

Summary Translation of Question & Answer Session at Briefing for Analysts on FY 2018 Second Quarter Financial Results and Management Direction

Date: October 26, 2018
Location: Fujitsu Headquarters, Tokyo
Presenters: Tatsuya Tanaka, President
Hidehiro Tsukano, Senior Executive Vice President & CFO

Questioner A

***Q1:** The profitability of your business outside Japan has long been weak, and I think that is an issue for you, but are you planning for the operating profit margin for your business outside Japan in fiscal 2022 to be 10%.*

A1 (Tanaka): That is for Technology Solutions as a whole, so we are not saying that the operating profit margin for our business outside Japan will be 10%. We are saying that the weighted average of our business in Japan and outside Japan is projected to be 10%.

***Q2:** When your operating profit margin reaches 10%, do you have a projection for what the operating profit margin will be for your business outside Japan?*

A2 (Tanaka): We are now in the process of putting together detailed plans, but we project that in fiscal 2022 it will be around 13% for our business in Japan and around 7% for our business outside Japan. This is for Technology Solutions, so it also includes hardware.

***Q3:** You did not comment about your network products business in North America, but if you have measures to address it, please let us know.*

A3 (Tsukano): Our network products business in North America is based on the linchpin of optical transmission equipment and the development of software that runs it. We already announced our plan to partner with Ericsson – a wireless company with a very long history and culture as well as technology. On the other hand, while Fujitsu is small-sized in that regard, we do both wireless and optical transmission equipment businesses. Our development partnership will first focus primarily on the Japanese market, but we would like to extend it outside of Japan over time. At that time, we are hopeful that our production facilities inside and outside Japan will be a strength of ours.

***Q4:** In the first quarter of this fiscal year you had one-time gains of around 100 billion yen on the impact of the change in your retirement benefit plan and the gain on the sale of your PC business, but how do you plan to use it in the second half?*

A4 (Tsukano): Although the figures were not definite, we anticipated that there would be a fairly substantial gain from the change in our retirement benefit plan. At the same time that the scale of the gain was becoming clearer, we also began to see the necessity of undertaking the measures we have described in our management direction. We are just at the starting phase now, and specific figures for each of the measures have not been determined, so they will become clearer as we examine them. On the other hand, we now want to take a close look at our core

business, and for that reason we anticipate that we will incur expenses of roughly the same magnitude, offsetting the gains. Step by step we will confirm, and then record the expenses, but our plan is that overall expenses will be roughly the same as the one-time gains or kept at a slightly lower level.

Questioner B

***Q1:** You are projecting an operating profit margin of 5% for fiscal 2019, but what is the projected breakdown between Japan and outside Japan? Also, while they are not on the slide, it appears that you are planning significant improvements for fiscal 2020 and 2021, and so it is difficult to imagine that you will reach 10%. How will you bring about the improvements?*

A1 (Tanaka): We are undertaking a variety of measures, including a large-scale shift in the allocation of our human resources, so we expect that it will take some time for the improvements to materialize, and currently we are being conservative in our projections. Outside of Japan, we will be implementing measures at a variety of locations, and we expect revenue to decline, but we anticipate that we will secure profitability. Including the impact of the measures we are undertaking in Japan, with solid demand we expect revenues to grow. This will be from organic growth.

A1 (Tsukano): Regarding the factors behind the improvement, there are about four elements contributing to higher margins, but all of the improvements will not materialize until the latter half of the period. The first is the closing of the Augsburg plant. In our plan, it will not be fully closed until about the first half of fiscal 2020, and we will begin to see the impact in the second half of fiscal 2020, with a full year's impact in fiscal 2021. The second is the large-scale shift in human resources. While expenses will fall, to shift human resources, around six months of training will be required, and we envision that there will be outside training, so we expect that it will take about a year before those people can fully contribute. We have already started that initiative, but we are not anticipating any significant impact in fiscal 2019, and we expect that we will not see the full impact until fiscal 2020 and beyond. The third is the start of our development partnership with Ericsson in the network products business. In terms of events, the Rugby World Cup in 2019 and the Tokyo Olympic Games in 2020 are approaching, but we are not expecting any major investments in real 5G in fiscal 2020 or before, so we will not see the impact until fiscal 2021 and beyond. Recently, there are rumors that investment will be moved up, but we should not be overly optimistic, so we currently are viewing the situation conservatively. The fourth factor is the reduction in company-wide expenses. We have already started this initiative, and expenses are actually declining, but they have not yet reached our target level, and we do not expect to see the full effects until fiscal 2021 or 2022. Therefore the impacts of these measures will disproportionately materialize in the latter half of the period, so we think the image will be of a more parabolic-shaped trajectory, rather than a straight line from 5% to 10%.

