

## Summary Translation of Question & Answer Session at FY 2014 Second Quarter Financial Results Briefing for Analysts

Date: October 30, 2014  
Location: Fujitsu Headquarters, Tokyo  
Presenters: Hidehiro Tsukano, Corporate Senior Vice President & CFO  
Youichi Hirose, Corporate Executive Officer

### **Questioner A**

*Q1: What is the status of IT sales growth in Japan in the first and second quarters, broken out by vertical sector, and what is your outlook for the second half?*

**A1 (Tsukano):** First I will discuss the first-half sales figures. For the first half, overall IT sales in Japan were up 1% from last year's first half. Sales were up 2% to customers in the manufacturing sector, sales were flat in distribution, up 1% in financial services, up 1% in social infrastructure, and up 2% in the public and regional sector. Because sales growth in the first quarter was especially high, there was a slight fall-off in the second quarter, with overall IT sales in Japan down by 4% in the second quarter, in comparison with an increase of 1% for the full first half. We do not have a publicly disclosed projection for the second half alone, but our full-year projection remains unchanged for growth of 2%.

For the second quarter, sales were up 4% in manufacturing compared to same period in the previous year, down 3% in distribution, down 5% in financial services, down 7% in social infrastructure, and down 6% in the public and regional sector.

Orders in last fiscal year's fourth quarter and this year's first quarter were very high, up by about 10%, and a disproportionate amount of these orders will be converted into revenue in the second half of this fiscal year. Moreover, the deals in our pipeline are high-revenue prospects, and we currently believe that these will lead to firm orders going forward. On the other hand, we are starting to see our system engineer resources for the financial services and public sectors becoming somewhat stretched. Still, we want to win more business, in addition to making the most of our internal resources and getting the cooperation of partners, we plan to prioritize business opportunities that are especially profitable or that are highly likely to generate follow-on business.

*Q2: For IT sales in Japan, please tell us how your performance in the first half differed from your previously announced projections. Also, for the full year, you are not changing your projections? You said your orders are improving, but does that mean that, because your supply of system engineers is tight, that your costs will rise because of higher overtime pay? Overall, please tell us whether your profitability is improving.*

**A2 (Tsukano):** For the second quarter of this fiscal year, we had projected an overall decline of 2%, but sales actually declined by 4%. The concentration of large-scale deals in the second quarter of the previous fiscal year had a big impact on the second quarter of fiscal 2014, particularly in the public sector, social infrastructure, and financial services.

We have not changed our full-year projections. We expect positive growth in the second half.

As for profitability, I expect we will prioritize deals that are especially profitable. As for our system engineers, there have been discussions on increased costs, but we have been able to control costs so far, so our view is that profit margins will increase and profits will rise. To the extent that we can win relatively profitable new business, we can increase profits even if our costs are slightly higher.

*Q3: With the spread of big data analytics, what is important is how to get real data. Particularly in the field of automobiles, the fact that Fujitsu Ten is a Group subsidiary is one of your strengths, but what are your plans for Fujitsu Ten? Do you plan to sell the company? If not, what do you plan to do with it?*

**A3 (Tsukano):** There are no plans to sell Fujitsu Ten. Fujitsu Ten plans to focus its business more on software. It is also beginning to invest in growth businesses that utilize big data, such as M2M and wireless technologies. On the other hand, there are some issues with big data, such as who owns it? In the auto sector, even amongst the same group's companies data ownership can be divided, making it difficult to use. In cases in which we want to do a field trial, we separately negotiate access to the data. Ideally, if we could, we would like to use analytical tools, such as our SPATIOWL service, create new value from the data, and provide services to customers. In the IoT world, making connections among things is what is important, and we can turn vehicles into terminals that are all wirelessly connected to create a world in which a variety of data, not just data on traffic congestion, flows back and forth, including vital signs monitoring data. Based on that type of concept, we would like to generate synergies within the Fujitsu Group between Fujitsu Ten and our services business.

