing, there are two main types of transformations we are undertaking. One is to transform our business structure, and the other is to transform our growth strategy. Both areas entail expenses, but in both cases positive benefits are sure to follow. There may be timing issues, but the benefits will surely flow. Up until now, we have not been able to point to many gains. Some of these gains will materialize in the fourth quarter, but most will be in fiscal 2017. Because the expenses come first, even if there are leftover expenses that will be recorded in fiscal 2017, there will be offsetting gains. What I want you to pay attention to next fiscal year is the extent to which we are able to grow profits in our core business.

Questioner C

Q1: *Regarding the performance of your Services sub-segment in the third quarter, although revenue from solutions and system integration services rose, it seems to me that there was not a commensurate increase in operating profit in the Services sub-segment. Aside from business model transformation expenses, were there any one-time expenses? Also, please tell us about business conditions in your IT business in Japan's vertical markets, as well as your projections.*

A1: First, for solutions and system integration services, performance has been strong, with new records for revenue every quarter since last year. We did not record any special expenses. Second, our infrastructure services business in Japan has also been performing very well, and, likewise, no unique expenses were recorded. On the other hand, as for our infrastructure services business outside Japan, while we are in the process of transforming it, we still have not seen significant results from these efforts. In addition, revenue is declining because of the impact of foreign exchange movements. Moreover, in the midst of this transformation, while this was not unanticipated, in terms of the way orders are placed, there are places where there is a misalignment between our resources and the business, so the uptake has been somewhat sluggish. This, however, is a temporary phenomenon, and we expect that, either in this fourth quarter or the following quarter, we will achieve alignment, at which time we expect our results to significantly improve.

As for conditions in Japan's IT market, on a revenue basis compared to the same period in the prior fiscal year, in the third quarter sales to customers in the manufacturing sector were flat, and are projected to rise 3% for the full year, down 4% in retailing and distribution in the third quarter, and projected to rise 3% for the full year, down 2% in financial services in the third quarter, and projected to decline by 3% for the full year, up 43% in social infrastructure in the third quarter, and projected to rise 17% for the full year, and up 12% in the public and regional sector in the third quarter, and projected to decline 3% for the full year. Overall, sales were up 10% in the third quarter, and are project to rise 2% for the full year.

Q2: *You are saying that, in the midst of the transformation of your services business in Europe, there currently is a misalignment with the way orders are placed, but what can we expect once this misalignment is eliminated and the transformation is over? Will profitability improve? Or will you be rolling out services for which demand is increasing?*

A2: Up until now, the governance of our business has been handled by our subsidiaries in each country. With the transformation of our business, however, management will be through a cross-functional approach in each country per respective business line, and Sales teams will laterally cover these areas. In terms of transforming our growth strategy, we will shift from infrastructure services toward digital services. Of course, we will pursue both types of business, but we are trying to focus our sales and delivery organizations on digital services, which is a growth area. If we can manage things well, both infrastructure services and digital services will improve, and, in particular, we expect improvements in terms of profits.

Questioner D
Q1: *In the explanation you just gave about your shift toward digital services in Europe, please tell us about the changes you see in the market. There has been a rapid shift toward public clouds in the US, and I get the impression that something similar is happening in Europe, but in the existing market environment, what kind of position are you seeking? Please give us more specifics about your business in Europe.*

A1: In Europe, where Fujitsu is best is in infrastructure services, an area referred to as "slow IT." Although it depends on the customers, contracts are typically renewed on a given cycle, or in other cases, if another vendor is doing some work for the customer, we might replace them, but the competitive environment is becoming more severe. We need to be very careful to win this business. At the same time, in the area of digital business, which is growing at a much faster rate than the market for infrastructure services, we go inside customers to deliver services. We want to focus on this area and grow our business there, and we are moving ahead with initiatives in that area. The way that we deliver services takes the form of orchestration and integration, and because it takes a multi-cloud approach, in Europe we want to leverage our MetaArc/K5 offerings to expand our penetration. We are going after the platform business as well as the applications that run on the platforms. We want to work from our existing base of business in infrastructure services and expand from there.

