

**Summary Translation of Question & Answer Session at
Analyst Briefing on the Strengths and Prospects of
Fujitsu's System Integration Business in Japan**

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Location: Fujitsu Headquarters, Tokyo
Presenters: Kazuo Miyata, Senior Fellow, Digital Transformation Business Group, Fujitsu Limited

Questioner A

Q1: Please tell us your view of how the scale of the IT services market in Japan will change over the next ten years. You mentioned that your business in the category of the problem-solving model has not declined, contrary to what we might have expected, but is the reason why business is strong because a significant portion of it is temporary stemming from cloud migrations? After the migrations have ended and many applications have become cloud-native, how do you view your long-term prospects in terms of changes in the scale of the market and your own competitive advantages?

A1: Ten years down the road, if you ask whether customers have shifted to cloud-native applications, for large-scale customers, I think they will not have shifted. More generally, however, I think the shift will advance over the next five years. As to whether that will be bad for Fujitsu, I do not think it will. Already the scale of our hardware business is not that large, and even if the platform for integration is the cloud, our system integration business is more important to us in terms of profits. Therefore, on the question of whether the shift to the cloud will have a negative impact on Fujitsu's results, I do not think there will be a significant impact. Because of the unique features of the market in Japan, if you ask whether, ten years from now, customers will have thrown away all of their current applications, I think the answer is that they will not have thrown them away. In Japan's social infrastructure today, customers have raised service levels, and they cannot afford for them to be lowered. There is no way that customers running BtoC businesses will lower their service levels, so I do not think they will shift over to global packaged software. Against this backdrop, over the next ten years, I think the current scale of problem-solving model business will not alter in terms of size, and I think Fujitsu may be able to increase its share in this market.

Q2: You talked about fostering digital talent, but do you have any quantitative targets in mind?

A2: We do not have many quantitative targets, but we will first convert one thousand engineers into professional consultants, with a target of each consultant generating 20 million yen per year in sales. The consulting should lead to additional business in terms of integration or business process outsourcing (BPO), so we are starting to allocate human resources to the market now with the goal of generating 100 billion yen in sales within a few years.

Questioner B

Q1: As indicated on page 37 of your presentation materials, it appears that your business consulting and strategic consulting is becoming more important to your approach. Within

Fujitsu you have the Fujitsu Research Institute (FRI), but how many people within FRI can pitch proposals to business executives or, for example, the head of marketing, as opposed to the head of an IT systems department.

A1: There are a few dozen people like that in FRI. Those consultants are working in customer business lines, and the portion of FRI's consulting business that is provided to customers is increasing. The current problem is that their business ends with consulting, with no follow-up by system engineers. To address that issue, we will select some of our digital innovators to be paired up with FRI consultants to increase the number of our consultants. Separately from that, we will work to secure more people from outside who have consulting skills.

Q2: I think that, even among your digital innovators, there are some people who have the expertise to be able to drill down into a customer's business to offer sound advice. If those people are included, how many consultants do you have?

A2: FRI has around 20-30 people whose work is consulting. Among our 16,000 system engineers, I would say about 10% can do consulting. By that, I mean they have the business know-how that is needed. But because they have not worked as consultants, we will pair them up with FRI's top consultants for them to get training and experience in order to foster their development.

Q3: With the deployment of K5 and MetaArc, the plan was to increase profitability by accumulating knowledge and then building on that in order to reduce costs, but is this initiative behind schedule?

A3: No, it is not behind schedule. In our system integration business, we have always shared knowledge. There was never going to be a significant change to our profitability.

Q4: Fujitsu's stance is to provide IT services to enterprise customers, but some IT services vendors take over actual services, such as transaction settlement activity or payments and receipts of funds, handling it in some cases as BPO business. Is Fujitsu's stance that you are a provider of IT services, and that you will not seek to engage in business that way?

A4: No, that is not our stance. We have been trying to do that for some time now, but because our business model up until now has been to provide IT services work on behalf of our customers, so we have to deal with such issues as contracts in which we take on new risks, but we want to do that starting this year in the Digital Transformation Business Group.

Questioner C

Q1: At the beginning of your presentation, you mentioned that, while the second platform market is declining, when it comes to services in the problem-solving model category, the market is either not changing very much, or could even be said to be increasing. Why is there a discrepancy between these two claims? I think that, in the second platform market, Fujitsu has very strong relationships with customers and a lot of business, but how should we understand the changes that are occurring in the market and how Fujitsu is approaching them?

