Business and Other Risks

Listed below are the principal business and other risks affecting the Fujitsu Group (Fujitsu Limited and its consolidated subsidiaries) that we believe may influence investors' decisions. With a view to proactively disclosing information to investors, we have also included items that may not necessarily have significant bearing on such decisions. We are aware of these risks and are making efforts to prevent them from materializing, avoid potential risks altogether, and immediately confront risks should they occur. Among the risks listed below are some items related to future developments, but the list only includes items that the Group deemed necessary to publicly disclose as of the date of submission of its securities report (June 30, 2005).

1. Economic and Financial Market Trends

Economic and financial market trends have an impact on the Group's business results, financial base and other aspects of its operations. Examples of such risks are listed below.

(1) Economic Trends in Key Markets

The Fujitsu Group provides IT products and services, telecommunications infrastructure equipment, as well as semiconductors, hard disk drives (HDDs) and other components, to corporate clients and consumers in every region of the globe. Hence, sales and income generated from these operations are greatly affected by economic conditions in each respective market. This is particularly true of Japan, North America, and Europe, our key markets, where economic trends can significantly impact Fujitsu Group operations.

(2) Hi-tech Market Volatility

The IT sector is periodically subject to dramatic changes in the balance of supply and demand that exceed the scope of cyclical market variations. This tendency is particularly evident with regard to semiconductors, PCs and other general-purpose products.

The Fujitsu Group gives ample consideration to market cycles and volatility when deciding to launch new products, initiate volume production, or scale back production, among other actions. Nonetheless, we may fail to accurately forecast market changes, or changes in market conditions could exceed our forecasts. Accordingly, there is a risk that we may be unable to recoup investment costs, as well as the risk of opportunity losses.

Further, the Group continuously implements structural reforms in a bid to respond to market changes. However, drastic market changes could force us to enact structural reforms on a far greater scale than initially expected, resulting in a temporary increase in related expenses.

(3) Exchange Rates

The Fujitsu Group imports a substantial amount of components and materials and exports various products. While import and export costs tend to roughly balance out over the course of a given year, sudden fluctuations in exchange rates and other factors could force the Group to incur losses on foreign currency translation adjustments. There is also the risk that exchange rate fluctuations could lead to the depreciation of overseas assets held by the Group, as well as appreciation of foreign currency-denominated liabilities.

(4) Interest Rates

In fiscal 2004, the Fujitsu Group reduced the level of interest-bearing loans by a substantial margin. The balance of these loans, however, is still in excess of ¥1,000 billion, and includes items that are directly impacted by interest rate fluctuations. Consequently, rising interest rates could result in an increase in the interest burden from interest-bearing loans, while the risk of higher financing costs in the future could affect our efforts to procure necessary funding for our operations.

(5) Capital Markets

Stock market trends in Japan and overseas have a substantial effect on the value of Group stockholdings in other companies and the management of pension assets. Weak stock market performance could thus force us to incur losses on the devaluation of marketable securities held or a reduction in pension assets, exposing the Group to the risk of higher losses.

2. Customers

Fujitsu Group operations are highly influenced by the business trends of strategic key customers. Examples of potential risks are described below.

(1) Customer Performance and Business Conditions

A large proportion of our IT systems and services, as well as communications infrastructure and other business is with telecommunications carriers, financial institutions, and large manufacturers. Business conditions within these industries, including structural reforms, could lead to changes in customer investment trends having a significant impact on Group sales and profitability. In semiconductors, HDDs and other operations where the Group provides components and other products, both demand and prices are impacted to a large extent by customers' ability to sell PCs, digital home electronics, mobile phones, automobiles and other products in which these parts are used. Accordingly, soft demand and falling prices for customers' products, or a decline in customers' market share, could negatively impact Group sales and earnings.

(2) Ability to Maintain Lasting Ties With Customers

The Fujitsu Group is committed to bolstering ties with customers, striving to serve as a business partner and provide solutions across the full IT system lifecycle. For semiconductors, HDDs and other operations where the Group provides components and other products, business stability hinges on maintaining lasting ties with customers that represent key sources of demand for our products. An inability to secure repeat business with such customers could therefore affect sales and profitability.