Q2: *Over the first 9 months of fiscal 2016, it seems that your base station and network products business is doing extremely well. While last fiscal year was extremely rough, this fiscal year the business is doing very well. It seems to me that the market environment has not changed that much, so could you please tell us what is happening now, and what direction it will be headed going forward?*

A2: Looking at just our business year by year, in particular with regard to mobile phone base stations, as you say, fiscal 2015 was moving in the exact opposite direction as fiscal 2016. Fiscal 2016 looks particularly impressive compared with the previous year, but in terms of the actual situation, it is only at a level that is slightly better than average. Rather than fiscal 2015, please look at the movement from fiscal 2014 to fiscal 2016, without being misled by the idea that overall demand should be distributed, but see the whole picture.

With regard to the overall trend, I think that telecom carrier investment in infrastructure hardware is gradually weakening. At the same time, I think that in the world of what is called software defined networking, the trend of software installed on standard servers replacing existing proprietary devices is definitely continuing. I think that a major trigger will be 5G. Going forward, I think difficult conditions will continue for dedicated equipment. For us, we recognize the necessity of shifting to services and software, and the need to make that shift as quickly as possible.

Questioner E
Q1: *You just explained how results for the third quarter exceeded internal expectations, and in the process you mentioned that operating profit in Technology Solutions fell short by 1.0 billion yen, but could you break out whether this was in solutions and system integration services, infrastructure services, or system platforms?*

A1: I said that Technology Solutions as a whole fell short of expectations by 1.0 billion, but the impact of foreign exchange was about negative 2.0 billion yen. At the same time, the actual business was up by 1.0 billion. The Services sub-segment fell short by 5.0 billion yen, most of which was in infrastructure services outside Japan. The negative impact of foreign exchange movements was slight. On the other hand, the core business of System Platforms greatly outperformed expectations, by about 4.0 billion yen. The impact of foreign exchange on this was also small. With regard to the Ubiquitous Solutions segment, sales were strong in our core business. The negative impact of foreign exchange was about 2.0 billion yen, but the actual business was more than able to cover this.

Q2: *It seems like the dent in the Services sub-segment was significant.*

A2: Our business outside Japan was difficult, both in terms of actual business and foreign exchange. As I explained earlier, in order to change our business model, we must walk this difficult road no matter what, as it is a hurdle we must cross. This is as we expected.

Q3: *With regard to your business model transformation, as part of the 140.0 billion yen of expenses and the 110.0 billion yen in gains, by the end of this fiscal year you plan to have recorded 86.5 billion yen, so that leaves 53.5 billion yen. In addition, in terms of gains, I do not know how much profit you will make on the sale of Nifty Corporation, but if we assume it will be between 10.0 and 20.0 billion yen, that leaves about 100.0 billion yen. Will the remainder of these expenses and gains all be carried forward to future quarters?*

A3: Yes, please understand that the difference will be carried forward into the next fiscal year.

Q4: *In the management direction progress review briefing in the fall of last year, you explained that the company's operating profit margin would reach the 5% zone next fiscal year, but does this exclude the carried forward expenses and returns? If these are included, then profits from the returns will be significant, but is the forecast excluding these one-time profits?*

A4: With regard to the goal an operating profit margin in the range of 5%, we are only considering the breadth of our actual business. We are considering one-time expenses and gains separately. In addition, you spoke about the profits from the sale of Nifty Corporation, and we expect the value of the sale to be around the order of 25.0 billion yen, with a gain on the sale of a few billion yen more than 10.0 billion yen. Please understand that this will be included not in this year's figures but in next fiscal year's.

Questioner F

Q1: *In your talk about services, you explained that you have not been able to achieve alignment in the way orders are placed. Does this mean that, rather than situations in which there is a lag because an account manager was transferred as a result of the business transformation process, for example, the form in which the order is placed is what is changing, so that, instead of recognizing revenue altogether, it is split into cloud-based revenue with some portions are deferred?*

A1: I think rather that this is a result of things not going well, and a variety of issues coming up in terms of things like leadership handoffs due to our shifting skillsets. I would like you to understand it as a lag due to things like the changeover from 3,300 roles with skills in previous technology to 1,200 roles with digital services skills.

