(1) Results of Operations and Financial Review

Overview of Fiscal 2005 Interim Period, Ended September 30, 2005

Consolidated Business Results

The Fuji Electric Group's operating environment in the first six months of fiscal 2005 was characterized by a moderate recovery overall, supported by rising private-sector capital investment, despite surging prices for materials.

Against this backdrop, sales rose in two business groups: Electronic Devices, on the back of expansion in the PC market and a substantial increase in storage device sales as demand for these components in digital consumer electronics gained momentum; and Retail Systems, thanks to higher sales of mainstay can vending machines and continuing strong sales of cigarette vending machines from the previous fiscal year. However, sales fell year on year in Energy & Electric Systems, due to a drop in sales volume in the e-solutions field, and ED&C・Drive Systems, reflecting the transfer of the power supply systems business to Energy & Electric Systems and other factors.

In a typical year, Fuji Electric expects to report a first-half loss due to the concentration of sales in the second half of the year, particularly in the Energy & Electric Systems Group, which is responsible for the electric power systems business. However, in the interim period under review, all business groups reported an improvement in operating profitability compared to a year earlier despite this bias. This performance was mainly attributable to total cost reduction measures, including Groupwide manufacturing innovation activities. As a result, Fuji Electric achieved a profitable first half in terms of both operating income and ordinary income. Net loss also narrowed significantly year on year, despite the booking of losses on the disposal of property, plant and equipment and other items.

Consolidated operating results for the interim period were as follows:

(¥ millions)

	Interim FY05	**Interim FY04**
Net sales	369,328	364,240
Operating income (loss)	3,331	(5,973)
Ordinary income (loss)	3,719	(7,753)
Net income (loss)	(744)	(5,210)

Note: Changes in the scope of consolidation:

New — 6 Excluded — 1

As of September 30, 2005, the Fuji Electric Group included 66 consolidated subsidiaries

Dividends

In light of the above interim operating results and forecasts for the full year, explained on page 19, the Company has decided to raise its interim dividend per share by ¥0.50, to ¥3.00. The year-end dividend is yet to be determined.

Segment Information

Energy & Electric Systems Group

Net sales declined 3.4% from the previous fiscal year to ¥129,384 million, while the operating loss improved ¥3,827 million to ¥12,609 million.

In the first half of the fiscal year, the trading environment for the general industrial sector was favorable against the backdrop of rising private-sector capital investment in the materials, assembly and other sectors. Public works spending and investment by power generation companies, however, continued to decline.

In this climate, Energy & Electric Systems continued to implement initiatives from the previous fiscal year to reinforce its operating structure. Efforts to restructure the business and channel resources into strategic fields paid off with an improvement in operating profitability.

Specifically, the group reduced its workforce and took other drastic restructuring steps, and at its plants, targeted unprofitable product lines and eliminated waste. Energy & Electric Systems also continued to reorganize its businesses. In the previous fiscal year, operations for small-capacity uninterruptible power supply (UPS) products were transferred to the group’s power supply systems business from ED&C・Drive Systems. In the interim period, the group also took over responsibility for ED&C・Drive Systems’ internal power supply operations, creating a unified operating structure designed to boost marketing and product development synergies. Meanwhile, in the measurement and control systems business, we reviewed our business strategy and then realigned the business framework to enhance operating efficiency. We also worked to enhance marketing capabilities in both domestic and overseas markets.

The group also took a number of forward-looking steps in the interim period. First, we implemented a major realignment of our marketing organization, creating a framework that will allow us to channel marketing resources into sectors that show potential for growth. Second, we worked to accelerate initiatives in new energy fields. This included a decision to build a plant in Kumamoto Prefecture to underpin a new volume-production framework for solar cells, and the signing of a wide-ranging agreement with Kumamoto University and Kumamoto Prefecture in the new energy field, primarily solar cells.

Sales in the e-solutions field declined year on year due to a drop in large orders. However, operating profitability improved due to a stronger performance by the information systems business, which was more selective about the kind of projects it undertook, and the benefits of business restructuring in the measurement and control systems business.

Environmental systems posted a year-on-year increase in sales thanks to a rise in large orders for water treatment systems. Operating profitability also improved, reflecting the benefits of cost reductions in water treatment systems and efforts to reduce the loss in recycling systems.

Sales in industrial and transportation systems were marginally down on the same period a year earlier. This was mainly attributable to a drop in large orders for transformer rectifier units to international customers, transportation systems and other products. Despite the lower sales, operating profitability improved. This reflected, among other factors, improved earnings from systems used for power electronics applications in the materials industry, a strong field for the group, and the benefits of restructuring in the power supply systems business.

