Summary Translation of Question & Answer Session at the FY 2019 Management Direction Briefing

Date: September 26, 2019
Location: Fujitsu Headquarters, Tokyo
Presenters: Takahito Tokita, President and Representative Director

Questioner A

Q1: *With regard to your management goals, you have said that you want to increase your revenue from digital, but how are you defining digital here? Also, how do you plan to increase revenue?*

A1: What we are defining as the digital field includes not only digital solutions for transforming the ways our clients connect with customers, but also modernizations aimed at digital transformation. I would like to set out and manage indicators that will clearly show the growth of this segment going forward.

Q2: *In terms of actual business, how are you counting the digital field within services?*

A2: I think that we need to have ongoing discussions from here on about the divisions between digital transformation and previous forms of IT. In broad strokes, we will be mostly dividing it into the parts that are digital transformation, broadly defined, and the parts that are extensions of our existing SI business, such as maintenance services, for example. We would like to continue to gradually subdivide this further going forward.

Q3: *You have said that you are aiming for revenue of 300 billion yen with your new digital transformation company, but is this what will be supporting that increased revenue? What are your thoughts on profitability here?*

A3: In terms of increased revenue, you are correct. With regard to profit margins, I will refrain from comment at this time, but at the very least, we are aiming to build a business that is more profitable than our existing SI business.

Q4: *You have increased your target revenue for fiscal 2022 from 3,150 billion yen to 3,500 billion yen, but did you change this level in light of the current external environment, or because your internal transformations are going well? Have you gained some confidence that you will be able to surpass the numbers the company set out last year? Please tell us why you increased these target values.*

A4: It is both. In light of these facts, both that the recent business environment has changed significantly, and that our internal structure is falling into place, we raised our target values.

Questioner B

Q1: *In order to achieve an operating profit margin of 10% in fiscal 2022, you will have to increase your operating profit by about 200 billion yen over three years, so how will you achieve this? Could you please break that down by specific items? Also, please tell us how much will be due to business expansion and how much will be due to cost reductions.*

A1: First, I think it will be necessary to push ahead with even further cost reductions in our Services business in Japan. Compared with our competitors, we are behind in structural reforms relating to our delivery structure, which will lead to cost reductions, as well as our offshoring ratio. We expect profit improvements of about 70 billion yen from both pushing further in our use of offshoring through our Global Delivery Centers, and from our efforts to improve productivity using technology, through measures such as automation in system integration. In addition, we are expecting revenue from business outside Japan of about 1 trillion yen, so if we consider our target operating profit margin of 7% for that revenue, we expect an increase of about 60 billion yen in profits from the current level. With regard to Network Products, we expect improved profits of 20 billion yen from both business expansion and structural transformation, while in our new business of digital transformation, we plan to generate about 50 billion yen in profit, based on a high profit model in light of the high added value of the business. Moreover, by reducing expenses from Other/Elimination and Corporate by 30 billion yen, we will make improvements to our expenses. If you add all of that up, you get over 200 billion yen. Of course this plan involves many extremely difficult challenges we will have to undertake, but that is why we are putting our internal structures in order, so I appreciate your understanding with regard to these goals.

Q2: *You have three and a half years from now to achieve these goals, so what sorts of steps will you be taking to expand your profits? Your current profit is about 150 billion yen, and to go from there to 350 billion yen is more than double. Will your profits primarily increase in the last two years, or is it already visible in some way now, and should we expect an increase of about 70 billion at this pace in FY20, with the growth in profit more visible early on?*

A2: To be honest, a great deal relies on the degree to which the new company specialized for digital transformation is able to expand in this new field. At the moment, there are increasing calls in Japan for modernization in preparation for digitalization. In that sense, we feel that we are already on an upward trend, or rather that this is an environment that can generate a positive cycle, so we are not assuming that there will be a sudden and dramatic profit growth at the end. As I said earlier, however, I think that everything may depend on how this new company, which will be established after January of next year, is set up, and to what extent it is able to drive the digital transformation field.

<u>Questioner C</u>
Q1: *Listening to you speak about the new digital transformation company, it sounds like the relevant personnel will not be doing their previous work, but will instead set out to acquire new business. In some cases, I think they may not initially generate profits while still generating overhead costs, so please tell us about how you will build out this new company.*

A1: The new digital transformation company will start with about 500 people, and the base for that will be employees from Fujitsu itself, including Sales, SE staff, and team members involved in software development, data business, and AI business. On top of that, the company will consist of consultants at the Fujitsu Research Institute who have been responsible for the consulting business. We consider that they will be a team that will fundamentally focus on new business and reaching customers we have not been able to reach previously. We will make sure that this new business will not hamper our existing business.

