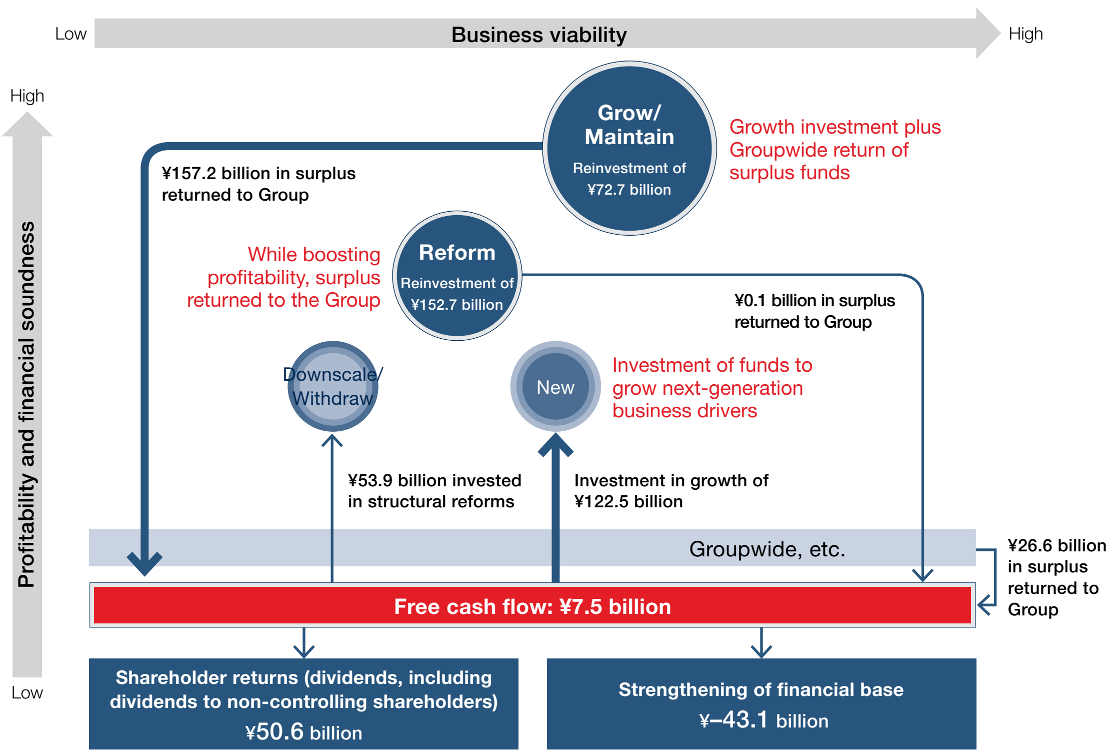
CFO's Message

Strengthening Cash Flow and Securing Investment Capital for Growth in Preparation for Opportunities Ahead

Masanori Koguchi
Member of the Board,
Executive Vice President and CFO

FY2015 Cash Flow

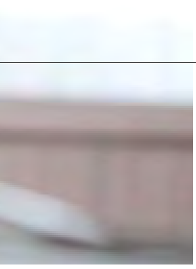


Basic Financial Strategy Policy

The MHI Group is implementing a raft of measures through its 2015 Medium-Term Business Plan to remain ahead of the pack and sustain global growth. We aim to become a highly profitable company with a business scale exceeding ¥5 trillion. To do this, we need to define clear growth strategies while preparing the necessary resources to achieve them. At the same time, we must deal with ongoing risk and set aside funds to manage uncertainties related to growth-oriented investments. In terms of financial strategy, our fundamental policy is to meet funding requirements using cash flow generated by our business activities.

In order to drive growth forward—and to effectively respond to risks—we must maintain and further strengthen our current financial structure. Maintaining sound finances through stable cash flow leads to greater efficiency across our business, meaning enhanced competitive strength. I believe improving our cash flow will bolster business processes and ultimately become an important indicator of improvement in operating results.

Based on this approach, I am focusing on maximizing cash flow while allocating management resources appropriately.