Plants operated by the electric power systems business were running at high capacity against the backdrop of a buoyant power generation facility market, centered on Asia. In the interim period, the business won overseas orders for thermal power generation facilities, helping to drive sales up year on year. However, operating profitability deteriorated slightly due to the impact of surging prices for materials used in large-scale turbines for thermal power generation.

Sales in plant facility construction fell compared to a year earlier, mainly due to a drop in large orders in a tough operating environment characterized by falling public works spending. Operating profitability, however, improved due to reductions in operating expenses and rigorous project management.

ED&C・Drive Systems Group

Net sales declined 5.5% year on year to ¥83,806 million, while operating income increased

11.1% to ¥3,255 million.

In the domestic market, machine tool manufacturers, the group's main customer segment, continued to perform strongly. Consequently, we worked to stimulate demand from existing customers and develop new customers in this field.

Overseas, we aimed to expand the group's business in China and other parts of Asia by strengthening our marketing framework and setting up new sales sites in these regions.

The group also focused on boosting profitability and reinforcing its operating framework by withdrawing from unprofitable product lines and actively eliminating waste.

In ED&C components, domestic sales declined overall, reflecting the transfer of the group's power supply systems business to Energy & Electric Systems and other factors. However, sales remained at high levels, continuing a trend seen in the previous year, as we worked to boost sales to key customer segments. In overseas markets, although we worked to expand our lineup of global products and strengthen our joint venture with Schneider Electric Industries S.A.S., sales were lackluster due to a drop in business to Taiwan and other factors. As a result, ED&C components posted a year-on-year decline in sales. However, operating income increased as efforts to pare back total costs, including management expenses, bore fruit.

Domestic sales slowed in control and drive systems. Although sales of inverters were on a par with the previous year thanks to sustained, strong demand from the automotive and machine tools sectors, sales of servomotor systems and programmable controllers fell due to a drop in demand from customers in the semiconductor and injection molding fields. Overseas sales declined as strong demand for inverters in Europe could not compensate for weaker sales to China where fiscal tightening measures impacted demand. As a result, sales of control and drive systems were slightly down year on year but operating income was steady.

Electronic Devices Group

Net sales rose 7.6% year on year to ¥75,952 million, while operating income increased 27.5% to ¥6,602 million.

In the first half of fiscal 2005, the group used ongoing technology development programs to boost the ratio of new products in its semiconductor, storage and imaging device business fields. This was aimed at creating a high-growth, high-earnings operating structure.

In semiconductor devices, demand for automotive-related products was strong, supporting higher sales of automotive metal oxide semiconductor field effect transistor (MOSFET) devices and hybrid ICs for igniters. In the industrial sector, the impact of protracted inventory rundowns by some sectors of the market led to significantly lower year-on-year sales of insulated gate bipolar transistor (IGBT) modules. In IT and power supplies, demand for ICs and MOSFETs used in flat-screen TVs grew, although this was tempered by a significant drop in sales of diode components used in conventional CRT TVs and monitors. As a result, semiconductor sales fell from a year earlier. Operating income also fell substantially year on year, reflecting falling market prices for semiconductors, an increase in depreciation and lease expenses and other factors.

In storage devices, the PC market strengthened and demand for hard disk drives (HDDs) expanded as these devices were increasingly adopted for digital consumer electronics. In this climate, we took a number of steps to significantly boost output in response to rising demand. In addition to our mainstay 80GB product in our lineup of 3.5-inch aluminum magnetic disks, we began volume production of a 120GB version and are now working to bring volume production of 2.5-inch glass magnetic disks on stream. As a result of these efforts, sales rose sharply year on year, driving a major turnaround in operating profitability.

Despite the launch of new products and the growing popularity of color printers, sales of imaging devices declined year on year due to intensifying competition in the US and European markets. The transfer of production activities to Shenzhen in China, however, is helping to enhance cost-competitiveness, resulting in a year-on-year improvement in operating profitability.

Retail Systems Group

Net sales increased 6.8% year on year to ¥87,666 million, while operating income jumped 87.8% to ¥5,362 million.

In the first half of fiscal 2005, the group focused on actively growing sales as demand related to the issue of redesigned yen bills in November 2004 started to run its course. In response to surging steel prices, Retail Systems also worked to boost manufacturing efficiency and cut costs further.

In vending machines, food service equipment and currency handling systems, sales of mainstay can vending machines were higher than in fiscal 2004, when sales were affected by customers waiting to buy new equipment prior to the issue of redesigned yen bills. Sales of cigarette vending machines maintained strong growth from the second half of the previous year. Although sales of cup vending machines declined due to a shrinking market, currency handling system sales grew year on year, supported by rising demand for point-of-sale cash settlement terminals used with contactless IC card equipment. As a result, sales of vending machines, food service equipment and currency handling systems rose overall. This sales increase, combined with cost-reduction measures, drove a significant improvement in operating income.