(3) Changes in Customer IT Investment Trends

A major portion of Group sales and earnings is dependent on the provision of IT systems and services to enterprises, public institutions and other customers. Changes in customer IT investment behavior, including reductions in corporate IT spending, can have a profound effect on Group sales and profitability. Alongside corporate clients, national and local governments represent another important customer base for the Fujitsu Group. In the UK, for example, government-related projects are an especially important part of our business. Accordingly, changes in the approach to e-Government and other national-level IT utilization policies being promoted in Japan and elsewhere could impact sales and profitability.

3. Competitors/Industry

The IT sector is characterized by intense competition and fast-paced technological innovation. Events within the industry or actions by competitors could therefore have a substantial impact on our business results. Examples of such potential risks are listed below.

(1) Price Competition

Intensifying competition is directly linked to declining prices for products and services. Anticipating such technology- and competition-driven price erosion, we are pursuing a variety of measures to reduce costs, including the introduction of Toyota Production System reforms, standardization of system development methodologies, and software modularization, as well as efforts to expand sales of new products and services. Despite these steps, the Group still faces the risk of larger-than-expected declines in prices, as well as the risk of being unable to achieve sufficient cost reductions and sales growth due to fluctuations in the price of semiconductors and other components, either of which could negatively impact Group sales and profitability.

(2) Competition From New Market Entrants and Others

In addition to challenges posed by existing industry peers, competition from new market entrants continues to intensify in the IT sector. Today, new entrants continue to emerge in market areas where the Fujitsu Group wields a competitive advantage, thus entailing the risk that we may lose our competitive edge, or fail to secure a clear competitive advantage in future business operations.

(3) Competition in Technology Development

Technological advancement in the IT sector occurs at an extremely fast pace, leading to rapid turnover in new products and technologies. In this context, remaining competitive requires the continuous development of state-of-the-art technology. While the Fujitsu Group does its utmost to maintain highly competitive technologies, a loss in competitiveness versus other companies in the race to develop innovative technologies could lead to a decline in the Group's market share and profitability, which would negatively impact sales and earnings. Further, sales and profitability could be affected by the development of groundbreaking technologies and other actions by competitors that would severely compromise the value of the Group's products and services.

4. Partners, Alliances, etc.

In the course of its operations, the Fujitsu Group conducts business and forges alliances with a range of different companies. Accordingly, any significant changes in relationships with these and other business partners could affect Group operations.

(1) Procurement

The Fujitsu Group utilizes sophisticated technologies to produce a range of products. There is therefore a risk that we may encounter difficulties in procuring a stable supply of certain key components, or, in cases where regular supply channels are unavailable, that we may be unable to secure alternative procurement sources. There is also the risk that the Group may be unable to sufficiently procure certain parts in the large volumes required. Moreover, natural disasters, accidents and other events, as well as any deterioration in business conditions at suppliers, could hinder the ability of business partners to provide the Group with a stable supply of required components. These and other events could cause delays in product shipments, resulting in postponement in the delivery of products to customers and opportunity losses, among other problems. In respect to component procurement, foreign exchange rate fluctuations, tight supply and demand conditions, and other pressures could drive procurement costs higher than initial estimates, leading to diminished returns on products, as well as lower sales due to the need to raise product prices. Additionally, while we make every effort to ensure the quality of procured components, we cannot guarantee that all components purchased will be free of defects. The discovery of such issues could result in processing delays, as well as defective products, opportunity losses, repair costs, and disposal costs for defective goods, plus the potential obligation to pay damages to customers.