***Q2:** How many employees work at the Augsburg plant, and how large an asset are you recognizing on your balance sheet? Also, you mentioned cutting your number of locations in EMEA in half, but how many locations do you have now, and how many employees? In streamlining the number of locations, does it mean you will simply exit some countries and remain in others, or will you consolidate your R&D locations or manufacturing locations?*

A2 (Tanaka): The streamlining and integration of locations in EMEIA is a plan for the sales locations. As we shift to services business, however, right now our business headquarters get a disproportionate amount of their business in Japan, and we need to correct that imbalance. Of course our business headquarters and R&D unit have operations outside of Japan, but nowhere near enough. When we think about a services business, we need to have a firm grasp of local needs, and then I want us to launch services to meet those needs. For that reason I want our business headquarters and R&D unit to be positioned around the world. That way, just as we do in Japan, I want us to look after our customers with great care and develop high-quality products and services together with the delivery teams and sales teams that are close to the customers. The command posts, however, should be in whatever location is most appropriate, not necessarily Japan. As we collect information from each region, we will develop global products, and the services using those products will be tailored to local needs. For example, for product development in AI, we created a headquarters in Vancouver, and the process for developing technology will have English as its base language, so we will have a diversity of individuals participating in the development team. By doing so, we hope to create globally competitive products that we can then import to Japan.

A2 (Tsukano): Please allow me to refrain from commenting on the specific number of people at the Augsburg plant. The reason is that, while it is a factory in name, not all of the employees are engaged in product development or manufacturing. Some are doing sales or other work. It is not as if everyone there will be made redundant. We now need to move ahead with discussions with the work council, so allow me to refrain from commenting. For EMEIA as a whole, we have about 24,000 employees. It includes everything from India in the east, the Middle East, continental Europe, the UK, Ireland, and all of Africa. In terms of streamlining the number of locations, some locations have several thousand employees, while other may have only one person. It may be more concrete to think in terms of the number of countries rather than locations, but there may be places that are completely shut down, while, for locations that are just handling sales, we may consider handing them over to a third party. It is not a good way of expressing it, but we just want to select and retain the locations where business is good. For EMEIA as a whole, we are doing business in about 40 countries, and what we are thinking now is to exit countries where we have very few people. The scale of our business has nothing to do with it. Regarding the asset size of the Augsburg factory, we have been slowly depreciating it over time, so it is no longer very big.

Q3: Regarding the streamlining of locations in EMEIA, should we understand that, in terms of assets or people, it will not be a big reduction? Or, in monetary terms, would it be better to think more drastically, that half will be cut?

A3 (Tsukano): If we think in terms of sales, countries in which our operations involve a smaller number of employees are where our business is not doing well, and that is where we will be reducing our scale. It is not the case that we will suddenly cut by half.

Questioner C

Q1: What businesses will bring your operating profit margin in Japan up to 13% in fiscal 2022? What businesses currently have an operating profit margin above 10%, and how will they evolve in the future? In addition, for several years we have been hearing about providing services that

increase the sales of your customers, but how large are your sales of such services now, and do they have a double-digit operating profit margin? Also what is the ratio of the sales in your Global Services Integration Business Group?

A1 (Tanaka): What will bring up our margin is the Global Services Integration Business Group, which handles infrastructure services, application development, and operations. Our plan now is to make it stronger. In the system integration business in the past, a request for proposal would be issued in accordance with the customer's needs, and we would provide high-quality development work, services, and operations. On top of that, instead of seeking to increase operational efficiency, customers now are using ICT to make their services more sophisticated, so no request for proposal is being issued like it was in the past. We seek to be a partner to our customers' businesses as ICT professionals, diving more deeply into their business to achieve expansion, and generate synergies with their legacy systems. We are diversifying our sales unit with specialty sales, and putting together optimal teams that will work with our customers. Our system engineering groups will also undertake corresponding shift in their pool of talent. For that reason, we need people who can work with the businesses of our customers at the very top, so we will strengthen our senior-level consulting capabilities. In Japan, by diving more deeply into the businesses of our customers, we want to expand our profits. Also, while I cannot give you specific figures, our Global Services Integration Business Group generates a double-digit operating profit margin, and we want to raise that further.

A1 (Tsukano): If we are talking in terms of Japan alone, our operating profit margin is over 10%, between 10% and 11%. We were speaking earlier about SAP-related services, and it is an area we have hardly touched to date, but we will devote ourselves to it in the run-up to 2025, and we will work to hold down unprofitable projects. Our engineers in Japan, in particular, are multi-talented, and, including in our resource shift, we want to allocate as many of them as possible to the areas where we can make the most money, or where the margins are highest.

