Summary Translation of Question & Answer Session at the Briefing for Investors and Analysts on Fujitsu IR Day 2023 (Day 1)

Date:             May 29, 2023
Location:         Fujitsu Headquarters, Tokyo, Hybrid event (At venue/Live stream)
Presenters:       Hidenori Furuta, COO
                  Vivek Mahajan, SEVP, CTO and CPO
                  Megumi Shimazu, SEVP
                  Yoshinami Takahashi, SEVP

Questioner A
Q1: I want to ask about Uvance. From 200 billion yen in revenue in fiscal 2022, you seek 700 billion yen in fiscal 2025. I would like to know what the situation is in Japan and overseas, and what will be the factor for growth towards fiscal 2025. Who will your competitors be in Japan and overseas, and will the competitive landscape change? You said that you seek to gain 5% of the share of the market for sustainability transformation, but according to market research company figures, you have about 13% share of the market for systems integration in Japan, so 5% seems relatively conservative. Therefore, I want to ask if you think the competitive landscape will change.

A1 (Takahashi): For the fiscal 2025 target for Uvance, we want about 40% to come from International Regions. As I explained just now, because the main market for sustainability transformation will be overseas, we want to have a solid footprint overseas, so we would like to aim to capture a certain amount of volume in fiscal 2025 as a milestone. As to competitors, a variety of companies are in the sustainability transformation business. I will refrain from mentioning their specific names, but we see a wide variety of competitors, from big consulting firms to system integration vendors. On the other hand, there is not yet a company that comprehensively offers all solutions, so I think that is where Fujitsu may have an edge. Looking at current trends, there are upstream consultancies, and there are many companies offering tools for visibility, but rather than just visibility, as Vivek Mahajan just explained, when it comes to using connection chains to integrate data, collaborating with data from a variety of industries using blockchain, in addition to making it visible, we think only Fujitsu can do it, so we think we have an advantage there. At the same time, we now have 24 Uvance offerings, and we will increase the number from here. While we expand those capabilities through the cloud, we will offer new solutions for problems that we do not have yet.

(Furuta): In fiscal 2022, total revenue for Uvance was 200 billion yen, and more than half was from horizontal areas, such as Hybrid IT, Business Applications, and Digital Shifts. In terms of vertical areas, the only revenue was from Sustainable Manufacturing. In terms of the proportion from Japan and overseas, over half of the revenue from Hybrid IT is from overseas. As Yoshinami Takahashi mentioned, as we look toward fiscal 2025, our target is to significantly expand in the vertical areas. In terms of the competition, the competition is completely different in the vertical and horizontal areas. For the seven key focus areas of Uvance, the companies we benchmark are different, and our strategy is different. For the main horizontal areas of fiscal 2022 and 2023, there are many traditional competitors. For Hybrid IT that leverages computing, we have technologies that give us an advantage. For Business Applications related to SAP,
ServiceNow, and Salesforce, the key for the growth is securing resources. On the other hand, in the four vertical areas that we want to significantly grow from now, we think we have white space. We think competitors will emerge, from startups to large companies, but we actually want to be active in working with startups that have unique capabilities. From the point of view of the startups, our strength is our wide customer base and market share, so we want to take advantage of that and generate synergies with those startups as we aim to increase sales revenue by 500 billion yen. The way we work and the way we approach the vertical and horizontal areas is naturally different, so we have a variety of strategies.

Q2: I want to ask about your disclosures and commitments with regard to Uvance. You have disclosed your annual targets, but will you disclose your results every quarter? Also, internally, have you allocated Uvance sales targets and earnings responsibilities to specific business units?

A2 (Furuta): We will think about our method of disclosure. Up until now, we have shown our focus areas in terms of For Growth and For Stability, but now Uvance is our growth driver, so we would like to think positively in terms of disclosure. And, yes, we have set internal targets for business units. That is not just for fiscal 2023. As we look to fiscal 2025, we have Uvance sales targets for each region, which includes Japan, Europe, APAC, and the Americas, as well as for all the business units in Japan, and we are tracking them every day.

(Takahashi): We think it is important to share our KPIs. To launch a new business domain like Uvance, we need to have the whole company working toward the same target. We shared some KPIs internally for fiscal 2022, but from fiscal 2023, as Mr. Furuta said, we have set detailed targets for each focus area for all business units, all regions, and the whole company. We want to move forward with this business on a company-wide basis.