(2) Collaborations, Alliances and Technology Licensing

To enhance competitiveness, the Fujitsu Group works with a large number of companies through technology collaborations, joint ventures and other means, a practice that we intend to continue for the foreseeable future. If, however, as a result of managerial, financial, or other causes, it becomes difficult to establish or maintain such collaborative ties or to gain sufficient results from them, the Group's business could be adversely affected. Moreover, many of our products and services employ other companies' patents, technologies, software, and trademarks with the consent of their owners. However, there is no guarantee that other companies will continue to grant or license the right to use their property under terms acceptable to the Fujitsu Group.

(3) Stability of Partner Financial Institutions

Deterioration in the business conditions of financial institutions with which the Group has dealings could lead to changes in financing terms and other developments that could affect the ability to procure required funds.

5. Public Regulations, Public Policy, and Tax Matters

The business operations of the Fujitsu Group are impacted by a variety of public regulations and trends in public policy, as well as laws pertaining to tax and taxation. Specifically, wherever it operates, the Group must comply with a variety of regulations, such as authorizations for business or investment, import/export regulations and restrictions, as well as laws pertaining to antimonopoly policies, intellectual property rights, consumers, the environment and recycling, labor conditions, and taxation. The failure to strictly comply with these laws and regulations may result in the revocation of permission to conduct business, the termination of bids for certain projects, and lead to other issues that could adversely impact Group sales and profitability. Earnings might also be affected by increased compliance costs associated with stricter or otherwise revised regulations. We also provide solutions in certain fields and business domains such as healthcare and communications that are subject to other public regulations, meaning that regulatory trends in these sectors may potentially impact Group businesses.

6. Other Operational Risks

The Fujitsu Group can offer no guarantee of its ability to always achieve the optimal outcome desired in the course of executing business operations. Some of the specific risks faced in this respect are detailed below.

(1) Deficiencies or Flaws in Products and Services

Quality is a core value of the Fujitsu Group. We are committed to improving quality at the design and development stages as well as in manufacturing. We are also promoting stricter quality control when purchasing components from external suppliers. These efforts notwithstanding, it is impossible to totally eliminate the possibility of deficiencies or flaws occurring in products, including software. While the Group is also promoting software modularization and standardization of development work in order to improve the quality of system development and other services, the possibility of defects arising cannot be excluded. In the event that such deficiencies or flaws occur, the Group may have to initiate product recalls or repairs, engage in system recovery work, pay damages to customers or suffer opportunity losses, all of which would negatively impact Group sales and profitability.

(2) Project Management

Due to such factors as the increasing scale of systems and more rigorous demands from customers, as well as the advance of open system environments, system development work is becoming increasingly complex. At the same time, greater competition is leading to increasingly intense pricing pressures. In fiscal 2003, the emergence of certain loss-generating projects prompted the Group to implement extensive risk management measures, including standardized guidelines for projects of a set scale and above, the introduction of the percentage of completion method, and other measures to help prevent the occurrence and facilitate the early identification of such projects. In fiscal 2004, we strengthened these efforts by establishing a new organization to screen projects at the contract negotiation phase and curtail the occurrence of projects with deteriorating profitability. Additionally, in April 2005, we established the Systems Integration Assurance Unit, a body with enhanced powers that reports directly to the president and is charged with bolstering efforts to prevent new incidences of loss-generating projects. Along with these measures, the Group continues to maintain reserves for losses as necessary. Nevertheless, in spite of these measures, there is a possibility that we may be unable to completely prevent the occurrence of loss-generating projects.

(3) Investment Decisions

In the IT industry, large investments in R&D and facilities and equipment are necessary to maintain competitiveness. Accordingly, the success or failure of investment choices has a profound effect on the business results of the Fujitsu Group. When making such investment decisions, we give ample consideration to a range of factors such as market trends, customer needs, the superiority of Group technologies and our business portfolio. There is, however, the risk that promising markets and technologies identified by the Group may fail to grow as anticipated, or that supply and demand imbalances or price erosion may be more severe than expected. Investment in semiconductor facilities and equipment represents one such area with a high degree of risk. In addition to substantial funding requirements, this field is characterized in particular by short product cycles, major changes in the market landscape and stiff competition from other companies. The Group takes a number of steps to mitigate this risk, including responding to these inherent fluctuations by dividing investment into multiple phases and forging agreements with customers prior to investment. Nonetheless, there is no guarantee that the Group can generate sufficient returns on such investments.

