Fujitsu Limited

Summary Translation of Question & Answer Session at FY 2006 First-Half Financial Results Briefing for Analysts

Date: October 26, 2006
Location: Fujitsu Headquarters, Tokyo
Presenter: Masamichi Ogura
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Mr. Kawada, Mizuho Securities: *Operating income for the first half was 30 billion yen above your initial projections, yet you are not making changes to your full-year projections. What factors have caused you to effectively lower your projections for the second half by 30 billion yen?*

Mr. Ogura: Business for Systems Platforms is typically concentrated in the fourth quarter; the market for Ubiquitous Product Solutions is subject to considerable fluctuations; and we see some weakness in customer trends in our Device Solutions business between the summer and the year-end holiday sales season, though we do not expect this to persist. Considering all these factors, we do not see reason to increase our projections for the full year.

Mr. Kawada: *Could you please explain the results for the PC business in the first half and your projections for the full year?*

Mr. Ogura: Of the 19.9 billion yen in operating income for Ubiquitous Product Solutions recorded in the first half, PCs and mobile phones accounted for about 16 billion yen and HDDs accounted for about 4 billion yen. Of the 30 billion yen in operating income projected for the full year, we expect PCs and mobile phones to account for roughly 25 billion yen and HDDs account for about 5 billion yen. This figure for HDDs may appear conservative, but in light of the difficulties in forecasting market conditions in the second half, this is our view at the present time, and so we are maintaining our projections.

Mr. Izumi, JP Morgan Securities: *Could you please explain the reasons for the change in your method of allocating operating expenses? I understand that it is intended to further the independence of various business units and provide them with a greater sense of responsibility, but going one step further, do you intend to move to a holding company structure?*

Mr. Ogura: The change primarily involves the allocation of expenses for headquarters staff. Basic research costs for the entire company, expenses incurred by staff whose work concerns overall corporate strategy, expenses of teams dealing with company-wide IT resources, and expenses associated with internal control and employee training are all considered headquarters expenses. Apart from these sorts of Group-wide expenses, we have decided to allocate to each business segment the fair share of headquarters expenses that each business unit in that segment would otherwise incur if it were to operate as a separate company.

Even if we were to move to a holding company structure, there would be no change in our approach to the allocation of operating expenses.

Mr. Wakabayashi, Finnoweb Investments: *If you were to change to a holding company structure, how would that affect subsidiaries whose results are included in your consolidated results?*

Mr. Ogura: We are not yet thinking of changing to a holding company structure. Nor have we made any concrete decisions on how we would handle publicly listed consolidated subsidiaries.

Mr. Izumi, JP Morgan Securities: *Your full-year projections for operating income have not changed overall, but there seems to be a decrease of 10 billion yen for Technology Solutions and 5 billion yen for Device Solutions. What is the reason for this?*

Mr. Ogura: This is simply due to the change in allocation of operating expenses.

Mr. Matsuhashi, Goldman Sachs Securities: *Could you please explain in quantitative terms the status of orders for Solutions/SI business for the first half and your projections for the second half by industry segment?*

Mr. Ogura: Looking at the overall picture, there was a year-on-year increase of 1% in the first half, and we foresee a 2% increase for the full year. Orders from financial services and public sector customers are relatively good.

Orders in the manufacturing and retail sectors were down 4% for the first half and are expected to increase by 5% in the second half, resulting in a projected 1% increase for the full year. With respect to first half manufacturing sector orders, please note that we had particularly strong orders in the first half of last year due to large-scale orders from the automobile industry. Excluding this factor, orders for the first half in the manufacturing sector were flat. In the retail sector, because there is a relative sense of recovery in the sector and companies around the world are trying to differentiate themselves through IT investment, orders increased by 7% in the first half.

In the social infrastructure field, next-generation network construction is gradually having a positive effect on the IT investment environment. Business deals for enhancement of fiber optic communication equipment and investment in 3G infrastructure have been relatively solid and contributed to a 2% increase in orders for the first half. Due to particularly strong 3G infrastructure orders in the previous year's second half, we are projecting a 2% decrease for the second half of this year on a year-on-year basis.

Orders in the financial services sector have benefited from increased investment due to favorable performance of large banks and IT system upgrades tied to growth in the securities market. Major financial services groups are working to strengthen their management and are continuing to look at IT outsourcing and systems integration and shared use. As a result, increased investment tied to the strong performance of large banks, active investment by major securities companies, systems integration projects arising from consolidation in the leasing industry, and J-SOX (Japan version of Sarbanes-Oxley corporate reform legislation) compliance all contributed to a 4% year-on-year increase in orders for the first half. For the full year, we expect favorable conditions to continue and forecast a 3% increase.

In the public sector, there has been a decrease in supplementary budgets for government agency IT-related investment. In addition, I think the impact of price declines due to open bidding and other factors has been fairly significant. The scale of this market appears to be shrinking somewhat. But because of new business opportunities, such as integrated operational systems for ministries, and expected growth in the health care field due to market demand for electronic medical records and other factors, we believe the public sector market overall will be about the same level as last year. In terms of Fujitsu's business, we have been seeing a pick-up in orders in several areas, such as business geared towards the privatization of public-sector entities, business in the educational sector, and business in electronic medical records for small-mid-sized hospitals. Orders increased approximately 23% in the first half, although that is in comparison with a very weak first half last year. We expect the second half to be slightly better than last year's second half, so for the full year, we expect an increase of about 9%. Among the various business sectors in which we compete, this area is performing fairly well.