Questioner B

Q1: In your explanation of your delivery strategy, you had some quantitative KPIs, such as increasing the ratio of work done internally from 59% to 64%, or having the usage ratio of the Japan Global Gateway go from 30% to 45%, but what specific effects will that have on earnings or profitability? For example, I have heard in the case of other companies that, by reusing software assets that have been stored, processes were reduced by 60% for simple deployments. You have set operating profit margins for yourself in your medium-term management plan that will be among the top of the IT services industry in Japan, but how much profit will be contributed over the next three years from meeting your KPIs for offshoring or the Japan Global Gateway? Or will you be able to reduce the man-hours required? Please also give us an idea of the timing or schedule of these effects.

A1 (Shimazu): In last week’s briefing on the medium-term management plan, CFO Takeshi Isobe explained that expense improvements and efficiencies would generate 80 billion yen. In our delivery strategy, we want to make large contributions to the 1% improvement of our gross margin each year for three years. I will refrain from giving detailed figures, but over three years it will be in the several tens of billions of yen. Regarding the schedule, every year we will expand the ratio of offshoring, the ratio of work performed internally, and the ratio of work
performed by the JGG and GDCs, so the earnings contribution will expand every year starting from fiscal 2023.

**Q2: If it is 30-40 billion yen for the three years, is it correct to assume that it will account for roughly 20% of operating profit improvement from fiscal 2022 to fiscal 2025 of your medium-term management plan?**

A2 (Shimazu): The 1% improvement in gross margin is not just from the delivery strategy. As Mr. Takahashi explained, it is also from the expansion in profitability of Uvance, so it is the combination of those benefits.

(Furuta): I would like to add that, for Service Solutions, we are aiming for 2.4 trillion yen in revenue for fiscal 2025. That is 400 billion yen more than the 2 trillion yen in revenue for fiscal 2022, so even a 1% improvement per year represents a large absolute value. The use of JGG or the GDCs, and performing more work internally, all have benefits as a set. For the GDCs, it is not just lower piece rates. There are also overhead costs, so when we share resources, we not only make up for the lack of sufficient resources in Japan. We also produce better work. The improvement in the gross margin of 1% per year will represent substantial amount of profitability since it is an efficiency improvement implemented while aiming for a revenue growth of 400-500 billion yen.

**Q3: If revenue in Service Solutions increases from 2 trillion yen to 2.4 trillion yen and the gross margin improves by 1% per year, that represents 20 billion yen in improvements per year, or 60-70 billion yen over three years. That is about double the several tens of billions of yen, that you mentioned earlier. Are there other factors?**

A3 (Furuta): What Ms. Shimazu explained was the amount gained through greater efficiencies through delivery strategy. There are also the effects of automation as well as higher revenues from the solutions themselves. From the 1-to-1 contract model that Mr. Takahashi mentioned, these figures factor in sales efficiencies when it gets to be 1-to-N.

**Questioner C**

**Q1: In terms of the various application packages you have now for different industries, how will those packages be positioned and handled from the perspective of Uvance or the GDCs and JGG?**

A1 (Takahashi): We will switch what we can switch from the previous packages to Uvance. There are still many things that we are handling individually, and that is around the world, not just Japan, so by having global offerings, it will also make our R&D more efficient. Rather than just 0 or 1, we can deliver services in a way that is most competitive for Fujitsu while taking into consideration the circumstances of the customer.

(Shimazu): The development and maintenance of our current packages is mainly handled by the GDCs and JGG. As we shift as much as possible to Uvance, the knowledge and expertise of the GDCs and JGG will make a contribution.
In terms of the packages for different industries, they are almost entirely for Japan, and we cut down what had been around 2,000 proprietary industry packages to around 1,000 today. We will continue to pare that number down, and for industry packages that are no longer competitive, we will basically put an end to them, and we will shift our human resources to businesses like Uvance, where we are more competitive and where the future value should be higher. For example, GK Software, for which our tender offer bid was recently accepted, has a cloud application supporting sophisticated point-of-sale systems, and we will roll it out in Japan and elsewhere in Asia. We basically plan to end the separate POS applications we had up to now in Japan and Asia. There will of course be some industry packages that we retain, but basically want to shift to Uvance, and of the 1,000 packages that remain now, only the competitive ones will be retained.

Q2: Will the FBaaS solution for banks be one of them?

A2 (Furuta): FBaaS is a SaaS solution for internet banking, and it is not part of Uvance. Software packages that are for regulated industries, such as for local governments or electronic medical records, are not easy to take global, and FBaaS is also a regional offering that we will retain.

