Summary Translation of Question & Answer Session at FY 2022 Second Quarter Financial Results Briefing for Analysts

Date: October 27, 2022
Location: Live-streamed from Fujitsu Headquarters, Tokyo
Presenter: Takeshi Isobe, SEVP & CFO

Questioner A

Q1: You said that the impact of the global chip shortage is moderating, starting in the second quarter, and that by the fourth quarter you should be in a better position compared to last year's fourth quarter, but I think the negative impact in the first half was larger than you anticipated in your plans at the beginning of the period. How much of an impact are you anticipating for this year's fourth quarter? In the auto industry, we hear talk that the impact of the chip shortage could last several years. Will you not still experience some effects next fiscal year?

A1: The impact of the global chip shortage is as we anticipated. There was a bit of a negative impact in the first quarter, but, particularly from a supply perspective, the situation slightly improved in the second quarter, and we were able to recover. The negative impact on sales was 27.8 billion yen in the first quarter and 13.2 billion yen in the second quarter. Initially we thought the impact to sales in the second quarter would be similar to the impact in the first quarter, but there was an improvement. It is not the case that the issue of shortages has been resolved for all of our product areas, but we now see clear prospects for procuring components for which there had been bottlenecks. We think the impact will reduce sales in the third quarter by around 3-5 billion yen, but we think the impact in terms of higher costs will shrink. In terms of profits, we have raised our list prices, which has served to pass on a total of several billion yen in higher costs through higher prices, so we think we are at the point where we can recover from the decline in sales. While the absolute amounts are not large, in our plans we anticipate that we can show a slight improvement in the third and fourth quarters.

Q2: Does that mean that you will eliminate the 23.9 billion yen reduction in operating profit that you experienced in the second half of last fiscal year and, on top of that, through higher sales and by passing on higher prices to your customers, you will further improve operating profit?

A2: We started passing on higher costs through higher prices in the fourth quarter of last fiscal year. From the first quarter into the second quarter, that eliminated several billion yen from the hit we were taking to operating profit, so please understand that these measures are behind the results you see now. These measures enabled us to plug that hole, so we will eliminate the 23.9 billion yen hit to operating profit we took in the second half of last year, and in this year's second half we should be able to add a few billion yen on top of that. For example, compared to the same period last year, we should see a positive impact of close to 30.0 billion yen in this year's second half.

Q3: You explained that orders for network products have declined from the high levels of the previous year, but, in looking at the trends among telecom carriers and media coverage of

some of their suppliers, I have the impression that, overall, including for base stations, their investment spending is concentrated in the second half. How are you viewing this situation? Do you think there is a risk that investment spending among telecom carriers will not significantly materialize in the second half?

A3: I do not think that our business with domestic telecom carriers will go away, but I do think it will weaken to certain extent. In particular, the current trend among large telecom carriers in Japan is to focus more of their investment spending on high value-added software, so investment spending on hardware is not very strong. Overall, for our network business in Japan, we are expecting sales revenue to decline a bit. Outside of Japan, we have base station business with Dish Network in North America, but they are switching over to a new generation of equipment, and a second vendor has also entered the picture, so competition is intensifying. On the other hand, large telecom carriers in North America are purchasing our optical transmission equipment, and demand for this equipment continues to be extremely strong. If we can execute a solid recovery through that business, I think that we may be in a position to achieve an overall increase in sales revenue.

Q4: You are saying that you would like to achieve an increase in sales revenue for network products, but how does that compare with your forecast?

A4: In comparison with our original forecast, our performance in mobile systems is somewhat weak.

Q5: If that is the case, are you thinking that you can make up for that with higher Services orders?

A5: Yes, that is what we are thinking.

<u>Questioner B</u>

Q1: In response to questions from the media, you stated that your backlog of orders for fiscal 2023 is up by 15%. Could you explain the meaning of that statement?

A1: Please understand that I was talking about the different periods in which orders would be converted to sales. The current trend in orders is very strong, and some orders will result in sales this fiscal year, while other will be for next fiscal year. Some projects have long lead times, so we have some orders now that will result in deliveries and sales next fiscal year. I explained that our backlog of orders for which we expect to record sales in the second half of this fiscal year is up by 11% in Japan compared to the previous fiscal year. Compared to the backlog of orders for fiscal 2022 that we had at this time last year, this year's figure is 15% higher. Instead of just orders for fiscal 2022, we already see demand in the form of orders for beyond this fiscal year. Of course, the absolute value of backlog of orders for deliveries in fiscal 2023 is lower than the backlog of orders that we expect to convert into sales in the second half of fiscal 2022, but my explanation was meant to convey a sense of the momentum with which we are receiving orders.

Q2: I would like to ask about your book-to-bill ratio. Last fiscal year, your orders for Solutions and Services in Japan were strong, but my understanding is that sales declined. My

presumption is that it was because the absolute value of your orders was lower than your sales. Now, however, with your order backlog accumulating, I am assuming that the value of your orders has finally exceeded your sales, but please confirm the absolute values of your orders and sales levels.