In cold-chain equipment, the group posted an increase in sales to the convenience store sector, thanks to new orders for new store formats, amid a slight year-on-year increase in store openings. New customers also supported higher sales of Ecolo Unit, a modularized store construction system. Despite these successes, sales to the supermarket sector fell due to lower levels of investment across the industry, resulting in flat sales in cold-chain equipment overall. Operating income declined, reflecting an increase in management and other expenses related to sales expansion initiatives.

Others

Net sales increased 26.7% to ¥24,986 million, and operating income jumped 50.6% to ¥953 million. This mainly reflected the consolidation of a company providing shared personnel, administration and staffing services to the Group.

Measures initiated by key companies in this group during the period under review were as follows:

Fuji Life Corp., in response to the adoption of asset impairment accounting for fixed assets, sought to improve the soundness of its asset portfolio by promoting more effective utilization of the Group’s real estate assets. The company also worked to reduce interest-bearing debt.

As the Group’s core financial services provider, Fuji Electric Finance and Accounting Support Co., Ltd. carried out fund procurement activities, and worked to expand its agency scheme for collecting accounts receivable. These and other initiatives were aimed at raising the efficiency with which funds are procured and managed throughout the entire Fuji Electric Group.

Fuji Electric Information Service Co., Ltd. worked to reinforce the security of IT systems by monitoring and preventing unauthorized access to the Group’s intranet and implementing unified computer virus countermeasures on a timely basis across the Group.

Fuji Brain Trust Co., Ltd. worked to respond to diverse human resource needs from the Group by promoting its staffing and recruitment business and expanding its staffing and placement services targeted at external customers.

Financial Position

Free cash flow (free cash flow = net cash provided by operating activities + net cash provided by investing activities) was ¥19,872 million on a consolidated basis in the interim period, an improvement of ¥25,471 million from negative free cash flow of ¥5,599 million in the same period a year earlier.

Cash flows from operating activities

Net cash provided by operating activities was ¥17,560 million, an improvement of approximately the same amount from a year earlier when cash flow was almost zero. Cash inflows chiefly came from an increase in internal funds from income before income taxes and minority interests, and efforts to collect trade receivables and advances from customers. This was partially offset by an increase in inventories in preparation for sales in the second half of the year.

Cash flows from investing activities

Net cash provided by investing activities was ¥2,312 million, an improvement of ¥7,843 million compared to cash outflows of ¥5,531 million in the previous interim period. This was mainly attributable to the use of leaseback agreements for capital investments related to key facilities, mainly in the Electronic Devices Group, and a significant decrease in cash used to purchase marketable securities compared to a year earlier.

Cash flows from financing activities

Net cash used in financing activities was ¥18,991 million, compared to ¥9,555 million used in the previous interim period. This was mainly due to net decreases in commercial paper and borrowings.

As a result, cash and cash equivalents as of September 30, 2005 increased ¥1,651 million from the previous fiscal year-end, to ¥17,866 million.

Outlook for the Fiscal Year Ending March 31, 2006

In the first six months of fiscal 2005, Fuji Electric posted year-on-year growth in consolidated net sales. This increase in sales, together with total cost reduction measures that included manufacturing innovation activities, supported a significant improvement in profitability compared to a year earlier.
Although the operating environment in the second half of the fiscal year presents some concerns, Fuji Electric has upwardly revised its previous full-year forecasts announced on July 27, 2005 after factoring in the improved interim performance.

These forecasts assume an exchange rate for the second half of the fiscal year of ¥105/US$1.

（¥billions）

	FY05 Forecast (27 July)	FY05 Forecast (27 Oct.)	Change	FY04 Results
Net sales	885.0	885.0	0	844.2
Operating income	35.0	37.0	＋2.0	26.8
Ordinary income	33.0	36.0	＋3.0	22.2
Net income	14.0	16.0	＋2.0	7.7

Segment Information

Consolidated net sales by segment for FY2005〔forecast〕

（¥billions）

	FY05 Forecast (27 July)	FY05 Forecast (27 Oct.)	Change	FY04 Results
Energy & Electric Systems	395.0	394.0	-1.0	374.7
ED&C・Drive Systems	175.0	177.0	＋2.0	178.2
Electronic Devices	165.0	166.0	＋1.0	143.2
Retail Systems	160.0	163.0	＋3.0	168.1
Others	50.0	51.0	＋1.0	45.7
Eliminations	-60.0	66.0	-6.0	-65.9
Total	885.0	885.0	0	844.2