Q2: *Please tell us about the 500 billion yen of investment over five years. For example, could you give us a sense of how things would break down if you split investments from periodic expenses? Also, how much have you invested under those same definitions in the last three years?*

A2: Of the 500 billion yen of investment, about 200 to 300 billion yen will be fresh spending, which we will invest in the digital field and in internal transformation. Of that, we would like to spend a little less than 200 billion yen in the digital technology field, and 40 to 50 billion yen on things like internal transformation and personnel training.
On the other hand, we will continue to push forward with reducing expenses in Other/Elimination and Corporate, from the current level of about 100 billion yen to 60 billion yen.

Q3: *Please tell us what your target dividend payout ratio is, or when you expect to be able to conduct stock buybacks. Also, you have a goal of free cash flow of over 150 billion yen, but with the change to the lease accounting standard, I believe that you have had a technical increase of about 50 billion yen, so is this goal predicated on that change?*

A3: We have been aiming to provide stable dividends for some time and our dividend payout ratio is at 30% which we understand to be a common level. We would like to take into to consideration the overall situation of the company first and then make decisions on carrying out stock buybacks, but the size of buybacks is not something I will be able to comment on today.

We would like to take into to consideration the overall situation of the company first but our goal for free cash flow is a level over 150 billion yen - a target that hasn't changed.

<u>Questioner D</u>
Q1: *With regard to the 500 billion yen in investment, please tell us what we should expect each fiscal year in terms of numbers.*

A1: While the value will change somewhat each fiscal year, please think of it as being the average figure of about 100 billion yen per year.

Q2: *You explained that one of your financial goals is to have a stable financial foundation suitable for a company that supports social infrastructure, but at the same time, you have removed "shareholders' equity ratio of 40%" from your KPIs. Please tell us about your way of thinking about that.*

A2: Our way of thinking is that we will conduct things like investments in growth and shareholder returns in a well-balanced way, thereby securing an appropriate shareholders' equity ratio.

Q3: *You have set a goal of increasing profit from Services by 70 billion yen by fiscal 2022, but should we understand that you mean services in Japan? Also, could you please tell us which one of the items you mentioned in your explanation, such as offshoring and automation using technology, will contribute most to this increase?*

A3: The increased profit of 70 billion yen is for services in Japan. The greatest contributor will be expanded use of offshoring. We are also continuing to push forward with policies to improve productivity with tools, but we will really have to reduce our subcontracting expenses somehow, and, as I must say we are being left in the dust by our other competitors in terms of offshoring ratios, this is really where we would like to focus even more heavily.

<u>Questioner E</u>
Q1: *You have said that with this new digital transformation company, you will particularly strengthen your consulting, but there has been talk of that for some time, such as for example with Fujitsu Research Institute or with things like your field innovators, but from the outside, it really does not look like this has really stood up on its own yet. What has been the issue, and why are you assuming this new company will be able to stand up on its own? Could you tell us what has changed?*

A1: We have been working on training consultants for some time. We also consider that our field innovators have brought certain definite results to our business. Up to this point, however, our consulting business and the system integration business, which is positioned below consulting, have been organizationally separate, and in the midst of the demands of the digital wave, I think we have not been able to deliver sufficient value with the speed that customers are demanding. With the new company, it will become possible to not only provide consulting, but to deploy technology as well in a one-stop service model. In addition, for the new company's processes and the technology it uses, we will be able to deploy institutional design and systems focused on accelerating digital transformation, so because it will not have the organizational issues that have become factors in limiting speed, we expect the new company to be able to start with the potential to accelerate.

Q2: *You explained about your supercomputer business earlier, but while Fujitsu has been handling all types of hardware, from mainframes to x86 servers, has there been a change in the overall direction here? Or do you plan to continue in this way?*

A2: Fugaku is a supercomputer that is built on a different architecture than the previous K computer. The PRIMEHPC FX1000 and FX700 are based on the same architecture, so we have launched them as new products. There are many reasons for the change in architecture, but one of those is because this is an architecture that can support the use of certain types of applications and software that have become standard in the industry. In particular, we have an architecture that is suited for artificial intelligence digital technology, which is expected to be used in the future. We expect that a variety of research institutions may use these alongside the use of Fugaku, and we consider that these products might form the infrastructure that will bring computing power that will deliver significant results in a variety of fields and industries, within the bounds where supercomputers can reach. They are not being offered as stand-alone hardware, but alongside services, and we hope that they will be used in a variety of fields. At the same time, we introduced these products with the understanding that competing with just stand-alone hardware makes for an extremely difficult business environment.