A2: There are markets in which many projects have long lead times, and there are also markets in which there are many smaller projects with relatively quick turnaround times, so if I were to explain in terms of 12-month moving averages, I might not be able to give you a complete picture, but in all areas our book-to-bill ratio is over 1. Sales were basically flat, while the orders increased, and it resulted in a book-to-bill ratio exceeding 1. In March of last year, there was wide variation among industry segments, with some strong and some weak, but the industry segments for which, on a 12-month moving average basis, the book-to-bill ratio exceeded 1 were only private enterprise business, finance, social systems, and national security, and public sector digital business, and national government ministries and agencies did not exceed 1. As you stated in your question, now the book-to-bill ratio exceeds 1.

Q3: This fiscal year you have allocated up to 150.0 billion yen to share buybacks, but my understanding is that you have not yet started your purchases. Please tell us when you will start and why you have not already started these purchases.

A3: It is not as if we would set an allocation limit and then do nothing. I will refrain from commenting on the details, but we are closely watching for the right time, and we will proceed with share buybacks.

<u>Questioner C</u>
Q1: Earlier you said that meeting your full-year forecast of 400.0 billion yen in operating profit is not a fantasy, but, in contrast to other companies, only Fujitsu has announced such a high full-year forecast, and the stock market appears to assume that you cannot meet it. My understanding is that Fujitsu has a tendency to wait until the third-quarter earnings announcement before revising down your full-year forecast, but this fiscal year, if you had revised down your full-year forecast along with your second-quarter earnings announcement, I think the stock market would have accepted the revision. Please tell us the reason why you have decided to wait until your third-quarter earnings announcement before revising down your full-year forecast. Is it because, before then, you might see some glimmer of hope of meeting your full-year forecast?

A1: Because we are receiving orders and the order backlog is increasing, we feel it is probable that sales will increase. Because we have orders for this period that are for sales in fiscal 2022, there may be a risk as to whether the current brisk pace of orders can continue in the third quarter. I have confirmed with our salesforce that demand is strong, and our ability to meet our forecast is premised on the continuation of a strong flow of orders. At present, we do not see any projects that are unprofitable and that would generate losses in the second half, and by accumulating sales we think we can meet our full-year forecast. Of course, it is not as if we have nothing to worry about. In the first half, in Technology Solutions we were presented with the negative impact from currency movements. When sales expand, in the second half, hardware sales in Technology Solutions will be affected by currency movements. We are working to pass on higher costs in the form of higher selling prices, but it is not easy. At the present time, our view is that no negative factors have emerged that would cause us to abandon our full-year forecast.

Q2: In terms of meeting your operating profit target of 300 billion yen in the second half, can we assume that you intend to meet it through your underlying business without any special items?

A2: Yes. Our plan calls for meeting it through our underlying business without special items.

Q3: It seems that, in your briefing materials this time, you were more straight-forward. What changes were there in terms of decisions to sell businesses or subsidiaries? Did something change in terms of your objectives or criteria in selling, such as that you will sell if you can meet certain conditions?

A3: With the carve-out of PFU and Socionext's IPO, because there was impact to our cash flow, on page 26 of the briefing materials we presented information on initiatives to achieve our desired business portfolio. The reason we included this information was not related to any particular new development or event. I understand that some people are of the opinion that the order or sequence of our sales of businesses should be different, but we are considering to sell non-core businesses that are publicly listed. Because we are working on sales of businesses or partnerships, including carve-outs that would raise our corporate value, and because some carve-outs are easier than others, it can take time for the sale to occur. At the same time, we are working to enhance our capabilities. We have not made any major acquisitions, but because we have a reserve of cash for growth investments, including acquisitions, we are evaluating multiple factors, such as whether a potential acquisition candidate shares the same strategic direction, or whether the acquisition would generate synergies, and in which areas we could gain capabilities. We are working to enhance our capabilities in our focus areas, and any acquisitions we make would mainly be smaller ones. In terms of our non-core business areas, we are looking for counterparties who will improve corporate value of a particular subsidiary or business, and we intend to do more carve-outs when we find them.

Questioner D

Q1: Please tell us the factors behind the approximate 8% decline in operating profit for Solutions & Services in the second quarter.

A1: In the second quarter, operating profit in Solutions & Services declined by approximately 2.8 billion yen. There was what we refer to as special items, which resulted in a one-time charge. I cannot go into all the details, but to give an example, something like transferring a specific Global Delivery Center to a different location is one significant factor that affected our results. If we exclude special items, then operating profit is essentially unchanged from the previous year. We also incurred some other costs in the second quarter. Because we had to deal with unprofitable projects and certain issues that were made in creating a package of assets in an offering, operating profit did not increase in the second quarter.

***Q2**: Is the cost for transferring the GDC on par with the 2.9 billion yen impact from the global chip shortage?*

A2: The cost was in the single-digit billions of yen.