Conditions in our regional business are rather severe. Although private-sector demand is increasing in the major urban areas, such as the Tokyo greater metropolitan area and the Kansai region, demand in outlying regions has declined somewhat, despite our expectations to the contrary, and orders were down about 3% in the first half compared to last year. In the second half, we are expecting some further recovery, primarily in private-sector demand, leading to an increase of about 9%. For the full year, we project an increase of about 3%.

Mr. Matsuhashi: *Please tell us about the earnings situation for the server business in the first half and the outlook for this business in the second half, including any variances from your expectations at the beginning of the fiscal year. Also, has the influence of upfront strategic investments impacted your initial outlook?*

Mr. Ogura: Sales for the first half exceeded our projections at the beginning of the year, but there was no significant difference in terms of profits. Overseas sales, in particular, were relatively robust, but it appears that the second half may be quite tough. There are several issues, such as the large number of models we offer, and I think we need to make some real progress in addressing these issues. For low-end models, unit sales volumes are strong, but price competition is severe, and in the second half we need to deal with structural changes and other challenges in our server business. We will address these issues as important company-wide priorities. Regarding upfront investments, they appear to be increasing in the middleware and virtualization areas. Although our development investments in these areas may be on the heavy side, we feel they are important. Because they support our overall systems business, including operational services, we need to make these investments.

Mr. Wakabayashi, Finnoweb Investments: *Which business segments within Fujitsu will benefit most by work related to J-SOX implementation?*

Mr. Ogura: In terms of standardizing business processes, our Services segment is responsible for that business, but in terms of helping companies to centralize management of disparate business processed, we think it will benefit our server business.

Mr. Wakabayashi: *Could you explain how Fujitsu, itself, is preparing for J-SOX?*

Mr. Ogura: We have an internal corporate IT unit, and it is deciding how our various internal IT systems should be structured and designed. We are integrating a patchwork of different IT systems, and we plan to leverage the expertise we gain from that work and apply it to our customers' businesses. Internally we've brought together about 60-70 of our most talented people to work on this. We intend to make Fujitsu's IT infrastructure a reference model for customers.

Mr. Aiba, Nomura Asset Management: *Within second-quarter operating income for System Platforms, how much income did Servers and Network Equipment post? Similarly, within Services, what was the breakdown for Solutions/SI and Infrastructure Services?*

Mr. Ogura: In System Platforms, we posted a loss in the first quarter, but the second quarter was profitable. Network Products had a slight loss in the second quarter but was profitable for the first half as a whole. The second quarter loss in this sub-segment was due in large part to investment in development for the photonics business, including our business in North America and the UK (NGN business). In comparison with last year's first half, profits for our North American network business were lower. In regard to Services, please understand that our Infrastructure Services business tends to be more significant in terms of profitability.

Mr. Aiba: *Has your systems integration business in Japan improved?*

Mr. Ogura: We have cleared up the problem of loss-generating projects. That issue is now relatively under control, so there should be no sudden emergence of large losses. The business is shifting toward smaller-scale projects. We now divide systems development work into different stages in our customer contracts, and we receive payment based on the achievement of clearly defined business milestones. In addition, we are changing our approach in various ways in order to generate profits on related work. So overall we are making progress in improving earnings in this business.

Mr. Aiba: *Regarding your medium-term plans, what areas are you focusing on and how would you like to see Fujitsu change in three years' time?*

Mr. Ogura: Up until now we have been consolidating our focus on core business segments and, while working to stem loss-generating business, shifting our focus to concentrate on Technology Solutions. We have positioned Ubiquitous Product Solutions and Device Solutions as areas that can autonomously pursue volume business. The issue now is how we will deal with Technology Solutions over the medium-term. For both System Platforms and Services, the task is how to build a structure that can provide customers with total support while increasingly generating annuity-type recurring revenues.

Mr. Shimada, Tokyo Mitsubishi UFJ Securities: *What is your outlook for operating income for LSI Devices?*

Mr. Ogura: In the first half, the LSI Devices sub-segment posted a slight loss, and we expect a similar result for the full year. In terms of market outlook, the summer sales season was somewhat weaker than anticipated, particularly for PCs. Even in the digital AV products area, although the television market was comparatively strong, my impression is that there was considerable variability depending on the product. So the outlook for the LSI devices market is a bit weak. That could cause a slight discrepancy from our initial projections. It is too early to determine whether we should change our projections. For one thing, from the end of this calendar year until the first quarter of fiscal 2007, it appears that the market will recover somewhat. Judging from the current situation, my feeling is that some of this bearish outlook is evident in the results.

As for customers for 300mm products, orders seem to be a bit delayed compared to our earlier projections. But when we take into account the expected market recovery, it may well be that, before we know it, we will be at full capacity. It is still not clear what will happen.