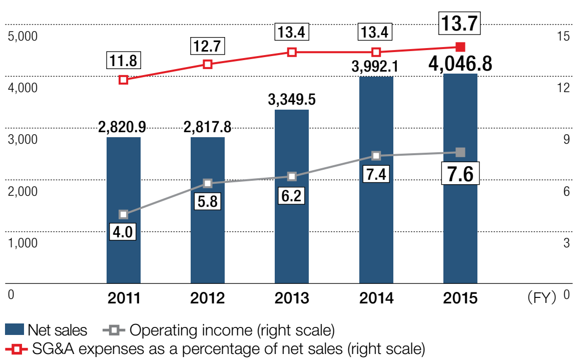


Business Portfolio Enhancement through Our Strategic Business Evaluation System

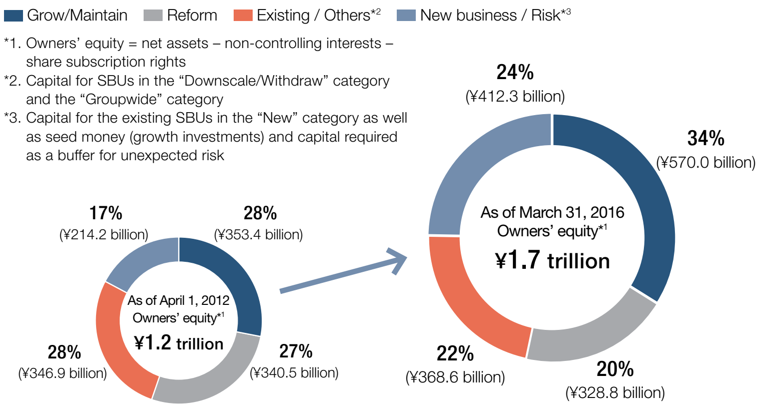
Building an appropriate business portfolio is essential to the MHI Group's steady and continuous growth. To this end, we launched a strategic business evaluation system in 2010, dividing our strategic business units (SBUs) into four categories—"Grow/Maintain," "Reform," "Downscale/Withdraw," and "New"—based on an evaluation of their profitability, financial soundness, and business viability. We then allocate management resources based on the category. In fiscal 2015, ¥72.7 billion of cash flow generated by SBUs in the "Grow/Maintain" category was reinvested to achieve further growth. At the same time, ¥157.2 billion was returned to the Company.

In the six years since this system was introduced, management resources have been heavily allocated toward 'Grow/Maintain' businesses. At the same time, ongoing efforts to optimize our business portfolio mean that our business scale has been expanding steadily toward our ¥5 trillion target. Our operating margin has also been improving. We anticipate that further improvement is possible if, through more effective post-merger integration (PMI) efforts, we can reduce our SG&A expenses, which temporarily increased with M&A activity. Meanwhile, for our "Downscale/Withdraw" businesses, we are taking steps to form joint ventures with other companies or selling off such businesses completely. A review of activity over the past four years shows that redistribution of capital has made progress, with the ratio increasing in the "Grow/Maintain" and "New business/Risk" areas and decreasing in the "Reform" and "Others" categories.

Expansion of Business Scale and Increase in Profitability



Capital Allocation for Becoming a Highly Profitable ¥5 Trillion Enterprise



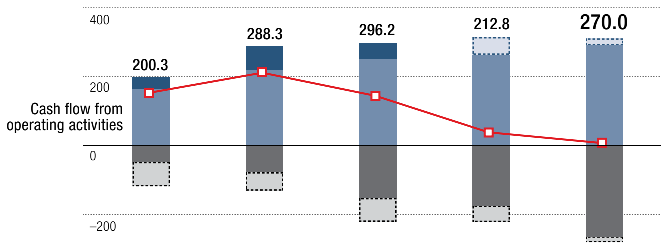
Cash Flow Improvement

The optimization of our business portfolio, achieved through redistributing management resources, is enabling a steady expansion of cash flow generated from profits. In addition, cash flow is now being generated through greater balance sheet efficiency, primarily through the reduction of working capital, but also by the liquidation of idle assets and securities. With respect to working capital, the situation will further improve as we set cash conversion cycle targets for each SBU. The cycle was already shortened from 143 days in fiscal 2012 to 97 days in fiscal 2015. We are currently striving for further improvement, setting a new target of 70 days. I believe that through these various measures we will be able to increase our business scale, generating a stable cash flow without expanding the balance sheet.

Results Achieved in FY2015

On a cash basis, fiscal 2015 was a challenging period, owing to growth investments such as the MRJ and the acquisition of UniCarriers Holdings, as well as the need to allocate funding for losses incurred in the cruise ship construction business. Financial stability is closely monitored at all times, as any deterioration can have an adverse impact on future growth potential. Although we responded in a significant way to these monetary requirements—providing more than ¥300 billion in total—ultimately, we were able to keep free cash flow positive throughout the year. This is indicated by the fact that EBITDA has reached the level of ¥500 billion. In my view, our initiatives have enabled MHI to generate and secure the cash it requires.

