Summary Translation of Question & Answer Session at
FY 2024 First Quarter Financial Results Briefing for Analysts

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Presenters: Takeshi Isobe, Representative Director, Corporate Vice President, CFO

Questioner A

Q1: Please tell us the extent to which the backlog of orders in Japan for Service Solutions has increased. In the fourth quarter of last fiscal year, the year-over-year increase had been over 10%, but could you tell us what it is now?

A1: It has not changed much. Compared to the same period in the previous year, the trend in the backlog of orders is up by 9-10%. Orders in this first quarter were slightly low, but because, in the first quarter of last year, we received large multiyear public sector orders, we really have not been affected much by a decline in the backlog of orders. Since then we have won new orders, and they are building, so the trend is up 9-10%.

Q2: Looking at the trend in adjusted operating profit for Service Solutions on page 35 of your presentation materials, it appears that your rate of progress in this year's first quarter is rather high, and it strikes me that we might be able to expect that, going forward, your results will exceed your targets. Please let us know if you anticipate any unusual seasonal factors in the second quarter or beyond. For example, it could be that your first quarter performance was especially good, and now there will be fewer mainframe and other high-margin deals, or that you could be affected by licensing issues with VMware. Please tell us how you are viewing this fiscal year's full-year targets.

A2: We do not think there are any major or exceptional seasonal factors. As of now, we have only made 12% of the progress we need to make to meet our full-year targets for Service Solution. Still, our first quarter this year was better than usual, and my hope is that we can continue this momentum and build on these results. On the other hand, as we have already announced, we have plans to enhance our consulting resources, among other investments, but we did not spend a lot of money in the first quarter in expanding our consulting resources, either through reskilling or recruiting experienced consultants from outside. In this area, we have investment plans for the second quarter and beyond. Regarding this year's first quarter, we certainly built up our orders and made progress in improving profitability, but we view it as a quarter in which nothing especially bad happened. Conversely, one could say that this is basically our cruising speed, and that is how we would like you to interpret it. Regarding VMware, we are in the midst of separate negotiations with VMware as well as our customers, and we also want to think about pricing. I cannot say that it will have no impact on our financial results, but we want to minimize the impact as much as possible.

Questioner B

Q1: The improvement in the profit margin Regions (Japan) is outstanding, but could you comment on the factors behind this trend and whether the trend can be sustained?

A1: Profitability in Regions (Japan) is improving. In the first quarter, the adjusted operating profit margin increased by four percentage points compared to the previous year. Even if we just look at the gross margin, it improved by a little over three percentage points. On top of that, because the gross margin is improving, higher sales revenue has the effect of boosting our operating profit margin. And because Regions (Japan) has the highest volume of sales, the use of the Global Delivery Centers and the Japan Global Gateway to standardize and automate system integration development processes means that the improved productivity effects are especially strong. For example, for a advanced project using SAP, we present customers with a rate card and get them to recognize the value the project will deliver. Through these types of ways, we are working to increase our pricing. In Regions (Japan), where our capabilities are most concentrated, in addition to the ability to make sure that the profitability is sufficient when we receive an order, there is also the strong and ongoing impact of measures to improve productivity, and these were the factors that pushed the gross margin up by just over three percentage points. In looking at the Service Solutions segment, while there is also a contribution from Global Solutions, but increases or decreases in middleware sales can also affect results, so the biggest factor contributing to the rise in the gross margin in Service Solutions is the performance of Regions (Japan).

Q2: In Regions (Japan), for the full year you are planning a rise in sales revenue of 8.5%. In relation to that target, the progress in growing sales in the first quarter appears to be a little weak. When will the balance of orders and new orders be converted into sales?

A2: For the second quarter and subsequent quarters we expect double-digit sales growth.

Q2: In Hardware Solutions, was the scale of the decline in profit in line with your internal estimates? Will the decline in profit continue in the second quarter? Please tell us your outlook going forward in relation to your original targets.

A2: The performance figures for Hardware Solutions in the first quarter were not very good, but they actually exceeded our internal estimates. For network products, in North America there was a slight increase in demand, or the timing of purchases was pushed up earlier than we had anticipated. In Hardware Solutions, there is also the pullback from last year’s large-scale deals, and we were resigned to the fact that the segment would post a loss. We expect the weak conditions to persist in the second quarter relative to the previous year. In the second half, especially in the fourth quarter, we expect a firming of demand, but that expectation can also pose a risk, so we need to be sure to build sales.

Q2: When you say that you expect the weak conditions to persist in the second quarter, is that because of the impact of the pullback from the prior year in system products?