Questioner D

Q1: In the section on business applications on page 7 of your materials on Fujitsu Uvance Business Strategy, you state that you will deploy products from other companies, including SAP, ServiceNow, and Salesforce. Because these are other companies’ products, won’t your gross margin be very thin? Moreover, solutions of Sustainable Manufacturing for the supply chains or digital factories are also provided by global ERP vendors. It seems to me that it will be difficult for you to make a high profit without packaged systems for which high sales can be expected. Please explain how you can aim for a gross margin of 40% for Uvance.

A1 (Takahashi): Let me explain it first in terms of Business Applications. Regarding SAP, ServiceNow, and Salesforce, in addition to expertise on individual software, in the automation of ServiceNow, for example, the process mining step is what is important. Only Fujitsu can take on the flow of which processes can be improved and automated to maximize digitization and efficiency. Utilizing vertical expertise, the 3S (SAP, ServiceNow, and Salesforce) applications and process mining, I think we can deliver services to customers comprehensively. Accordingly, for Business Applications, the structure of our profitability will change because Fujitsu can do the process mining or the SAP success factors that is one stage before that and not just systems integration. Other than that, we are also integrating intellectual property with other partner companies. We aim to improve the overall added value by integrating IP, such as optimization and automation using the digital annealer, and delivering IP to customers using CRM, including for customer retention. In vertical areas, we are adding offerings in which the relationship goes from 1-to-1 to 1-to-N. For example, in SaaS offerings, we use reference models, and instead of delivering something from scratch to the customer, it is 60-70% standardized, and it is just the remainder that is customized. This is already being done with software makers outside of Japan, and Fujitsu can maintain scalability and expand earnings.
Q2. In the past, Fujitsu has stated that it has been unable to break away from its “services peddler” approach to businesses outside of Japan. Will you really be able to change this situation in the span of three years?

A2 (Takahashi): I will explain our overseas resources, starting with Business Applications. We acquired a company called Enable with ServiceNow capabilities, and it provides a template. ServiceNow’s deployment method is methodology, and by reverse engineering it, Fujitsu can now utilize the company’s case template to create resources. Therefore, we will not necessarily only build resources through external recruitment and reskilling, but also expand our capacity by using new technologies, as we have done with Enable. We also explained that our technology consultants would be placed close to the frontline. Starting in fiscal 2023, we are planning to place a little less than 100 employees with expertise, such as process miners and data scientists, on the frontlines, including outside of Japan. Doing this will enable our specialists and frontline employees to win sustainability transformation projects for Fujitsu.

Q3: Does this mean that you will place a little less than 100 of these experts in each region?

A3 (Takahashi): It means that Fujitsu will deploy a little less than 100 Uvance-related specialists globally.

Questioner E

Q1: Regarding the market for modernization on page 12 of the delivery strategy materials, what were the sales composition ratios for the on-cloud, modernization, and on-premise areas in fiscal 2022? You explained to us that on-cloud (digital transformation) will surpass the growth rate of on-premise, but on-premise is a large-scale business at Fujitsu, so will this not have a significant negative impact overall?

A1 (Shimazu): I cannot speak to the exact percentage of what the sales composition ratios were, but on-premise was a larger percentage at the end of fiscal 2022, and we anticipate that our modernization customers will increase during these three years. So, we believe that the composition of our on-premise business and on-cloud (digital transformation) business will be about the same by around fiscal 2026, and then the composition of our on-cloud business will increase even further. Fujitsu will not only assist our customers with modernization, but also provide support to them afterwards. Also, we used the term “aggressive” modernization, but by no means does this only apply to current customers of Fujitsu. We will also take on the challenge of proactively modernizing customers that are using other companies’ systems.

Q2: I understand that, as competition increases, your aim is to provide on-cloud support to your customers after assisting them with modernization, but are your customers actually choosing you to provide that service?

A1 (Shimazu): There have been very few instances that ended with us only providing our customers with modernization services. Basically, the majority of customers continued to receive support from Fujitsu after their modernization.
Q3: Could you please give us some background on your investment in human capital? I was impressed by how generous Fujitsu was with its investments in this area compared to other companies. What issues are you aware of and working on?

A3 (Furuta): In addition to technology, people are also an important part of supporting transformation. We are taking measures to increase the productivity of our talent, but in addition to increasing the productivity per person, we will also need a volume of resources that enables us to pursue business scale. As mentioned in a book published by Ridgelinez, the four X’s, two of which are Experience (Customer Experience [CX] and Employee Experience [EX]) and two of which are Excellence (Management Excellence [MX] and Operational Excellence [OX]), are supported by human capital. So, transformation must be centered on our talent. When formulating the medium-term management plan that we recently announced, we discussed that human capital will be the most important factor in it. As our business portfolio changes, we need to make investments in reskilling our talent to match it. Our employees, regardless of age, are seeking new opportunities to learn. Their desire to learn is the reason behind our investment in our human capital.