(4) Intellectual Property Rights

The Fujitsu Group has accumulated technologies and expertise that help distinguish its products from those of other companies. Legal restrictions in certain regions, however, may impair our ability to fully protect some of the Group's proprietary technologies, with the result that we could be unable to effectively prevent the manufacture and sale of similar products developed by third parties using the Group's own intellectual property. Moreover, the creation of comparable or superior technologies by other companies could erode the value of the Group's intellectual property. The Group has instituted internal policies, including stringent clearance procedures prior to launching new products and services, to ensure that no infringement of other companies' intellectual property occurs. However, there is the possibility that the Group's products or technologies may be found to infringe on other companies' intellectual property. In addition, the Group has previously instituted a program to compensate employees for innovations that they make in the course of their work, and will continue to implement this program in the future in accordance with the revision of Japan's patent laws. Nevertheless, the Group faces potential risk from lawsuits initiated by employees in regard to compensation for innovation created in the workplace.

(5) Human Resources

The growth and profitability of the Fujitsu Group depends heavily on human resources. As such, a major issue for the Group is the ability to recruit and foster talented researchers, system engineers, managers and other key personnel; the inability to do so could negatively impact Group growth and profitability.

(6) Environmental Pollution

While committed to minimizing environmental burden in accordance with the Fujitsu Group Environmental Policy, the Group cannot guarantee that environmental pollution will never occur as a result of its operations. Moreover, although we monitor soil and wastewater as well as engage in clean-up activities at former factory sites, this does not mean that pollution will not be found at such sites in the future. In the event that environmental pollution were to occur or be identified, clean-up and other costs could be incurred that adversely affect Group earnings.

(7) Information Management

In order to safeguard the personal and confidential information of customers and business partners, the Group has established strict regulations and instituted training programs for employees. Nevertheless, the Group cannot absolutely guarantee that information will not be leaked. In the unlikely event that this should occur, trust in the Fujitsu Group could decline and the Group may be obligated to pay damages to customers.

(8) Credit Ratings and Other Factors that Affect Trust in the Group

In addition to having a major influence on capital procurement, credit ratings by outside institutions serve as reliable sources of information when conducting transactions with business partners. Lower credit ratings caused by failure to meet earnings targets, deteriorating financial conditions and other reasons could influence our ability to procure needed funds, and place the Group at a disadvantage in bidding for projects and in other business dealings.

7. Natural Disasters and Unforeseen Incidents

Natural disasters and other unforeseen situations could have a major impact on the business results and financial standing of the Fujitsu Group. Examples of the potential risks posed are found below.

(1) Damage From Earthquakes, Other Natural Disasters and Accidents

The Group has taken measures to make its business sites more resistant to earthquakes and conducts regular inspections and disaster readiness drills. Nevertheless, there is a possibility that the Group may be prevented from continuing operations due to damage to facilities and equipment or interruptions in the supply of electricity or water as a result of earthquakes and other natural disasters and accidents. Such occurrences could interrupt shipments to customers or disrupt shipments of parts for the Group's internal use, thereby affecting factory production at other Group business sites. Semiconductor fabs and other plants where high-precision processing is carried out are particularly susceptible to the effects of earthquakes and similar events. In the wake of such incidents, some time may be required to resume normal operations due to the array of highly specialized equipment and devices used at these sites. Damage caused by natural disasters may also hinder our ability to provide information system support for Group customers, which could interrupt their business activities.

We have a well-developed system in place to ensure the integrity and stable operation of critical in-house networks, which are a key element of our business infrastructure. However, the Group cannot guarantee its ability to prevent invasive computer viruses and other disruptions from impeding network operations.

(2) Geopolitical Risk

Conflicts, political instability, currency crises, natural disasters, epidemics or other events in nations or regions where the Fujitsu Group operates could have a significant impact on its businesses.