*Q4: You had an exhibit on your vegetable factory at CEATEC, but what are your thoughts on new areas of diversification? Are you promoting it for your big data business, or are you thinking of converting other semiconductor or other component factories?*

**A4 (Tsukano):** In addition to its benefits in terms of consolidation and concentration of resources, one of the core concepts of the cloud is its use as a platform on which many participants can share software and functions. An example of this is our agricultural cloud. We want to conduct iterative field trials, get a wide range of individuals and farmers to use it, and make it into a platform for increasing productivity, reducing costs, and precisely balancing supply and demand.

### **Questioner B**

*Q1: According to recent newspaper reports, there is a strong possibility that a telecom carrier will undertake further cost cutting. This may affect your mobile phone and network equipment divisions, but what is your view of this? Also, with respect to overseas market trends, do you see a risk that the environment for your businesses outside of Japan is changing?*

**A1 (Tsukano):** We think cost-cutting initiatives by the telecom carrier will impact us. There may be requests for price reductions, but we want to compete in somewhat different arenas going forward, such as SDN (software-defined networking) and the wireless business.

In terms of market trends outside of Japan, in light of recent IMF statements about economic deceleration, there are a variety of aspects that one could consider. The scariest scenario is one in which some event suddenly triggers capital flight that moves exchange rates, and we think we are monitoring that risk very closely. Another risk is geopolitical risk. We need to assess the potential ramifications of each country's internal political issues. Right now the focus is on the Ebola virus. We have very significant operations in countries such as the UK and France, which had colonies in Africa, and if the virus spills over into those countries, it could result in a significant economic slowdown. On the other hand, since a significant part of our business is infrastructure services, in which we receive monthly payments from customers under long-term contracts, even if there was some impact, we would not immediately feel the effects. Because of that, I am confident that we will achieve our financial targets for this fiscal year.

*Q2: Is there a risk that, because of cost-cutting by telecom carriers, you would, for example, have to significantly reduce the price of your Raku-Raku (easy-to-use) phones in the second half, thereby negatively impacting your financial performance? Also, have you heard anything from your subsidiaries outside Japan or managers there that the market environment is beginning to change?*

**A2 (Tsukano):** We are the only ones to offer the Raku-Raku phone, and we are launching new models for which we are seeing strong demand. Because we do not need to make significant additional investments, we think it is a business that will support us for a long time to come. As for our business outside Japan, in the first half we were able to hold unprofitable projects down to nearly zero. In terms of big deals, there was a contract for ATMs and maintenance services with CaixaBank in Spain, and we also received a large order from a public sector organization in Germany, whose name I cannot divulge, for mainframes and operational services. These services are based on ongoing monthly contracts, so we do not feel we would be directly affected by any fallout from immediate risks. If there were any impact, it would be limited.

### **Questioner C**

*Q1: Your second quarter operating profit from the System Platforms sub-segment declined from the year-earlier period, and it seems that, compared to your performance in the past, the performance of that business in fiscal 2014 is rather weak. What is the reason for that?*

**A1 (Tsukano):** For our system products, including servers, storage, and middleware, much of our business is with public sector entities, and it goes through cycles in which there is a concentration of system upgrades, followed by a drop-off in business. Our system maintenance business also follows the same cycle. With this business structure, there was a concentration of system upgrades in the second quarter of fiscal 2013. In this

year's second quarter, however, it was the complete opposite, representing the trough in the cycle of system upgrades. That is the direct reason. Still, in the third quarter and into the fourth quarter, we expect to see another concentration of deals.

*Q2: Based on your full-year projections, we can calculate that you are projecting operating profit of 57.7 billion yen in the second half from your System Platforms sub-segment. Compared to past trends, this is a very high target, but can we assume that it is because you have a significant number of deals that, with a high degree of certainty, will generate operating profit in the second half?*

**A2 (Tsukano):** Yes, that is exactly right.

*Q3: Big data is a business area that is attracting a lot of attention, but there is an increasingly diverse group of platforms, and the number of competitors is increasing. Do you think these players could pose a competitive threat to Fujitsu? What are current conditions like in the Japanese market?*

**A3 (Tsukano):** Network product companies, computer companies, and internet services companies are all going after the same business area. One area where we see this is an area called cloud-based networking, which are supported by SDN and network function virtualization (NFV). In discussions about big data business, the buzzwords “business intelligence” and “business analytics” are often used. One good example of how these are used is in functions that recommend products based on user preferences, but this is still a very elementary example. These trends are starting to lead to an environment in which applications can be offered that transcend industry and business category. Fujitsu would also like to help create such environments.