(Takahashi) There is a scarcity of talent in Business Applications that are well versed in SAP, ServiceNow and Salesforce. To acquire talent that specializes in this area, we are benchmarking the compensation level of other piers, as well as collaborating with our partners to thoroughly implement internal reskilling. For example, Fujitsu is collaborating with multiple partner companies to promote a flow of talent where Fujitsu employees are dispatched to the partner companies and then return to us after the projects have been rolled out. Also, for reskilling, we believe that areas other than 3S (SAP, ServiceNow and Salesforce) are important as well. In recent years, how to create Microsoft Service Architecture and develop applications in the cloud has become increasingly important. Essentially, we are utilizing the training and systems of GK Software, which we acquired, and are dispatching our engineers to the company for several weeks. Another example is our utilization of templates from our partnership with Enable. We have established global training agreements with partner companies, and Fujitsu is working to put in place a global reskilling organization. The most important factor for our future business expansion is how quickly we can respond to market changes and develop and reallocate talent.

(Shimazu) Yoshinami Takahashi already explained this, but there is fierce competition for recruiting talent skilled in SAP, ServiceNow, and Salesforce. In addition to recruiting talent, we believe that, in order to retain our current engineers, we need to offer the same amount of compensation as competitors outside of Japan. Global delivery centers outside of Japan currently have many employees with the same skill set to handle service desks and management services, but as this area becomes more automated in the future, we will need reevaluate the allocation of human resources. Until now, we had not been able to provide care for this area, but Fujitsu will now provide these employees with a reskilling program to reskill them, rather than having the employees leave Fujitsu.

Questioner F

Q1: I have a question about the competitiveness of Uvance. I believe the horizontal domain is an area that a lot of other companies doing integration are offering services for, so I think it will be important to think of how to expand the offerings for vertical areas. Due to this, I
would like to ask where your strengths lie in the vertical areas. For example, is it with using technology to establish software-oriented components, or systemizing and simplifying past customization and integration methods and applying them, or both? Please give us a detailed explanation about this.

A1 (Takahashi): One example, in the area of Customer Experience, is how Fujitsu and other companies provide transactional point of sales services (point of sales for payment). One of the things we are trying to do in collaboration with GK Software is to incorporate a personalization engine into our point of sales service. Providing our customers with services that suit their needs in real time will be one way that we retain customers. In distribution business circles, the most pressing issue is how to enclose customers by retaining them from transactions. It is in this context that we plan to develop a combination of our own technologies, such as demand forecasting engines and blockchains for traceability, and GK Software’s dynamic pricing, as our strengths. There are not many companies in Japan that do business in this area, so we will create Customer Experience offerings that combine our technologies, which form our current base, and international user cases. For manufacturing, the visualization of how much greenhouse gas emissions are being emitted in the supply chain is something that many companies are doing now in the scope 3 area. On the other hand, regarding how to view greenhouse gasses as a whole in the broader context related to suppliers and related companies, the data integration and ontologies used in blockchain technology and Palantir’s platform must be utilized to create an output database, so we believe this will be our strength. We do have a large customer base in the manufacturing area, so, in addition to that, we plan to leverage our propriety technologies and make them a source of our competitiveness.

(Furuta) I believe that Fujitsu has four major strengths. The first is that Fujitsu has a large customer base. This enables us to know in real time what direction our customers will move in. For example, we can experience firsthand how a customer who controls the supply chain of a certain manufacturing sector will be forced to make changes with a sense of urgency in order to respond to scope 3 issues. The second is, through having business packages, we have the business know-how of our customers. Our strength lies in our potential to provide ideas for what our customers will need, even without being asked to. The third is we will need a computing and secure software environment to achieve success in Uvance’s vertical areas, and, as Vivek Mahajan explained earlier, we have many of these technologies in-house. Although IP from other companies will be included in our technology holdings, our ability to integrate them will be one of our strengths. The fourth is our internal reference models. We are investing in the OneFujitsu program, and this will serve as a reference model for our other programs. It is important for us to be able to experience for ourselves whether it is feasible to create offerings, for not only horizontal areas, but vertical areas as well. The OneFujitsu program will continue until 2030, and will be regularly updated. This will be a strength that we can use internally and also bring to our customers.