A2: Looking at comparisons with the prior year, the impact of the pullback in system products will continue. In terms of an absolute level, just as in the previous year, by and large we expect the same low level of sales in network products to continue throughout the year.

Questioner C

Q1: You talked about ensuring profitability when you receive an order, and you explained that you have been raising prices, but where have you been able to raise prices? In particular, if you have raised unit prices on the same services you had been selling before, what ratio of your services does that represent, and to what extent has that ratio increased? In addition, separate from that, I believe that an increasing level of your business is in high value-added services, and I would like to know the extent to which your average unit price has increased from this changing mix of services.

A1: It is difficult to put a precise numerical value on these impacts. With Uvance, there are parts of the business in which we use rate cards, but even in our conventional system integration business, because we were affected by higher labor costs, after discussing the issue with our customers, there are areas in which, to a certain extent, we have raised prices. In addition, in cases in which we are facing extremely high demand, if we decide to take on a project, we will give priority to accepting projects that we are certain we can complete with a profit, so we are managing profitability when we receive an order.

Just to clarify, first, even with conventional system integration business, we are negotiating price levels that are a few percent higher than a couple of years ago. Second, for Uvance business, particularly if it is a project in a highly specialized area in which there are not enough expert resources, such as an SAP-related project, we present a rate card and move forward while making sure the customer understands the value being delivered. A third scenario is when we face multiple similar projects from different customers, in which case we take a close look at which ones we are certain to be able to complete with the highest profit before we accept a project. In the past, if we could estimate that we could make a certain level of gross profit, we would typically accept a project, and then work to improve productivity in an effort to achieve higher profitability. Of course, in the past there were projects for which our estimates of profitability turned out to be horribly flawed, and we tried to be more careful, but now, for all deals we consider, we estimate what the profitability will be while deciding how all resources will be allocated. Please understand that it is a combination of these scenarios that has enabled us to raise our pricing.

In my explanation, I said that profitability in Regions (Japan) has improved, with about an increase of around three percentage points in the gross margin. Of that, a little over 1% can be attributed to improvements in automation and standardization. The remaining portion is from the areas I just explained, such as better control over our selling prices and improvements in profitability when we receive an order.

Q2: I think Fujitsu's defense-related business is rather large, but could you talk about your outlook for this business in your targets for this fiscal year and over the medium-term horizon?

A2: It is true that we are involved in multiple aspects of the defense-related business, but I will have to refrain from commenting on such issues as the scale of investment spending by any particular customer. We are providing our products and services based on each customer's needs, and that is the role we would like to continue to play in the future. As you know, this is an area that will require even greater advancement going forward. Within this area, in terms of handling the need for equipment with built-in information capabilities, in particular, because this is an area in which we also play a role, we are expecting a decent level of growth in this business.

Questioner D

Q1: In Regions (International), there was a reduction in losses. Could you please share with us the progress you have made in the sub-segment's structural reforms?

A1: Although Regions (International) still has a low level of profit, the extent of the sub-segment's losses has significantly decreased, particularly in the Europe region. Our overall effort has been to concentrate on the business of global offerings, such as Uvance. As part of this process, in the previous fiscal year we carved out the German private cloud business, which was unprofitable. This resulted in lowering the extent of the losses a little more than 2.0 billion yen in the first quarter. This was the biggest factor behind the decline in losses. In addition, we are also consolidating corporate functions and exiting areas with low-profitability, but it is not as though these efforts have resulted in anything close to billions of yen.

Q2: Between the Vertical areas and Horizontal areas, which show more promise for improving Uvance's profit margin?

A2: To improve the profit margin in Uvance, we are hoping to increase the volume of revenue in the Vertical areas. I explained that the Vertical areas' gross profit is currently close to 40%, but we believe that it can grow even further. At this moment in time, we are envisioning it to increase to 40-50%.
But more than that, first quarter revenue for the Vertical areas was approximately 30.0 billion yen, but we believe that it will expand to 180.0 billion yen this fiscal year, 400.0 billion yen in fiscal 2025, and further beyond that. There is also the aspect that an increase in revenue volume in areas with gross margins of over 40% will lead to an overall increase in profitability, and naturally improve gross margins. It is for this reason that we are working to invest in the Vertical areas offerings even further, have customers understand these offerings, and increase in our revenue volume. On the other hand, the gross margin in our Horizontal areas is low, and we do not believe that this is a good thing. In the Horizontal areas, while we do think that we will be able to increase the gross margin, which is currently a little less than 20%, to approximately 25%, we believe that it will be difficult to achieve a large improvement in gross margin without changing the cost structure or how we handle partnerships.

