

## Q&A Summary

Event Name: Q1-3 FY2022 Financial Results

Date: February 7, 2023

Speaker: Hisato Kozawa, Member of the Board, Executive Vice President, and CFO

### **Questioner 1**

**Q:** Please let me know your evaluation of performance in Q1-3. How do you evaluate the Q1-3 results against the company's plan?

**Kozawa:** I feel that the results were a little disappointing. The main cause of this was the -¥35 bn in one-time expenses in thermal power and other businesses, as mentioned on page 9 of the Q1-3 FY2022 Financial Results presentation materials. The impact of this factor has grown since 1H. To provide a breakdown of this factor, there are two main items. The first is provisions booked for additional organizational transformation expenses related to our Machine Tools business, which was divested in FY2021. The second is provisions booked for one-time expenses associated with international projects. Regarding the second item, we had to book these provisions in accordance with IFRS accounting standards, but, as we expect that these costs will be covered by insurance in the future, we believe that this is a conservative accounting treatment. Moreover, regarding the Integrated coal Gasification Combined Cycle (IGCC) plants, we had expected to see a YoY decrease compared to the provisions that we had booked in Q1-3 FY2021, but due to recent plant operation instability, we had to book additional provisions. In terms of the full-year forecast, performance in Energy Systems fell short of the plan, while Aircraft, Defense & Space (ADS) slightly exceeded the plan. In Logistics, Thermal & Drive Systems (LTD), we are finally beginning to see the benefits of price increases. However, rising electricity and fuel costs, not only in Japan but also around the world, caused the positive value of the "Others" bar on page 9 to decrease.

**Q:** Looking at Q3 alone, one-time impact in thermal power businesses contributed -¥18 bn in profit decline compared to Q3 FY2021. Could you please provide a breakdown of this figure?

**Kozawa:** In the 1H FY2022 presentation materials, we described this factor as "one-time charges in thermal power businesses," but the Q1-3 FY2022 materials describe this as "one-time expenses in thermal power and other businesses," as this item now includes expenses from businesses other than thermal power. The

breakdown of the -¥35 bn from thermal power and other businesses is -¥21 bn from thermal power businesses and -¥14 bn from other businesses.

**Q:** What was the amount of organizational transformation costs related to Machine Tools? Also, is it true that the negative one-time impact from thermal power businesses increased by -¥4 bn from -¥17 bn in 1H to -¥21 bn in Q1-3?

**Kozawa:** I will refrain from disclosing the exact figure, but not all of the -¥14 bn in one-time expenses in businesses other than thermal power are related to Machine Tools organizational transformation expenses. Provisions booked for international projects are included in both the thermal power and non-thermal power portion of these expenses.

## **Questioner 2**

**Q:** Is the increase in the ADS segment business profit forecast attributable to Commercial Aviation or Defense? I believe the appreciation of the yen was also a negative factor for profit, so please comment on this.

**Kozawa:** Better than expected progress in Q1-3 in Commercial Aviation was the reason we increased the business profit forecast in this segment. Also, regarding foreign exchange effects, the average rate in Q3 was more than ¥140/USD. Our USD exchange rate assumption for Q4 is slightly lower than initially expected, but we expect that the average rate for 2H will likely be around to the original forecast of ¥140. Although Boeing 787 deliveries have, as forecasted, not increased much, in addition to a certain amount of upside from fixed cost reductions, deliveries of commercial aircraft including business jets and Boeing models other than 787 were healthy.

**Q:** You said that additional costs were booked due to IGCC plant operation instability. Do you plan for this impact to be settled in this fiscal year? Or has the situation already normalized?

**Kozawa:** Currently we are in a situation where we have to shut down the plants intermittently due to issues with areas other than the main equipment. Unfortunately, although we have already booked provisions, we will need to perform an appropriate amount of repairs at a suitable time, and there is a certain amount of risk there.

## **Questioner 3**

**Q:** Regarding the SpaceJet Program, it is my understanding that no additional costs will be incurred related to the discontinuation of development, as accounting treatment has already finished. Is there any possibility that, similar to the Machine

Tools business that you mentioned earlier, additional costs will be incurred in the future?

**Kozawa:** Basically, accounting treatment is already finished. In order to finally discontinue the project, we recognized the costs which we had not been able to take care of in the past in Q3.

