Part II. Explanation of Financial Results

1. Overview

Business Environment

With regard to the business environment during the fiscal year, overseas, the US and China experienced a temporary slowdown in growth as a result of surging oil prices and rising interest rates, but those regions as well as Europe were able to maintain economic growth, and factors tempering growth appear to be easing. In Japan, there was a shift from the robust conditions that had prevailed in the digital home electronics sector until the beginning of the period, and the market for electronic components rapidly deteriorated, leading to a temporary flattening out of overall economic growth, though there appear to be prospects for a mild recovery in fiscal 2005.

Looking at IT spending trends, while IT spending prospects overseas appear to be bright, led by an aggressive spending posture among global corporations, in Japan the outlook varies according to industry, company size, or region, and there is a continuing lack of robustness overall. On the other hand, spending on open architecture IT infrastructure systems is enjoying strong growth in both qualitative and quantitative terms, and there is rapidly increasing demand for greater stability and efficiency in such systems. In addition, with more attention being paid to security issues as a result of the enactment of the Personal Information Protection Act in Japan this year, there is greater demand than ever for the capabilities that IT can deliver in supporting internal compliance and other measures to enhance security, and an increase in IT spending on public infrastructure systems as well as by individual corporations can be expected.

In the world of ubiquitous networking, which is made possible by sophisticated IT infrastructure comprised of high-performance, high-reliability servers, networks and software seamlessly integrated in an open environment, it will be possible to securely and conveniently deliver advanced services in such areas as shopping, banking, and healthcare. As a leading provider of server and networking technology and services essential to the ubiquitous networking era, Fujitsu seeks to provide comprehensive solutions that bring together high-performance, high-quality products and services – such as biometric authentication technology for enhanced security – to meet the specific needs of individual customers.

FY 2004 Full-Year Summary

(Billion Yen)

	FY 2004 (4/1/04 – 3/31/05)	FY 2003 (4/1/03 – 3/31/04)	Change
Net sales (Percentage change vs. prior fiscal year)	**4,762.7** **(-0.1%)**	4,766.8 (3.2%)	-4.1
Operating income (Operating margin)	**160.1** **(3.4%)**	150.3 (3.2%)	9.8 (0.2%)
Extraordinary gains and losses	**134.4**	107.2	27.2
Income before income taxes and minority interests	**223.5**	157.0	66.5
Net income	**31.9**	49.7	-17.7

Note: Throughout these explanatory materials, yen figures are converted to US dollars for convenience only at a uniform rate of $1=107 yen, the approximate closing exchange rate on March 31, 2005.

Fiscal 2004 Priority Issues and Initiatives

At the beginning of fiscal 2004, we targeted consolidated sales of 4, 950.0 billion yen, operating income of 200.0 billion yen and net income of 70.0 billion yen. In striving to achieve these targets, we carried out a number of initiatives during the course of the year. Details about these initiatives and their results are described below.

First, we worked to strengthen our existing businesses. Specifically, as a mid-range goal, we have been working to reduce costs as a ratio of sales by 1% per year through a variety of cost and expense reduction initiatives. In our Software & Services business, in addition to promoting our System Development Architecture and Support (SDAS) and TRIOLE initiatives, we have worked to boost productivity by implementing groupwide organizational reforms. Nevertheless, in fiscal 2004, we were unable to stem the deteriorating profitability of certain projects, and these dragged down overall efficiency levels, resulting in a 1.1% decline in the Software & Services operating margin in comparison with the previous year. On the other hand, through the introduction of the Toyota Production System, we advanced manufacturing innovation in our Platforms and Electronic Devices hardware divisions. The impact of higher production volumes together with cost reductions through tighter integration of design and manufacturing helped us to achieve a targeted 1.1% improvement in the operating margin for these divisions, in spite of declining prices. As a result of the foregoing, however, consolidated operating income for the year was held to 160.1 billion yen (US$1,497 million), an increase of only 10.0 billion yen over fiscal 2003.

Addressing the deterioration of profitability in Software & Services, we put in place and have been working to thoroughly implement a system to quickly identify and contain the risk of project losses. In addition, we are putting great emphasis on programs and policies designed to improve productivity, including increasing utilization of tools such as SDAS to boost the efficiency of development activities, as well as fostering the professional skills of our personnel. At the end of fiscal 2004, about 75% of projects (on a value basis) with deteriorating profitability were completed, and we mostly eliminated the incidence of problematic new projects (see p. 26).