Q3: *For your business outside Japan, you said that you seek to achieve an operating profit margin of 6-7%. When your business is still not improving, it is difficult to see how you will stop the decline in revenue and raise profitability. I would like you to comment on the pathway over the foreseeable future of the next 3-4 years, and how the business will change to enable you to maintain revenue of 1 trillion yen.*

A3: We initiated this first with Northern & Western Europe (NWE), where we merged its delivery organization into the Global Delivery Center (GDC). As the same time, we split off Central & Eastern Europe (CEE). Those two regions have quite different characteristics. The core of NWE consists primarily of the UK and Ireland, an area where our services business is already strong. By contrast, the core of CEE is Germany, an area that is focused on hardware products. We had grouped those two areas together, but now we have separated them, enabling us to manage each region in accordance with its characteristics. For NWE, we integrated it into the GDC, and our aim here was to address the cause of the time delays in our delivery structure compared to our competitors, which was due to the ratio of our offshoring work, so we implemented the current scheme to accelerate the creation of an organization that can handle delivery on a much more cost-competitive basis, utilizing more off-shore capabilities. To get CEE out of the extremely severe circumstances of the hardware product business, we are implementing structural reforms and shifting our business toward services. We are still in the early stages, but we are using the example of NWE as a reference point in shifting our business toward services. In the Americas region, as well, we are trying to change to a structure in which there is alignment with the GDC. We will expand the same initiatives to all regions. The management line is under the direct control of headquarters. We have switched to an organization in NWE in which the industry expertise of Fujitsu in Japan can be utilized, and we are hoping this will produce results.

Questioner F

Q1: *To enable your business outside Japan to reach a profit level of 60-70 billion yen, will additional restructuring costs be required? Will you be able to keep the structural reform expenses for your business outside Japan within the 15 billion yen that are planned for fiscal 2019?*

A1: At the present time, we are not considering any major restructuring costs, and we plan to keep the costs for fiscal 2019 within the 15 billion yen we budgeted.

Q2: *When imagining how Fujitsu will look in fiscal 2022, can we assume that everything besides the Technology Solutions segment, such as the Device Solutions segment, will be completely eliminated? Or have you not yet decided on a specific timeline?*

A2: We have not changed our directional intent for any of our businesses outside of Technology Solutions. We are making steady progress. There are some things that are beyond the control of both sides, so there are some parts for which we are not at the stage at which we can make a commitment. Therefore, I will refrain from talking about timing, but there has been no change in the direction of our intentions.

Questioner G

Q1: *You mentioned in your presentation that you have had difficulty in generating added value for customers with your technology, but could you explain again why that has been the case?*

A1: In our Services business in Japan, particularly our system integration business, we have had a very strong vertical structure for each industry, and for stand-alone business we were able to mobilize that strength for each industry. In the digital era, in which customers are working to create their own ecosystems, we are no longer able to generate significant growth in our business with a services structure in which technology is provided to just one industry vertical in isolation of the others. It turned out that we needed an organizational formation in which we were able to take a cross-industry approach in providing services.

Q2: *In seeking to expand the staffing of your GDCs to 20,000 people, I think that represents an increase of around 8,000 people from current levels, but does this mean you will increase the number of partnerships you have? How much of an investment will this entail? Which regions do you particularly want to strengthen?*

A2: Right now we have a little over 14,000 people in our GDCs, and all are Fujitsu employees. India is the largest, and we will have 20,000 people across eight countries, including Poland, Portugal, and the Philippines, but they will all be hired as Fujitsu employees. At this moment, I will refrain from disclosing the cost of the added employees.

Use on the part of Europe is biggest in India, and Japan's use of India and the Philippines is growing. We have positioned India as our solutions hub for ERP business, with the Philippines positioned as a sub-center. Each of the GDC centers has its own strengths, and we are having them function as solution hubs. We are building an organization with globally uniform offerings and delivery capabilities.

Q3: *Are you considering a strategy in which you would expend costs to increase the number of your partners?*

A3: Already in Japan we are supported by many partners. In our digital business, as well, we expect to work in collaboration with many partners. At this time we are not considering measures in which we would bear special costs to increase the number of our partners. We already have very many capabilities.