**Q:** Was the amount of the SpaceJet-related costs recognized not large enough to appear on the Profit Bridge (page 9 of the presentation materials)?

**Kozawa:** That is correct.

**Q:** The impact of materials and logistics cost inflation as well as semiconductor shortages was -¥17 bn in 1H and -¥13 bn in Q1-3. Comparing these figures, is it correct to say that the effect of sales price increases in Q3 alone was +¥4 bn? Also, what do you expect the total impact to be over the full year? In particular, I would like to know the probability of achieving the full-year plan in LTD.

**Kozawa:** The breakdown of the -¥17 bn in 1H was -¥29 bn from cost inflation and +¥12 bn from price increase benefits. In the Q1-3, -¥41 bn was due to cost inflation, and +¥28 bn was from price increases. In Q3 alone, cost inflation was -¥12 bn, while price increase benefits were +¥16 bn, meaning that the benefits of price increases have come to exceed cost inflation impact. Considering the progress in price optimization benefits in Q3, I believe that improvements in Q4 are within reach. Moreover, if you add in the positive effects of the depreciation of the yen, I believe that achievement of the full-year forecast in the LTD segment overall is possible.

**Q:** Please let me know the progress in cost passthroughs in each LTD product.

**Kozawa:** The benefits of price increases are now being seen in all products in this segment. In the Forklifts business especially, although we had been raising prices for a while, production had not been able to keep pace, and deliveries were delayed. Now that we are able to ship these products, we are beginning to see the benefits of price increases.

#### **Questioner 4**

**Q:** Regarding provisions related to technical accounting factors associated with international projects, you said that these costs will be reimbursed by insurance, but when will that be?

**Kozawa:** This issue will not be resolved in FY2022 and not necessarily in FY2023 either. As such, we will likely have to formulate the FY2023 full-year forecast based

on the assumption that these expenses will not yet have been reimbursed by insurance.

**Q:** Regarding SpaceJet development costs, the plan had been to recognize ¥20 bn over the three years of the 2021 Medium-Term Business Plan. Will these costs be zero from the next fiscal year onward?

**Kozawa:** That is correct. Although we had planned to spend ¥20 bn over three years, the actual amount of costs incurred over the last two years has been kept below 2/3 of the planned amount. There is still R&D, including that related to Sustainable Aviation Fuel (SAF) and electrification, and research commissioned by the government, so the costs will not be completely zero. However, in total, we will be able to perform this research within the normal range of R&D expenses in the ADS segment.

**Q:** Why did you announce the discontinuation of SpaceJet development now?

**Kozawa:** Although discontinuation was always an option, over the past two years, we considered a variety of possibilities, including cooperation with other companies. However, considering the current market environment, development progress, and the additional investments required to launch the business, we determined we did not have the option of working with another company and that the business was not expected to be viable, which led us to decide to discontinue the project. We had spent a sizeable amount of money on development, so we were trying to find a way to make it work.

#### **Questioner 5**

**Q:** In the Energy Systems segment, could you please share your evaluation of the Q1-3 results and the path to the Q4 forecast in terms of growth in after-sales services and Aero Engines, excluding one-time effects?

**Kozawa:** Energy Systems needs an additional ¥70 bn in profit to achieve the full-year forecast. Looking at past trends, there is a tendency for profit to be high in Q4. Considering that the Aero Engines business has been recovering, the full-year forecast is at an achievable level.

**Q:** What is the status of growth in GTCC after-sales services?

**Kozawa:** Order intake is growing steadily, and revenue increased by around 10% YoY in Q1-3. We are forecasting around 10% in growth for the full-year as well.

**Q:** The SpaceJet Program page in the presentation materials mentions initiatives going forward related to the aircraft OEM business. Are you planning to continue to attempt to enter the OEM business? Please explain how we should understand what is written here.

**Kozawa:** This is referring to our CRJ business, which provides OEM after-sales services. This business is overseen by MHI RJ in the US. We plan to continue this business, which still expects to see growth. There are currently over 1,000 CRJs in operation, and we want to increase the market share of our CRJ maintenance business going forward. Also, market ratings of our maintenance services are high, and we would like to obtain maintenance work for other OEMs' aircraft as well. In the presentation materials, the third item in that section is "consider next-generation technologies with eye toward aircraft development programs." The main focus of this initiative is not on OEM aircraft manufacture, but rather on next-generation technologies. We would like to develop technologies that could become central to aviation if SAF or electrification were to receive real-world implementation. I think the second item, "Deepen partnerships with global OEMs," is a point that everyone is concerned about, but please understand that this does not refer to joint development with global OEMs. To date, the Aero Structures business has basically served to manufacture parts according to technical drawings designed by OEMs such as Boeing. Our SpaceJet development work was highly regarded internationally, so we are hoping to expand the involvement of our Commercial Aviation business to include participation from the design phase, not limiting ourselves to simply following the customers' technical drawings.