Questioner G

Q1: *With regard to semiconductors, we speculate that the expansion of dual cameras in smartphones has been the trigger for the ongoing improvement in the business environment. Looking at the roadmap, it looks to be heading in the direction of further miniaturization, but can Fujitsu hold on to its partnerships with customers going forward? Once things move below a 40nm process, what options will Fujitsu have?*

A1: The image sensors in cameras have two components: a sensor component and a logic component. The logic component, as you said, is continuing to miniaturize, including moving from a 40nm process to a 26nm process, and miniaturization may continue further going forward. At the same time, we think that sensors will remain at a specific level. This is an area we are grateful for on the demand side. We are recovering from a temporary reduction in demand, and we think the recovery is spreading not only to smartphones, including dual cameras, but also to a wide variety of areas, such as cars, for example, placing what we think will be a hard floor under demand.

Q2: *It is difficult to get a handle on the reasons Fujitsu might be earning higher profits in fiscal year 2017 and beyond. Compared with when the IT services market in Japan was growing significantly in fiscal 2013-14, can Fujitsu grow its profits in the midst of the current 1-2% growth? At the current stage, looking forward to fiscal 2017 and 2018, can you give us a couple of hints as to what elements of Fujitsu you would like us to look at?*

A2: The answer is different inside and outside Japan. Within Japan, we think that a number of symbolic events, such as the 2020 Olympics, Osaka's bid for a world's fair in 2025—though we do not know about that yet, and the potential entry of casinos into Japan, will stimulate the economy and trigger a number of infrastructure investments. At the same time, our system integration and solutions business has been exceeding past records in sales every quarter, and while I think the common understanding is that the world of this sort of customized system build-out was always going to gradually wither away, in reality it has not faded much at all. The field represented by the so-called cloud is definitely expanding, but the world of customized systems is actually surviving just fine. Rather, I think as large-scale projects increase, the number of vendors in Japan that can handle them is shrinking. Overall demand is also holding strong to some degree, and we are coming to see that it is not as pessimistic a situation as we initially thought. On the other hand, in order to grow further, we must fully expand the area of digital services in Japan represented by AI and cybersecurity. We are still in the investment phase, but I think that we will be steadily increasing our profits in these areas by fiscal 2017 or 2018. On the other hand, outside of Japan, we previously competed only in the area of infrastructure services, but we want to expand to new fields, so we have spent the past two years transforming our business model, changing our skillset and structure to focus more on the customer. In addition, we would like to extend a variety of the expertise, experience, and practical know-how we have in Japan to our locations around the world.

Q3: *Do you mean, then, that changes to sales and cost structure outside Japan will be more easily visible in the numbers, while results in Japan will gradually get better?*

A3: The ICT market in Japan has generally been seen to be growing at a moderate rate of 1-2%, and we think this will continue. Against this background, we are working on a plan aimed at growing at around 3%, though that is just a goal.

Questioner H

Q1: *At the financial results announcement for another company in the same industry yesterday, they explained that the competition in the server business is getting fierce because of a contraction in the market. At the same time, looking at your company's numbers this time, your sales are in line with projections, and you only had a negative impact of about 2.0 billion yen from foreign exchange, so could you please tell us about how you see the environment in the server market?*

A1: We see the server business as firmly transitioning. We want to use technology as a base to protect our position in servers, while expanding it. At the same time, what is happening in the market is that people are not continuing to pursue absolute performance in a single server, but rather there is a trend toward collecting huge numbers of servers that each provide low functionality, but which offer high functionality as a whole. I think that we are seeing a change to the overall market trend.

Q2: *As a follow-up on the impact of the euro/dollar exchange rate, about two years ago, you had a significant loss on hardware in Europe due to foreign exchange impacts. With your business model transformation, you have had expenses but no gains yet, so how much have you changed your structure in the last two years in order to protect yourself against adverse swings in the euro/dollar exchange rate?*

A2: I do not have specific numbers on hand, so this is just an impression, but our dollar-denominated procurement is on the order of hundreds of billions of Japanese yen. The change is against this background, so if you do some calculations, you can envision the impact. Conversely, foreign exchange was not the only trigger for our business model transformation. Rather, we launched our business model transformation in order to shift more toward services, and to thoroughly shift from so-called "slow IT" in infrastructure services toward digital services, which will grow significantly going forward.