Moreover, we took a number of measures to further focus our resources and thereby improve profitability in fiscal 2005 and beyond. These included selling a distribution affiliate to an international logistics company in order to strengthen our global distribution network and further improve supply chain management, and the transfer of our flat panel display businesses, where a vertical business model has become essential.

Another priority has been to strengthen our global business development. Building on the progress from the restructuring of our international operations carried out in fiscal 2003, we were able to achieve a more than 20.0 billion yen improvement in income from overseas operations, thanks in large part to the expansion of our infrastructure services business in Europe and higher overseas sales of our servers, middleware and other products. Gains in Europe and the Americas were of particular note, but we secured operating profits in all regions. Moreover, alliances with leading global players and progress in cooperative ventures in fiscal 2004 are expected to improve product competitiveness and lower costs, thereby helping to position the Fujitsu Group for further gains in profitability in the future.

Since fiscal 2003, moreover, we have made progress in improving the soundness of our financial position. We were able to meet our goal of reducing interest-bearing loans to 1,100 billion yen or below by the end of fiscal 2004, ending the fiscal year with a balance of 1,082.7 billion yen as a result of cash flow generated from business operations as well as investment cash flow collected from sales of asset holdings. As a result, our D/E ratio reached 1.26, drawing closer to our mid-range goal of 1.0. Net interest-bearing loans, which subtract cash and cash equivalents, were greatly reduced to 628.0 billion yen, and the net D/E ratio reached 0.73. In terms of management indices expressing financial stability and efficient use of assets, in a number of areas we have exceeded the values for the recent peak year of fiscal 2000 (see p. 31).

We have also made efforts to deal with financial risks. In the same way that we did in the previous fiscal year, in fiscal 2004 we recognized upfront losses for problematic projects as soon as they were determined, including for work not yet implemented. In addition, we recorded valuation losses on idle property that we had no plans to use. Moreover, with respect to deferred tax assets, we recorded a valuation allowance to cover the amount in excess of what we are likely to recover in the future.

As a result of the foregoing, we recorded fiscal 2004 consolidated net sales of 4,762.7 billion yen (US$44,512 million), consolidated operating income of 160.1 billion yen (US$1,497 million) and consolidated net income of 31.9 billion yen (US$298 million). Unfortunately, due to measures to deal with Software & Services projects with deteriorating profitability, we fell short of meeting the targets that we had established at the beginning of the fiscal year. On the other hand, we were able to achieve our beginning-of-year targets for improving the soundness of our financial position, and to implementing necessary policies to ensure improved performance in fiscal 2005 and beyond.

Earnings by Business Segment

(Billion Yen)

		FY 2004	FY 2003	Change
Software & Services	Net sales	**2,108.9**	2,146.3	-37.4
	Operating income	**113.0**	138.7	-25.7
	Operating margin	**5.4%**	6.5%	-1.1%
Hardware Divisions Combined (Platforms + Electronic Devices)	Net sales	**2,656.3**	2,637.5	18.7
	Operating income	**87.5**	56.7	30.8
	Operating margin	**3.3%**	2.2%	1.1%

*Net sales includes intersegment sales

Earnings by Customers' Geographic Location

(Billion Yen)

		FY 2004	FY 2003	Change
Japan	Net sales	**4,024.5**	4,071.4	-46.9
	Operating income	**187.8**	203.7	-15.8
	Operating margin	**4.7%**	5.0%	-0.3%
Overseas	Net sales	**1,498.7**	1,417.2	81.4
	Operating income	**28.1**	7.0	21.1
	Operating margin	**1.9%**	0.5%	1.4%

*Net sales includes intersegment sales

Principal Financial Indices

(Billion Yen)

	FY 2004	FY 2003	Change
Total assets	**3,640.1**	3,865.5	-225.3
(Total assets turnover ratio)	**(1.27 times)**	(1.18 times)	(0.09 times)
Shareholders' equity	**856.9**	827.1	29.8
(Shareholders' equity ratio)	**(23.5%)**	(21.4%)	(2.1%)
Free cash flow	**262.1**	371.4	-109.3
(From business operations)	**(93.7)**	(89.1)	(4.6)
Interest-bearing loans	**1,082.7**	1,277.1	-194.3
(Cash and cash equivalents)	**(454.7)**	(415.8)	(38.8)
Net interest-bearing loans	**628.0**	861.2	-233.1
D/E ratio	**1.26**	1.54	-0.28
Net D/E ratio	**0.73**	1.04	-0.31