Consolidated operating income by segment for FY2005〔forecast〕

（¥billions）

	FY05 Forecast (27 July)	FY05 Forecast (27 Oct.)	Change		FY04 Results
Energy & Electric Systems	9.0	9.0	0		3.2
ED&C・Drive Systems	7.0	8.0	＋1.0		6.6
Electronic Devices	12.5	13.5	＋1.0		9.4
Retail Systems	6.0	6.0	0		7.4
Others	2.0	2.0	0		1.7
Eliminations/Corporate	-1.5	-1.5	0		-1.7
Total	35.0	37.0	＋2.0		26.8

Energy & Electric Systems Group

In the second half of fiscal 2005, Energy & Electric Systems will use the first-half realignment of its marketing framework to strengthen marketing initiatives targeting each industry, and continue with efforts to restructure its businesses and channel resources into strategic fields. Additionally, the group will reinforce manufacturing capabilities and offer highly competitive products underpinned by advanced technologies to carve out a unique presence in the marketplace. Business initiatives in China and other international markets will be accelerated to boost the ratio of consolidated net sales generated overseas. Using this approach, the group will strengthen its financial position and build a more powerful earnings structure.

ED&C・Drive Systems Group

The group expects buoyant levels of domestic capital investment to continue in the second half of fiscal 2005. However, there are some concerns about the impact of surging crude oil and raw material prices and other factors on manufacturing activities. Against this backdrop, ED&C・Drive Systems will target key industries as it looks to expand sales in Japan. Overseas, the group will upgrade its inverter production and sales sites and work to boost sales, mainly in China. The group will also strive to further boost profitability and strengthen its operating framework by withdrawing from unprofitable product lines and continuing to strip out waste from its operations.

Electronic Devices Group

In semiconductor devices, the group is anticipating more growth in the automotive electronic component sector. Targeting this demand, Electronic Devices will work to boost sales of automotive MOSFETs, as well as products for flat-screen TVs in the IT and power supply field. These efforts, together with the launch of new IGBT modules for the automotive component and industrial sectors, will help to drive sales growth in the second half of fiscal 2005.

With demand expected to continue growing in the storage device field, the group will boost output of both aluminum and glass magnetic disks and work to bring volume production of new products on stream.

Competition in the imaging device field is projected to intensify in both the US and Europe in the second half. In response, the group will work to ensure its components are adopted by manufacturers for their new products, and also boost cost competitiveness by concentrating production in Shenzhen, China.

Retail Systems Group

The Retail Systems Group will continue efforts to boost the efficiency of manufacturing and sales activities in the second half to generate higher earnings. It will also focus on developing cutting-edge technologies and strengthening marketing capabilities.

In vending machines, food service equipment and currency handling systems, demand spurred by the redesign of yen bills is expected to run its course. However, in drink and food vending machines, the group plans to capture a greater market share by introducing new products—value-added machines that are easier to use and more environmentally friendly and that can dispense products even during natural disasters; and safe, environmentally friendly vending machines that use CO_2 instead of fluorocarbons as the refrigerant. In currency handling systems, the group will focus on equipment for contactless IC cards, demand for which is growing rapidly.

In cold-chain equipment, Retail Systems will work to grow sales by accurately responding to the reorganization of major chain stores and the emergence of new operators from other industries in the retailing field.

Dividends

No decision has yet been made on the year-end dividend applicable to fiscal 2005.

Risk Factors

The Fuji Electric Group works to mitigate business and other risks in a systematic and methodical manner. However, as of September 30, 2005, the Group was subject to various risks, such as those listed below, which could have a negative impact on its operating results and financial position. These risks could have a bearing on investment decisions.

1) Risks related to changes in the operating environment
    1. Increases in the cost of raw materials and components
    2. A drop in the price of products due to sudden fluctuations in supply-demand dynamics in the electronics sector
    3. Deterioration in market conditions in China
    4. Exchange rate movements primarily between the yen and the US dollar
    5. An increase in the interest payment burden due to rising interest rates
    6. Deterioration in the financial position or operating environment of investees
2) Risks related to product defects, quality, manufacturing costs and other issues
3) Risks related to overseas business activities
    1. Unforeseen changes to laws and regulations and changes to tax systems that may have a detrimental effect on the Group
    2. Disadvantages arising from political conditions
    3. Social turmoil related to terrorist incidents, war, unrest and other events
4) Risks related to intellectual property
5) Risks related to the leak of personal information
6) Risks related to major natural disasters
7) Risks related to soil contamination issues
8) Changes in assumptions related to the calculation of retirement benefit liabilities