Questioner E

***Q1**: Please explain to us the factors for the change in operating profit for Technology Solutions compared to the previous year.*

A1: Excluding special items, operating profit was down by 11.0 billion yen in the first half of this fiscal year. Out of the 13.4 billion yen impact of the global chip shortage across the whole company, there was a 13.0 billion yen impact in Technology Solutions, and there was a positive impact of 2.0 billion yen from other factors. Revenue in Technology Solutions was essentially unchanged, but cost and expense efficiencies added about 10.0 billion yen to operating profit. Growth investments were all in Technology Solutions and reduced operating profit by 8.7 billion yen.

***Q2**: It does not seem as though there was much progress made in the optimization of costs and expenses, but would it be correct to assume that the use of GDCs is progressing as expected?*

A2: We are aiming to double the GDC utilization rate from the previous year, and our utilization and productivity are improving as planned. There are two reasons why the second quarter results in Technology Solutions appear as they do: the number of highly profitable public sector projects in regions outside of Japan decreased overall and we also incurred a one-time cost. In regards to the impact of exchange rates, the impact on revenue and gross profit is included in the revenue growth impact, and the impact on expenses is included in the costs and expense efficiencies. Compared to the first quarter, the exchange rate had a negative impact on expenses in the second quarter.

Questioner F

***Q1**: In Solutions and Services segment, in comparison with the same period of the previous year, I think you will need an increase in operating profit of 70.0 billion yen, but my impression is that result of the first half was not very strong, even excluding the unprofitable projects. Even if orders are strong in Solutions or IT services, I believe that there are a variety of reasons why orders would not be converted into sales. I believe that you anticipate that a large amount of the absolute value of the orders will be converted into sales and profits in the fourth quarter, but are there some orders that could be converted into sales and profits during the third quarter as well? Or, even if the pipeline of potential orders expands, will the bulk of the sales conversion still happen in the fourth quarter? Please give us a breakdown of the conversion of orders into sales by quarter.*

A1: I believe you are asking about how sales will increase. More of the increase is in the fourth quarter than the third. In Solutions and Services segment, there are orders from the first quarter that we have included as anticipated sales in the second half of the year. For example, if we receive an order in June, then the project will start several months later. Then, when the project begins, sales will then be generated on a periodic basis, so we will start to see revenue from sales starting in the third quarter. We forecast that this year's fourth quarter growth rate will be higher than in the previous year. Still, we have a clear backlog of orders, so sales will start to increase in the third quarter. If possible, we would like see growth in third-quarter sales in the double digits percentagewise compared to the previous year.

Questioner G

***Q1**: I have a question about the international regions outside of Japan. My understanding is that, although there was an operating loss in the second quarter, if you exclude one-time expenses, then it broke even with last year's level. Despite this, I feel like this result was not satisfying. Please share your thoughts about the actual results with us. Also, please share with us your outlook for the international regions, such as if you expect the large-scale projects you received in the UK to be included in sales and profit figures starting in the third quarter.*

A1: The international regions excluding Japan are facing difficulties. Your understanding is correct that, excluding the special items, performance would be break-even. In addition to a timing of the orders for large-scale projects, the effect of the weak euro in the euro to dollar conversion rate had a negative impact on hardware businesses, such as x86 servers and PCs, and the segment continues to be unable to bounce back. In addition, the economic environment for the international regions is much harsher than in Japan, which creates a difficult business climate overall. Though the international regions started to show a small amount of profit, business efficiency still needs improvement, and there are high overhead costs. Instead of further restructuring, we are focusing on improving the ratio of our overhead costs by winning orders and further increasing our sales, and, internally, reskilling personnel so that they can change their positions. The losses must be addressed, but for this fiscal year, we are thinking of measures that include a recovery from our business in Japan. In brighter news about orders, as I mentioned, we won major projects in the UK. Some were net additions, but many of them are large-scale contract renewals. The budget from the government sector has decreased significantly, and up until this point they would continue to renew projects while decreasing the size of the orders, but this time we were able to secure the renewal of multi-year projects without a significant reduction in order size. Therefore, these projects did not lead to a one-time increase in sales, but rather led to us being able to secure the current scale of sales for the future. The essential issue is that we need to definitively secure more business deals outside of these large-scale public sector projects. There is a sense of urgency that, in order to do so, we must strengthen our offerings, particularly with Fujitsu Uvance, but we are not yet at the point where these initiatives will be reflected in our performance figures. Though conditions still have yet to turn favorable, we are currently implementing global measures, such as further strengthening the GDCs, to get us on the path to sustainable growth. Please understand that, our overall perspective is we are working to be able to support the international regions with the earnings across all of Technology Solutions in the event that these measures do not work.

Q2. Do you expect your international regions excluding Japan to record an overall operating profit in the third quarter?

A2. Yes, that is our forecast. The amounts will not be large, but, in comparison with the second quarter, we expect to record slightly better figures in the third quarter.