Note 1:

- Total assets turnover ratio: net sales / {(ending balance of total assets in current period + ending balance of total assets in previous period) / 2}
- Shareholders' equity ratio: balance of shareholders' equity / balance of total assets
- Ending balance of net interest bearing loans: ending balance of interest-bearing loans – ending balance of cash and cash equivalents
- D/E ratio: balance of interest-bearing loans / balance of shareholders' equity
- Net D/E ratio: (balance of interest-bearing loans – ending balance of cash and cash equivalents) / balance of shareholders' equity

Note 2:

- The above are all calculated based on consolidated financial data.

Profit and Loss

Consolidated net sales for fiscal 2004 were 4,762.7 billion yen (US$44,512 million), a decrease of 0.1% compared to the preceding fiscal year. On a continuing operations basis, excluding the impact of restructuring, this represented an increase of 2.8%. Worsening market conditions reduced sales of products such as PDPs and LCDs, and in Japan, sluggish recovery in IT spending restrained sales of servers and solutions/system integration services. Overseas, sales of UNIX servers, optical transmission systems, PCs and hard disk drives improved.

Operating income was 160.1 billion yen (US$1,497 million), up 9.8 billion yen over the previous fiscal year. Although operating income was adversely impacted by lower prices and losses on projects with deteriorating profitability in the Software & Services segment, in the Platforms and Electronic Devices segments, despite intense price competition, operating income grew as a result of increased sales, cost cutting progress and expense controls. The cost of sales ratio deteriorated by 1.2% from the prior fiscal year to 73.8%, but at the same time the ratio of selling, general and administrative expenses to net sales improved by 1.4% to 22.8% as a result of increased efficiency, benefits from restructuring carried out primarily in overseas operations and shifting of certain subsidiaries to equity-method affiliates. As a result of the foregoing, the overall operating income margin rose by 0.2%.

In addition to the increase in operating income, in other income and expenses, there was an improvement in net interest of 7.0 billion yen as a result of the decrease in interest-bearing loans and other factors, a turnaround of 4.5 billion yen in equity in net earnings of affiliated companies from the net loss recorded last year, and an improvement of 17.6 billion yen in the amortization of unrecognized obligation for retirement benefits due to the increase in stock prices during last year and the transfer of the substitutional portion of employees' pension funds.

Extraordinary gains, including gains on the sale of marketable securities, were 134.4 billion yen. Income before income taxes and minority interests was 223.5 billion yen, and we posted 185.5 billion yen in income taxes and the valuation allowance on deferred tax assets.

As a result, net income for the year was 31.9 billion yen (US$298 million), a decrease of 17.7 billion yen from the prior fiscal year.

Extraordinary gains and losses **Total: 134.4 billion yen**

1. Gains from sales of marketable securities . . . ……. . . . .…. 133.2 billion yen
   Sales of portions of Fujitsu's shareholdings in FANUC Ltd. and Advantest Corporation on February 22 and 23, 2005 (129.2 billion yen) were among the gains recorded from sales of marketable securities.
2. Gain on transfer of operations . . . . 36.5 billion yen
   Agreement was formally reached on March 25, 2005 for the transfer of plasma display panel operations to joint venture partner Hitachi, Ltd. Together with gains from the transfer of other business operations, gains from this transfer were recorded as an extraordinary gain.
3. Restructuring charges . . . . 20.0 billion yen
   Restructuring charges relating to reductions and relocation of personnel and disposition of assets primarily for domestic manufacturing subsidiaries were recorded as extraordinary losses.
4. Real estate valuation losses . . . . 15.2 billion yen
   Valuation losses on idle property holdings were reported.

Income tax and other adjustments

5. Recording of valuation allowance for deferred tax assets. . . . . 93.5 billion yen
   Having significant tax loss carryforwards from the restructuring of operations in fiscal 2001 and 2002 fiscal years, we calculated deferred tax assets at year-end based on future taxable income. At this time, in light of delays in the recovery of taxable income from business operations primarily relating to unconsolidated accounts, we decided to record a valuation allowance to cover the amount in excess of what was likely to be recovered based on estimates of the next fiscal year's taxable income.