Q3: I do not believe that there are any other of your businesses with a gross margin of 45% or higher, but if there are businesses or services of a certain size with high gross margins, please tell us what they are.

A3: Middleware, mainframes, and network equipment, such as 5G base stations, are businesses with a high gross margin. They do, however, require investments in development, so if the profit volume is low, no matter how good the gross profit is, it will not remain as an operating profit. On the other hand, our services in Japan have a gross profit margin of over 35%. If we are able to further increase productivity, then we believe we will be able to reach 40%. In that sense, the Vertical areas has already achieved a gross margin of approximately 40%, but this is not our goal. We ultimately aim to grow it to 45-50% through Pure-Play SaaS and creating recurring business. In our current phase, however, rather than increasing the gross margin from 40% to 50%, we are focusing on increasing the Vertical areas' revenue from 100.0 billion yen to 200.0 billion yen, and then 300.0 billion yen.

Questioner E

Q1: I believe that you plan to increase your investment in Service Solutions by a little over 50.0 billion yen in this fiscal year. For the first quarter, how much of an increase is this compared to the first quarter of fiscal 2043?

A1: The increase in our investments into Service Solutions was approximately 8.0 billion yen in the first quarter. Business growth investments have not increased much for the company as a whole. As for the common growth investments included in Inter-segment Eliminations/Corporate, there was a rather low level of cutting-edge research and development, and investment related to the upgrade of our internal ERP system is concentrated in the second half of this fiscal year, resulting in a slight reduction in the first quarter. It is for this reason that, business growth investment for the company as a whole only increased by several billion yen.

Q2: This fiscal year, you plan to invest 20.0 billion yen to enhance your consulting capabilities. Please tell us if it looks like you will be able to recruit enough consultants based on the recruitment environment, as well as when during the fiscal year this investment will occur.

A2: Our plan is to invest 20.0 billion yen in recruitment and training to enhance our consulting capabilities. But in the first quarter, we did not make much of an investment in this. We originally thought that hiring, in particular, would begin in earnest from the second quarter. But it has become apparent that the recruitment market for human resources is so severe that we must revise our plan both in terms of how to increase the number of consultants we recruit and how to increase productivity with fewer people. It is for this reason that we have started to change direction toward diverting internal resources, and we have also started reskilling human resources who can be transformed into consultants, including employees in our corporate division. As for the timing of the investment, please understand that it will start in the second quarter. But the recruitment conditions are so severe that we do not believe that we will be able to use up all of the investment, and feel that we may need to revise our plan.

Q3: Decreasing the amount you invest will have a positive effect on this fiscal year's profit, including the contribution from the first quarter. If you are not able to increase your consulting capabilities, however, will that have a negative impact on your ability to achieve your Medium-Term Management Plan?

A3: We believe that this will also have a negative effect. To tell you the truth, we would like to increase our consulting capabilities, even if it meant investing more. But we know that it will not be as simple as that, and are reviewing not only external recruitment, but also the allocation of internal resources as well as acquisitions.

<u>Questioner F</u>

Q1: ***In Regions (Japan), in relation to the increase in revenue of 10.0 billion yen, the increase in profit was even higher, but even considering that the gross margin improved by 3 percentage points, it feels like the calculation does not add up a bit. Please tell us if there were any special factors, such as, for example, a reduction in some sort of operating loss recorded in the previous fiscal year, or that reserves previously taken were reversed and released in the first quarter.***

A1: There were not any special factors. Revenue in the sub-segment was approximately 270.0 billion yen, and its gross margin increased by 3 percentage points, so there was approximately 8.0 to 9.0 billion yen of profit from these figures. In addition, revenue also increased 10.0 billion yen compared to the same quarter of the previous fiscal year, so the gross profit from this increase was approximately 3.5 to 4.0 billion yen. So, please understand that, in total, there was an increase in profit of approximately 12.0 billion yen from these factors. Although in the past there have been unprofitable projects, there were no major unprofitable projects in the first quarter of the previous fiscal year. The improvement of profit is not due to such special factors.

Q2: Regarding the issue with VMware, it has been reported that VMware will stop providing OEM licenses to companies that provide servers, including Fujitsu. How many of these servers for on-premise applications are there in Hardware Solutions?

A2: There are a fair among of on-premise servers, however, as for VMware, there has been no talk that we would stop supplying servers, and by no means will VMware become unusable. For services and solutions that will not have any value if VMware is not used, price is something that we will obviously have to consider, but it is our understanding that customers will not be inconvenienced by VMware no longer being able to provide support, and we believe that we can guarantee the functions and performance of the servers.