A1: IDC is forecasting a CAGR decline of 9% in the second platform market, but the decline from year to this year has been around 4%. Fujitsu already has many customers in that market, and our business with those customers will continue. On top of that, because competitors are exiting the large-scale system integration business, we can generate added value by continuing in this field, while we maintain or possibly increase the volume of our business.

Q2: In reference to page 12 of the presentation materials, which shows a comparison of the composition of Fujitsu's business in relation to the overall market in Japan and the worldwide market, you mentioned the need for Fujitsu to strengthen its consulting and BPO businesses. You have talked about your initiatives in the area of consulting in your presentation, but how should we understand how you intend to strengthen your BPO business.

A2: The BPO market represents more than a 10% slice of the overall market both globally and in Japan, but Fujitsu has almost none of this business. In the system integration business we are doing, however, if we handle all of the customer's business including operations, then we will be able to get some of the BPO market. For example, in the call center business, we are already selling solutions, so we would just make proposals that include BPO services. There are many specialized BPO vendors, so we would like to enter the market and work to expand our business there.

Q3: In the operations services part of your business, why is that, up until now, you were not able to provide BPO services?

A3: Our main focus up to now was on our system integration business, and neither we nor other major companies were focusing very heavily on operations. On the other hand, many specialized vendors have been doing that business, and now Fujitsu also wants to enter that market.

Questioner D

Q1: FRI does not have many consultants, and Fujitsu's strengths lean towards the manufacturing sector. In terms of strengthening your consulting business, however, that will not necessarily be a big advantage. Will you be able to provide consulting services to customers in the financial services and securities industry?

A1: In Fujitsu's case, rather than getting talent from outside, we sent system engineers to FRI to become consultants. We have struggled for decades to create a consulting business. We are doing consulting based on the industry knowledge the system engineers already had, and I think that is why the result the figure for 'partner class consultants' stands at several dozen. Because system integration was the main part of our business up until now, in the past we did not send our best system engineers to become consultants. Now, however, if we take our group of 16,000 people and select, for example, the top 0.5% to work with consultants at FRI, we can expand our consulting business and lead it to create value for our customers. We do not think it will take ten years to achieve that. We think we can do it in about five years. Our system engineers already have industry knowledge as well as systems knowledge, so we want to take that talent and foster its development into consultants, thereby strengthening our consulting business.

Q2: Your presentation compared Japan with the US and Europe, but in terms of future expansion, will it not be the markets of China, Asia, Africa, and South America? For those countries, what is their approach or structure when it comes to system integration or IT? Is it the same as Japan, or is it European or US-style?

A2: China is clearly like the European and US model, in that, for customers, almost no thought is given to building one's own systems. Their model is that, if there is something good, they will buy it themselves and use it. In the case of Brazil, they are doing agile software development with the US. When it comes to building large-scale application systems involving tens of millions of lines of code from scratch, I think it could only be done by Japanese engineers.

Q3: In a study recently published by the Ministry of Economy, Trade and Industry that compared the compensation of IT personnel, it showed that, whereas top personnel in the US can make around 50 million yen per year, compensation in China and India is low, and it is thought that they have a subcontracting structure that is similar to Japan's. If that is the case, since there are also differences between capitalism and communism, can you really say that taking the same approach as Europe and the US is the right way?

A3: In the case of India, in preparation for Y2K, Indian engineers learned and developed with the trend in the US for companies to completely outsource their mainframe business, giving rise to giant IT companies like Infosys and Tata. There was no multilayered outsourcing structure. It was up or out. Talented people would survive, and untalented people would be forced out, falling into tier 2 or tier 3 companies. It is different from the model in Japan. Labor mobility is high, and India has achieved a model in which employees are replaceable. In China, the compensation of top-class IT engineers is very high. When you just look at averages, it appears low, but compensation of top talent there is on a par with Japan, and compared with general compensation levels in China, we can say that it is high. In my view, it is because, outside of Japan, there is a market in which IT engineers are evaluated as individuals, whereas in Japan that era still lies ahead.