Questioner H

Q1: *In your business outside of Japan, you will close unprofitable locations, and the scale of your revenues will decline, but you expect revenue to be about 1 trillion yen in 2022, with higher profitability. Please tell us the factors that will raise profits.*

A1: In our business outside of Japan, our major revenues and profits stem from what we call "global accounts," which are large corporations and government customers. In this business, while we will continue to provide services as well as needed hardware products, we will increase profitability by changing our delivery structure. It is true that we will close some of our sales locations for our hardware business, but none of these locations has been generating significant revenues and profits, so closing them will not represent a big loss. Europe and the US are ahead in terms of modernization and hybrid cloud business, and it is our understanding that this business will continue to expand, so if we maintain strong services and delivery organizations, we think we can get new business opportunities.

Q2: *Is the strengthening of your global delivery organization your main improvement factor? Some of your competitors have offshore organizations of 100,000 to 200,000 employees, so when you expand your from 10,000 to 20,000, how much of a competitive advantage do you think you can secure?*

A2: It is true that we have competitors whose scale of offshore resources is on the order of 100,000 employees. On a global basis, however, the scope of our offshoring organization is limited, so, even with an organization of 20,000 employees, I think we can create a delivery structure that is sufficiently cost competitive. One problem is the balance of onsite versus offshore employees, and this is where we are still weaker than our competitors.

Q3: *Earlier you explained that, to lower costs in your system integration business in Japan, you would increase your offshore work across the entire system lifecycle, but why were you not able to do that before now, and why will you now be able to do it?*

A3: For our business in Europe and the US, the ratio of the work done offshore is just 30%, whereas it is 70% for our competitors. That is how large the structural gap is in offshoring. For our business in Japan, the ratio of the work done offshore might not be even 10%. For several years now, we have been working to expand offshoring, and we have strengthened cooperation with partners in Japan. While working to change the division of roles and responsibilities, we have been changing the structure to enable the mobilization our respective strengths, and we have been increasing the work performed outside of Japan where we could. The biggest barrier, however, has been in the mentality of the engineers as well as in the ways they communicate. Even though they are all Fujitsu employees, there were difficulties in communication between engineers in Japan and engineers outside of Japan. Of course, language issues were a major factor, but, as I mentioned earlier, there were also differences in the personnel systems, including the systems for performance evaluation. In that sense, a big problem was that we had not built a globally uniform management organization. In each area, such as quality assurance or development processes, we are making progress on initiatives to either have things done globally as they are in Japan, or to have Japan switch to the way things are done outside of Japan. Whether we can accelerate that process is the biggest key to whether we will be able to improve the cost competitiveness of our services in Japan.

Q4: *Do you have a budget in mind for acquisitions?*

A4: We are continuing to think about acquisitions. We are looking for acquisitions that would make a significant contribution to the areas we want to grow. We are looking both in Japan and outside of Japan. That said, at this point we are not considering any large-scale acquisitions.

<u>Questioner I</u>

Q1: *In your business outside Japan, the business models are different, the languages are different, and your performance has been difficult, so I can imagine that it is very difficult to manage this business. You said you have not set a framework for M&A. From an investment perspective, however, I think it would be more efficient to simply sell your assets outside Japan, and use the cash to invest in your business in Japan. Have there been any internal discussions about taking such a drastic action? You spent two years outside of Japan, so you have seen for yourself, but now that you have become president, is there no chance of considering such a big change?*

A1: I fully understand the issues you have just raised. We are putting all of our options on the table and are discussing them. For our business outside Japan, my view is that the level of involvement of Fujitsu's headquarters has been much too low. Now we are rebuilding management lines and reporting lines to strengthen the management role of Fujitsu from Japan, and first I want to see what effect that has on raising our performance. For our business outside Japan, we have put drastic options on the table and are discussing them.

Q2: *I would like you to tell us about potential sales of certain assets you have, specifically three types of assets. The first is your cross-shareholdings. Looking at your financial statements, the balance of these shareholdings has been reduced, but do you plan to move towards eliminating them? The second category includes subsidiaries and affiliates such as FDK, Shinko Electric, Fujitsu General, and Socionext. What do you plan to do with these consolidated subsidiaries and equity method affiliates? The third is your Mie Plant, for which I think negotiations are still continuing. I think the deadline for the negotiations is October 1, but can you give us an update on the status of your negotiations?*

A2: For our cross-shareholdings, there has been no change in our stance of following the Corporate Governance Code. As you mentioned, from the end of fiscal 2018, when we had share in 402 companies, we now have shares in 320 companies. From the same perspective, there has been no change in our posture of determining upon careful examination whether to continue to hold them. On the second point, at the present time there has been no change in our posture with regards to companies such as Shinko Electric and FDK, so it remains as we have explained in the past. With regard to the Mie facility, our counterparty issued a press release yesterday, so please read it.