Free Cash Flow
FY2011 – FY2015
Billions of yen



(FY)	2011	2012	2013	2014	2015
Free cash flow	153.3	211.6	144.6	38.6	7.5
Cash flow from improvement in operating capital efficiency	36.1	70.7	46.6	–51.0	–20.6
Cash flow margin	164.2	217.6	249.6	263.8	290.6
Cash flow from investing activities	–47.0	–76.7	–151.5	–174.1	–262.4
Asset liquidation	70.5	53.3	68.6	46.7	17.2
Return on invested capital (times)	1.11	1.14	1.29	1.37	1.32
EBITDA	238.2	283.0	346.8	465.0	479.6
EBITDA margin (%)	8.4	10.0	10.4	11.7	11.9
Interest-bearing debt	1,157.1	1,031.2	957.4	975.5	1,052.1
D/E ratio (times)	0.89	0.72	0.54	0.46	0.53

Mission of the CFO Going Forward

In the past year or two, we have seen an end to the period of over-reliance on the Chinese economy, accompanied by falling resource prices, economic slowdowns in emerging countries, and industrial structural changes in developed countries. This has ushered in a phase of global oversupply in the medium term, which is gradually being felt by the MHI Group and its competitors. Instability in the global economy and upsets in political and economic frameworks—such as the United Kingdom's exit from the European Union—could continue throughout this period.

In this challenging environment, it might be thought that some curtailment is to be expected. However, if a company is able to successfully weather these difficult times, large growth opportunities await. Put another way, I believe that the extent to which companies prepare for future growth today—formulating business plans, investing in products and technologies that will drive growth, taking the right financial steps to support such initiatives, among other measures—determines who will be tomorrow's winners and losers. This is especially true of MHI, where we have a significant gap in business scale compared with our overseas competitors. We must hone our competitiveness using, for example, differentiated strategies, such as strengthening our engineering base through the harmonization of technologies.

In the coming years, I believe my foremost responsibility as CFO will be to consider how we can secure funds for growth investments while simultaneously strengthening our financial structure. We estimate that the cash flow required for large-scale investments in the MRJ will peak out around fiscal 2018, but even after then we intend to set aside some 20% of our total investment capital for new businesses capable of becoming future pillars of growth. In addition, we have to build up a solid financial structure that will allow us to maintain financial soundness even when we make major short-term, opportunistic growth investments, such as M&A. Risks are also expanding as we make more moves into overseas markets and increase large-scale businesses. It is essential that we build a buffer against such risks.

To that end, we will further accelerate the initiatives we have taken to date: for example, optimizing our business portfolio and improving our balance sheets. Furthermore, by undertaking asset management and pursuing asset liquidation, we will target a cash flow of ¥200 billion within the framework of our 2015 Medium-Term Business Plan. Through these measures, I aim to increase our owners' equity to ¥2 trillion, build up a risk buffer, and improve our financial soundness, while preparing flexibly to meet our increasing capital demands. These activities will ready us for the great growth opportunities that lie ahead.

ROE Improvement

As explained above, the MHI Group today remains in a growth phase. For that reason, I believe we will continue to increase our owners' equity while securing seed money to pursue aggressive growth investments and build risk buffers. At the same time, I fully recognize that enhancing our capital efficiency will be indispensable to maximizing shareholder value, so in our 2015 Medium-Term Business Plan we set a target of 10.2% for ROE in fiscal 2017.

In brief, I believe that MHI is today at a stage where we are simultaneously seeking to improve our profitability and raise ROE while building up our owners' equity. To achieve those aims, it will be vital to concentrate on our core competencies; in other words, we must invest management resources heavily into those businesses we expect to be highly profitable, while simultaneously cutting back on resource investments in areas that offer meager profitability or involve more risk than is worth taking.

Compared with our overseas competitors, our earning capacity lags sorely. This is reflected in the evaluations we receive from the market. While our competitors have an aggregate market value exceeding the scale of their net sales, in our case our aggregate market value is less than half of our scale of sales. Unless we improve our profitability, we will be unable to compete on a level playing field with our overseas competitors.

Dividend Policy

During the period of the 2015 Medium-Term Business Plan, our intention is to carry out shareholder returns through a targeted consolidated dividend payout ratio of 30%. At the same time, we will keep a close watch on the three points discussed above: investments in future businesses, strengthening our owners' equity to ¥2 trillion, and improving ROE. In fiscal 2015, our net income declined substantially as a result of the losses booked against our cruise ship construction business, but business as a whole was able to sustain solid results. Based on that assessment, we paid out an annual dividend of ¥12 per share, up ¥1 from the preceding year.

We ask for the continued understanding and support of our shareholders and investors in the years ahead.