A1 (Tanaka): From the perspective of profits, we need to improve our cost-performance. With the use of Global Delivery Centers about which we talked earlier, or by employing agile methods, these are specialized areas, not just simple offshoring, and the development teams supporting them also have specialized capabilities, and with that combination, we want to raise our profitability.

A1 (Tsukano): The sales ratio of the Global Services Integration Business Group is about 30%. It is closest to the Solutions/System Integration sub-segment, and had sales in the first half of fiscal 2018 of 490 billion yen. On the other hand, sales of infrastructure services were 710 billion yen, but that is the combination of Japan and outside of Japan. People say that Fujitsu's moneymaker in Japan is Solutions/System Integration services, but actually our infrastructure services business in Japan also has a high operating profit margin.

Q2: What form do you expect the effects of your efforts to reduce indirect expenses in EMEIA and Japan to take in fiscal 2022, and how big will the effects be?

A2 (Tsukano): We are thinking of things like shifting resources within Japan, moving people from indirect units to consulting, people who have extensive operational experience and

knowledge in areas like human resources, procurement, and accounting, rather than engineering, and who understand how the people using the products will use them. Whether a person is suited for consulting or not, however, depends on the individual. As a company, there are times when you think about wanting to shift about this many people, but it is also possible that there are cases where you cannot shift all of them, and we had the thought that it might be better in that case to have them open up a new path. In part due to this thought, I cannot give any actual numbers.

In addition, with regard to initiatives outside Japan, because the scale of revenue will decrease in the process of consolidating unprofitable locations in some form or another, naturally we will need to condense SG&A expenses as appropriate. This is also under careful scrutiny. Both within and outside Japan, we expect that we will be able to benefit from the effects of these efforts in the second half of 2020 or so. Within Japan, this is a resource shift, so the personnel expenses will not change, but we will be able to include it in business-side costs. We will discuss the scale of these efforts as we go forward, so I cannot give specifics right now.

***Q3:** You have achieved your free cash flow target of 150.0 billion yen, and your balance sheet is in a net cash position, but you have not said anything about how you will apply it. Could you please share your current thoughts on applications of your free cash flow, such as investments in growth, including acquisitions, or shareholder returns?*

A3 (Tanaka): I think that, in principle, we would like to conduct business that reliably produces profits and return a high level of dividends to shareholders. In today's management direction, I spoke about organic growth, and have not mentioned acquisitions, but we are considering acquisitions with the goal of accelerating business. I would like to actively consider companies in businesses where we want to grow, or companies that have technology with extremely high synergies with our technology, regardless of size. In addition to seizing that sort of opportunity, I would like to use this cash to grow our business, including investments in personnel.

Questioner D

***Q1:** I think that your explanation today is somewhat lacking in specifics, but is it the case that the business environment has changed from what you envisioned in April and May of this year, so you could not be specific? Or is this because several of your points, such as closing factories, require some time?*

A1 (Tanaka): I think that, in terms of specific measures toward the goal of concentrating management resources in Technology Solutions, which we set in fiscal 2015, we have already taken the steps of spinning off our Ubiquitous Solutions businesses and LSI businesses as independent businesses, working with appropriate partners. In our business in Japan, we are looking at a variety of changes in the environment, and we set forth this current direction after discussing what we should do to further strengthen ourselves once we have concentrated the management resources in Technology Solutions. If we can reliably execute the measures I spoke about today, I think we can increase both our profits and our market share for our business in Japan. Outside of Japan, there are a variety of issues, and we regret that the speed of our response was somewhat lacking. We have taken a number of measures, particularly in EMEA, and we analyzed the reasons we did not see an effect, and so today I have spoken about

countermeasures aimed at a number of issues that were raised. We have brought forward executive and personnel changes, and we are promptly implementing the new governance structure, in order to be able to move to the execution phase.

Q2: With regard to the numerical goals, you have changed what was previously a company-wide target of an operating profit margin of 10% to a goal for Technology Solutions. In this situation, how will you handle company-wide expenses?

A2 (Tsukano): This target has been set as profit for Technology Solutions and reflects the Other/Elimination and Corporate expenses in those figures.

Q3: You said you will be joining with Ericsson for 5G, but where are the benefits in terms of financial performance in joining with Ericsson for the mobile base station business in Japan?

A3 (Tsukano): Going forward, to meet all of a carrier's needs, it will not be possible for a single company to incur those development expenses and cover everything. By joining with Ericsson, we can concentrate resources on our own strengths, without trying to cover everything alone. Our dream would be to continue to expand together further and further, not just in Japan, but outside the country as well. In addition, as Ericsson is a company that is also working on IoT, we expect that we will also be able to do a variety of things together in that area, as well.