Questioner E

Q1: My question is about page 12 of the presentation materials. Should we understand this to mean that what Fujitsu is trying to do is to change its business to suit the Japanese market? In addition, the competition will not just watch from the sidelines with their hands folded, so I am sure that there will be areas where things do not go according to Fujitsu's plans, but what are you planning to do to differentiate yourselves to increase market share?

A1: Even among our competitors, the number of companies pursuing a system integration business model in the Japanese market is falling. Because it is labor-intensive and management is also difficult, a number of companies have exited the market. We have survived because we are performing reliably. With regard to how we differentiate ourselves, our focus has been on system integration up to now, and have not made consulting or BPO the core of our business. Through consulting, we are able to enter areas of even higher added value, doing business across the overall budget, including our customers' lines of business, and we will also be doing BPO as a business. The number of companies doing this is falling, so we can differentiate ourselves, and we can use a variety of technologies on the back end. By shifting from our previous business of

system integration and hardware sales to put consulting in the forefront, resolving customer issues, we will expand business utilizing our back-end technology. In particular, there is value in AI, not in incorporating it into our products, but by using AI over a long term in customer operations to resolve customer issues. By changing our business model, we will employ the full strength of Fujitsu. We would like to achieve this by entering the consulting business, which we had not previously entered.

***Q2:** How will your structure change in three to five years as your value-creation model business in the Japanese market?*

A2: We would like to expand consulting and BPO by at least 10%, increasing our profit margin by shifting toward high value-added business.

As for BPO, it is not only a simple cost-saving measure. Our customers in Japan will themselves soon be unable to handle things like call centers, for example, due to a lack of people. In light of that, we would like to propose the use of chat-bot solutions, as well as manned BPO centers, as ways of resolving the overall issues of customers.

***Q3:** Looking at the breakdown of your customers, I believe that the financial sector, especially big banks, and the public sector have made up a major proportion, but when it comes to digital, it seems to me that those sorts of customers are not making major IT investments, looked at individually. In your digital business, will you be able to proceed at the same speed with the big banks and the central government? I think you will need to aim for small projects and focus on volume, but how do you plan to adapt?*

A3: The big banks have been making their own fintech companies, in the process of launching initiatives before they get disrupted, so they are trying to build things in-house. The public sector has not changed much over these past ten years, despite the digital wave, so I think things will be fine there as long as Fujitsu continues to handle its current business reliably. Manufacturing and retail companies are in a position in which, if they do not enter the global stage and try something new, they will get disrupted, so they are now hiring people and creating new organizations, moving production in-house. Systems created by business units must be for practical use, so they will face the necessity of considering safety and stability in the end, and I think the IT systems departments will end up supporting them. As long as Fujitsu works with the IT systems departments in providing support, I think we will be able to conduct digital business as well.

Questioner F

***Q1:** You have explained how Fujitsu is strong in the unique Japanese market, but it seems to me that this strength has not translated when you have moved outside Japan. It seems that you see synergies between your businesses inside and outside of Japan, but could you please explain your thoughts on that?*

A1: Infrastructure Managed Services is one of Fujitsu's strongest businesses outside Japan, while, on the other hand, building business applications has historically not been so robust. The reason for this is that our various locations around the world have not been handling application

development, but have been doing easily standardized business that is quite close to infrastructure. We will be spreading the industry and process know-how we have accumulated within our strong system integration business in Japan to these locations outside Japan, though it will not happen overnight. Japanese companies are expanding outside Japan more and more, so we will initially teach our engineers on location about the applications area in partnership with these Japanese companies, gradually expanding the sort of development and consulting we are doing in the application space in Japan.

Q2: You are strong in infrastructure but weak in applications. I believe that hardware infrastructure, Linux and Windows, including virtualization, are pretty standardized, so should we take it that these are areas in which it will be difficult to differentiate yourselves?

A2: I think that is the case. This is an area in which automation is proceeding apace, so we are also replacing people at Fujitsu Services in the UK, one of Fujitsu's locations outside Japan, to move in the direction of more business-focused areas.

Q3: With regard to your response to clouds outside Japan, companies like AWS are putting out new applications almost every week. They have also begun to make infrastructure available in a format that can be totally optimized. I can understand the logic that says "our customers in Japan would not do that sort of thing, so we will be fine," but no matter how you think about efficiency, their offerings are more efficient, so it seems you do not have a response. Could you please tell us your thoughts on this score?

