Explanation of Financial Results

1. Overview

Business Environment

With respect to surrounding business conditions, although the Iraq War and SARS epidemic impacted the global economy at the beginning of the fiscal year, new trends in technology had a major impact on market conditions in the second half. In addition to continuing growth in demand for 3G and other new mobile telephones and significant expansion of broadband networks, demand for new digital electronics products suddenly intensified in late 2003, signaling the dawn of a ubiquitous networking era. U.S. and other stock markets around the world began to recover, and by the fourth quarter overall economic conditions were showing steady signs of improvement.

In the United States, renewed business confidence led to the start of a steady recovery, and in other regions as well there began to be gradual improvement. In Japan, the economy was boosted by a sudden jump in demand for digital electronics products in which Japanese companies maintained technological leadership, and corporate results improved, particularly for manufacturers buoyed by growth in exports. Along with considerable recovery in the Japanese stock markets, the value of the yen continued to rise against other currencies. In China and other parts of Asia as well, there was an awakening of new demand, and the overall global economy advanced.

At the same time, corporate capital investment began to rebound on a global basis, and since the end of the last year Japanese corporate investment in IT has become stronger again. As a result, we are seeing considerable activity in business orders.

Profit and Loss Situation

Fujitsu recorded fiscal 2003 consolidated net sales of 4,766.8 billion yen (about US$44.9 billion), up 3.2% over the previous fiscal year. On a quarterly basis, except for the first quarter, which was off 4.5% versus the first quarter of fiscal 2002, each successive quarter showed increasing gains over the comparable quarter in fiscal 2002, rising 3.1%, 5.0% and 7.4%, respectively. Overall, it was the first year-on-year increase in net sales since fiscal 2000. Sales rose only by a small margin in Software & Services, but Platforms sales finally rebounded to a level of parity with the previous year, and Electronic Devices sales jumped by nearly 20% both in Japan and overseas.

In addition to major gains in sales of logic chips, the fundamental device technology in popular digital electronics products, sales of other electronic devices driving the digital revolution – including plasma display panels (PDPs), liquid crystal displays (LCDs) and hard disk drives (HDDs) – enjoyed strong growth. In mobile communications, there was also a solidifying of the shift toward third-generation (3G) mobile telephones and base stations. In Japan, although corporate demand for IT-enabled services contributed to growth in services income, there was a decline in large-scale systems projects, which, together with intensifying price competition and other factors, led to sluggish domestic sales of servers, PCs and other hardware products. There was clear recovery during the second half of the fiscal year in the sales of transmission systems for North American operators, but investment by Japanese telecommunications carriers continued to be restrained.

Consolidated operating income was 150.3 billion yen (US$1,418 million), an increase of nearly 50% over fiscal 2002. Cost rate was 72.6%, up 0.5% from the previous year due to intensifying price competition. However, amid the 3.2% rise in net sales, we were able to boost efficiency in operating expenses by 2.8%, thereby making a major contribution to the overall increase in operating income.

By business segment, Electronic Devices, which had suffered a major loss last year, returned to profitability with a 60 billion yen improvement in operating income. In the Platforms segment, although intensified competition reduced operating income in PCs and mobile telephones, in transmission systems and HDDs, areas that had suffered large losses the previous year, there were major improvements in income. Moreover, in the fourth quarter, there was unique demand in Japan for financial terminals able to accommodate the introduction of new banknotes. As a result of these and other factors, operating income in the Platforms sector as a whole increased by close to 30 billion yen, making up for a significant portion of the nearly 40 billion yen operating income decline in Software & Services, where intensifying pricing pressures became more apparent in the second half of the fiscal year, and enabling us to achieve our overall operating income target set at the beginning of the fiscal year.

A total of 294.8 billion yen (US$2,781 million) in extraordinary income was recorded for the fiscal year. There was also an extraordinary loss of 187.5 billion yen (US$1,769 million), but this was more than offset by the extraordinary gains. (Please see the following section for details regarding these extraordinary items.) As a result, we were able to achieve consolidated net income of 49.7 billion yen (US$469 million). Of this amount, operating profits from business operations accounted for about 20 billion yen, and extraordinary profits about 30 billion yen. The increase in extraordinary income beyond expectations enabled us to exceed by 20 billion yen our net income forecast made at the beginning of the year.

Improvement in Financial Condition

During fiscal 2001 and 2002, following the bursting of the IT bubble, Fujitsu's financial condition deteriorated markedly as a result of worsening business results and the outlay of large restructuring expenses to cope with that situation. Along with concerted efforts to strengthen the profitability of our business operations, we have set forth basic financial goals as outlined below and undertaken various measures to restore our financial condition, including efforts to make more effective use of assets.

- Reduce inventories to 500 billion yen or below (by end of FY 2003)
- Reduce ending balance of interest bearing loans below 1.3 trillion yen (by end of FY 2003)
- Increase shareholders' equity to 1 trillion yen or above
- Reduce D/E ratio to below 1.0 (i.e., reduce interest bearing loans below 1 trillion yen)

With respect to improving profitability in our business operations, in addition to working to increase sales, we have pursued various cost reduction measures and trimmed expenses. As a result, we were able to improve our overall operating margin to 3.2% in fiscal 2003.

Although we made significant progress on our goal of cutting inventories in half from their peak level of 1 trillion yen by the end of fiscal 2003, we came in just over that mark, at 521.1 billion yen (US$4,916 million). Going forward, we will accelerate the introduction of Toyota-style production management throughout the company and apply the percentage of completion accounting method in our Software & Services business. We intend to set demanding new targets and to achieve them quickly through these measures.

Free cash flow was 371.4 billion yen (US$3,504 million), a major increase over fiscal 2002. To more effectively utilize our assets, we sold shareholdings in FANUC and other marketable securities, as well as some fixed assets. At the same time, through outside capital tie-ups, we moved several operations off our consolidated balance sheet, including realigning our flash memory business with AMD, our leasing operations with Tokyo Lease, and our FDK subsidiary with an investment fund. As a result, total assets at fiscal 2003 year-end stood at 3,865.5

billion yen (US$36,468 million), a decrease of more than 350 billion yen over the previous year and down below the 4 trillion yen level.

In addition to increased profitability as a result of higher income in our business operations, extraordinary income from gains on the sales of marketable securities and on the transfer of the substitutional portion of our employees' pension plan to the Japanese government led to an increase in shareholders' equity to 827.1 billion yen (US$7,804 million), and a recovery in our shareholders' equity ratio to 21.4%.

We achieved our target of reducing the ending balance of interest bearing loans to below 1,300 billion yen, recording a fiscal 2003 ending balance of 1,277.1 billion yen (US$12,048 million). After subtracting out cash and cash equivalents of 415.8 billion yen, net interest bearing loans stood at 861.2 billion yen. This represents an improvement of 639.3 billion yen over the previous year. There were improvements of about 217.5 billion yen on the sale of shares in FANUC, 254.0 billion yen on the shift to equity method accounting for Fujitsu Leasing and FDK, 65.0 billion yen from the sale of marketable securities and fixed assets, and about a 100.0 billion yen improvement in free cash flow from business operations.

The D/E ratio improved from 2.51 last year to 1.54, and the net D/E ratio, as calculated using the net balance of interest bearing loans, was 1.04, very close to our mid-term target number.

Going forward, we will continue to strive to raise shareholders' equity to 1 trillion yen or above, reduce interest bearing loans below 1 trillion yen, and hold our D/E ratio below 1.0. At the same time, we will set new targets aimed at strengthening the ability of our business operations to generate greater profits and cash flows.