*Q4: According to statistics, investments in software account for 25% of the investments made by corporations in Japan, but account for nearly 40% of the investments of companies in Europe and the US. Do you have any expectations that companies in Japan will suddenly increase their software investments and close this gap?*

**A4 (Tsukano):** I think companies in Japan are lagging behind in comparison with the US. To that extent, I think there is significant potential for growth in the future.

*Q5: In your Device Solutions segment, you had operating profit of 10 billion yen in the first half, and you are projecting operating profit of around 14 billion yen in the second half. What is the reason for the increase in profit in the second half compared to the first half?*

**A5 (Tsukano):** One reason is because one large customer is increasing its own production, and we expect that will lead to higher earnings for us. As we have announced, the new SoC company would no longer be consolidated in our earnings starting in the fourth quarter, and that impact, which will serve to slightly reduce operating profit, has been reflected in our projections, but, even so, we still believe we will be able to meet our

targets for operating profit. Even at our production facilities making standard logic devices, by consolidating production, we plan to improve our capacity utilization rates.

#### **Questioner D**

*Q1: What new products in your System Platforms sub-segment are you planning to introduce in the second half, and to what extent will that contribute to higher earnings?*

**A1 (Tsukano):** The new product is a new mainframe computer. Not just in Japan, but in Germany, too, we have won a contract to provide, in addition to the mainframe itself, the accompanying software and operational services. This is a highly profitable and long-term contract. Mainframes are upgraded on lengthy product cycles, but we will be able to offer this new model.

*Q2: Roughly what impact will the new model have on your financial performance?*

**A2 (Tsukano):** Including the accompanying software and storage, in addition to the mainframe systems, we aim to generate revenue of 20-30 billion yen in the quarter.

*Q3: For the second half, looking at the third quarter and fourth quarter separately, what are your sales expectations, particularly for the Technology Solutions segment?*

**A3 (Tsukano):** For the Technology Solutions segment as a whole, we expect to generate 40% of second-half revenue in the third quarter, and 60% in the fourth quarter, or possibly the ratio of sales in the third quarter could be slightly less. The reason why the ratio of sales for the fourth quarter is high is because we can estimate it based on current orders and from the status of our pipeline. We could clearly see this situation when we devised our fiscal 2014 financial projections at the beginning of the fiscal year. Especially in the case of system integration services, we received a high level of orders in the first quarter, compared to the same period of the previous year, and we expect these to be converted into revenue in the second half. While not as high as in the first quarter of this year, we also received a high level of orders in the fourth quarter of fiscal 2013, representing year-on-year double-digit growth, and these were long-term projects, resulting in the high figures for the second half. Sales in the first half were relatively low, but that is exactly what we expected, and the reason we exceeded our projections for the first half is because of better-than-expected performance in the Ubiquitous Solutions segment in the first quarter.

*Q4: What kinds of deals are included in the strong flow of orders that will generate revenue in the fourth quarter?*

**A4 (Tsukano):** One example is service business with recurring revenue, which is growing. In particular, business with recurring monthly income is growing. There are also a number of deals on the horizon that combine hardware with operating services or maintenance services, and we already have orders for some of these.

#### **Questioner E**

**Q1:** *Earlier you said that your recent flow of orders has been good, and that you are in a situation in which you will prioritize the more profitable projects, but do you expect that the earnings from your systems integration services business next year will be higher than in this fiscal year?*

**A1 (Tsukano):** Yes, because these are large-scale, long-term projects, we expect next year will be higher.