A3: We consider that what Fujitsu is offering in the cloud will be in the role of a partner as companies build private clouds. As you say, with regard to the public cloud, Azure and AWS are continually improving their functionality, so in those areas, we are beginning to proceed in a direction toward collaborating with them to create business on another layer above the customer.

Q4: While investment in software has grown a bit in Japan, and the conventional wisdom is that, because there are insufficient human resources and the population is shrinking, we still must increase the capacity utilization rate of factories, and therefore software is important. Despite this, it seems to me personally that the market is not growing. Why has the software and IT market in Japan had such difficulty growing?

A4: Until now, Fujitsu has worked as a system integrator by building systems after receiving orders from IT systems departments. Among our customers, there are many outstanding CIOs, and those CIOs have reduced their existing costs, and moved that capital to invest in new areas, investing in ways that linked IT with conducting business, viewing IT as a tool to expand business.

Now, however, I think this approach has unfortunately proven itself somewhat weak in the face of the challenge of that sort of massive transformation. While Fujitsu is the largest system integrator, I think that we must make ourselves capable of giving proper advice to our customers about conducting business, providing consulting that encourages transformation, including giving customers a sense of urgency by convincing them that IT is not a cost, that it is an area in which they need to make investments to remain competitive.

Another factor is assessing the value of IT engineers. Newly hired engineers who graduate from American universities earn yearly salaries of about 20 million yen, while in the case of Japan, it is only a few million yen. With this model, I think that the number of people who want to be IT engineers will not increase. I think that if we do not change our system, including both hiring and compensation, if we take a model similar to what we previously used in the manufacturing industry of gradually increasing value while also gradually increasing compensation, it will be difficult to create new IT innovation.

Questioner G

Q1: I think it is important to think of the IT industry in terms of gross profit per person. Hearing Fujitsu's current strategy, I cannot help but think that, if you do not increase your investment in people, your gross profit will not increase. I think that increasing your market share is a strategy, but as Japan faces a labor shortage over the next two or three years, even if your strategy succeeds by 2020, for example, I have doubts about its viability thereafter. Could you please tell us what you will be able to achieve when seeking growth with your existing system integrators.

A1: First, the business model I am currently thinking of is the business model we have used up to now, in which we have 16,000 engineers within Fujitsu, and we have partners working under their direction, using cheap labor to perform the actual integration. I believe, however, that it is not the case that all of these 16,000 engineers are essential to that business model, and that we will be able to take the top class engineers from that group and move them to the consulting space, gradually increasing the amount of high added-value business we handle. Also, I think there are still many areas of waste with regard to large-scale system integration projects. This is because system integrators are taking orders from customers, while if we start from the consulting stage, we will be able to make proposals for building a system that does not exactly line up with the original RFP. Customers have a variety of consulting companies make RFPs, and they send those to vendors, who compete for selection in a number of ways, including on price. Because many areas are determined based on price, what happens is that vendors include a massive number of pointless risks in their proposals, and the customer ends up wasting money. Therefore, we are aiming to further raise our current added value. This is why, if we can help our customers understand the critical chain project management and the theory of constraints I spoke about at the beginning, our customers will benefit. I think that by enlightening them, we will be able to move from a system integration business with low gross profits per person to one with increased gross profits. In addition, we aim to earn 3 to 4 million yen a month per person in a high added value business like consulting. Starting to train agile software developers is part of this effort, and demand is increasing with incredible speed, to the point that some are willing to pay 3 or 4 million a month for an agile development scrum master. I think that if 10% of those 16,000 people are able to increase added value in that sort of business model, while at the same time we are able to properly handle project management for our current system integration business, we will be able to reduce man hours while increasing added value.

Q2: As Fujitsu is the company with the largest market share in Japan, I think you probably have the most existing projects. I think that if you ask users, you will hear that they would like to reduce spending and increase efficiency for existing projects, as they want to use the money for

more competitive IT projects, but when prices fall, will Fujitsu be able to sufficiently reduce costs?

A2: I think that if it were around 5% or so, we would be able to reduce costs through measures such as efficiencies and offshoring, even with a low added value business model. I think the current business model, in which the more people we throw at a project, the more money we make, is not good for either party, and that the correct path for Japan is to change the contract model, so I think it would be best if we could move in that direction.