#### **Questioner 6**

**Q:** One-time impact in thermal power businesses in 1H was -¥17 bn, and in Q1-3 it was -¥21 bn. Is the difference, -¥4 bn, equal to the amount of additional costs booked in Q3 for IGCC?

**Kozawa:** This -¥4 bn includes no additional expenses from IGCC. This is related to additional provisions for international projects, which we had to book for accounting purposes.

**Q:** Even if we add back the -¥4 bn in one-time expenses in thermal power businesses, I think the profit margin for Energy Systems as a whole in Q3 was a bit low. Could you please explain why this is? Also, Plants & Infrastructure Systems (P&I) and LTD have incurred a combined -¥14 bn in additional costs this time. In order to offset this negative impact over the full year, are you expecting further benefits from price increases to materialize?

**Kozawa:** In P&I, we expect that profitability improvements in Metals Machinery will offset this. Moreover, in LTD, in addition to the effects of price increases, especially in Forklifts, units sold have exceeded the plan, which we expect to cover the additional costs you mentioned. Regarding IGCC, we had expected the negative effect of costs booked in FY2021 to be absent in FY2022, resulting in a YoY increase in profit, but that was not the case. In other words, we booked some additional costs in Q3, which is the reason why the Energy Systems profit margin appears low.

**Q:** Is the amount of provisions booked in Q3 for IGCC-related expenses separate from the -¥4 bn of one-time expenses in thermal power businesses?

**Kozawa:** Yes, that is correct.

**Q:** How much did you book in additional provisions for IGCC-related costs in Q3?

**Kozawa:** When comparing the additional provisions booked in Q1-3, FY2022 was at the same level as FY2021.

**Q:** Based on the current state of progress, your starting point on the road to the FY2023 business profit target of ¥280 bn seems a little far off, and I think you may not be able to reach it. Please let me know your thinking on this matter.

**Kozawa:** Even though there have been some benefits from exchange rates, I believe that, excluding one-time factors, our baseline business profit performance has risen, and we have the ability to reach next year's business profit margin target of 7%.

#### **Questioner 7**

**Q:** The breakdown of the -¥35 bn in one-time expenses in thermal power and other businesses was -¥21 bn for thermal power and -¥14 bn for other businesses. Comparing this -¥21 bn with the one-time impact in thermal power businesses in 1H (-¥17 bn) results in -¥4 bn in negative impact to profitability. Is it true that the amount of IGCC-related costs recognized in Q3 FY2022 decreased from the assumed -¥9 bn in Q3 FY2021 to -¥4 bn? Also, are organizational transformation costs in Europe, the absence of high margin projects, and increased fuel costs what caused the profit margin to be low this fiscal year?

**Kozawa:** The one-time impact shown in the presentation materials is a YoY comparison of the cumulative totals of the nine-month periods of Q1-3 in FY2021 and FY2022. Of this, one-time additional expenses in thermal power businesses in Q3 amounted to -¥4 bn. I explained that additional expenses in IGCC were at the

same level in Q1-3 FY2021 as in Q1-3 FY2022. Moreover, the amount of IGCC-related costs in Q3 FY2022 alone was larger than in Q3 FY2021. The negative impact on Energy Systems segment profit is the sum of -¥4 bn in one-time expenses, additional IGCC-related expenses, and other factors, which is higher than the figure for Q3 FY2021.

End of Document

**Note regarding forward looking statements:**

Forecasts regarding future performance as outlined in these materials are based on judgments made in accordance with information available at the time they were prepared. As such, these projections include risk and uncertainty. Investors are recommended not to depend solely on these projections when making investment decisions. Actual results may vary significantly due to a number of factors, including, but not limited to, economic trends affecting the Company's operating environment, fluctuations in the value of the yen to the U.S. dollar and other foreign currencies, and Japanese stock market trends. The results projected here should not be construed in any way as a guarantee by the Company.