CFO'S MESSAGE

Focusing on Cash Flow Management and Optimal Financial Balance to Increase Corporate Value in the Medium-to-Long Term

Masanori Koguchi

Member of the Board,
Executive Vice President and CFO

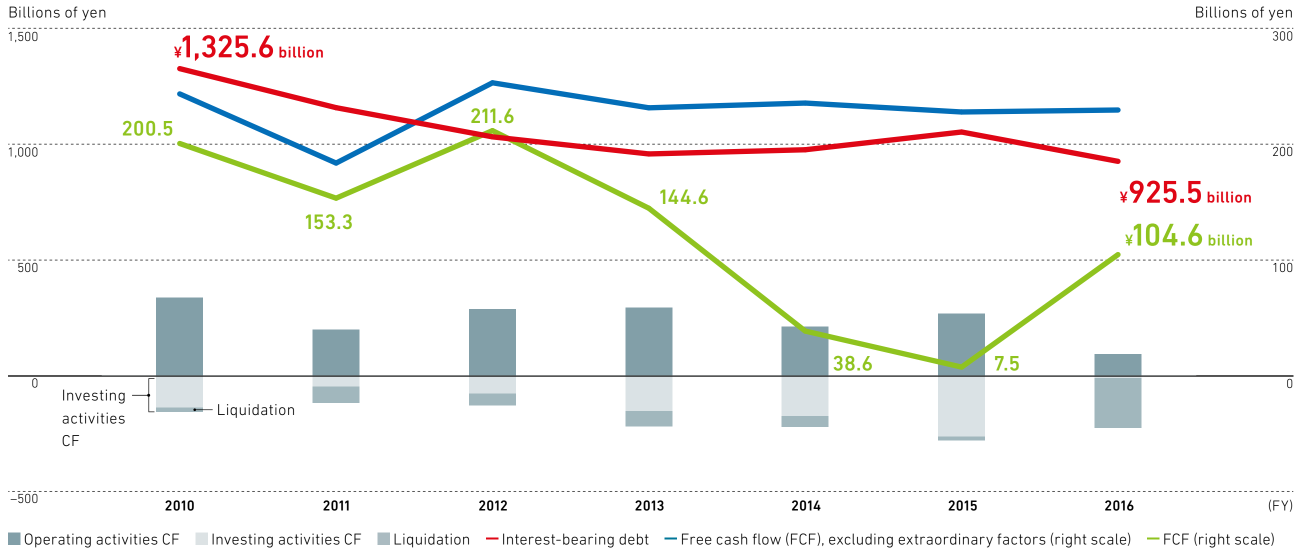
Steady Progress Made in Strengthening Our Financial Foundations

From around 2010, MHI Group began a major shift in management focus toward portfolio optimization based on a strategic business evaluation system and a new emphasis on cash flow. The shift was carried out in order to strengthen our financial foundations in preparation for future growth-oriented investments, and to build up risk resilience amid intensifying global competition and the aftermath of the global financial crisis that began around 2007. Between fiscal 2010 and fiscal 2016, we successfully secured a cumulative free cash flow near ¥1.6 trillion (excluding extraordinary factors*1). This was achieved primarily through improvement of profitability, resulting from concentration into our core competencies, and enhancement of balance sheet efficiency. Of the total free cash flow, some ¥810 billion has been allocated to new businesses and risk resilience. A further ¥570 billion was committed to achieving financial soundness and approximately ¥210 billion went to shareholder dividends. Our debt/equity (D/E) ratio in fiscal 2016 meanwhile was 44%, the lowest level in our history, and our interest-bearing debt was down 40% compared to fiscal 2009. These achievements were made despite undertaking large-scale future investments while setting aside funds to deal with our cruise ship construction business and other risk issues.

Regarding development of the MRJ business—an undertaking that requires large investment outlays—our fundamental financial policy is to rely wholly on our own funds, i.e. without resorting to loans. This stance is taken in consideration of our determination to develop the MRJ into a core business. Taken together, these various accomplishments demonstrate that we are truly making steady progress in improving our financial soundness.

*1. Expenditures relating to the cruise ship construction business, development of the MRJ, and the power plant project in South Africa; also, earnings in fiscal 2016 accrued from asset management initiatives.

Cash Flow (CF) and Interest-Bearing Debt



FY2010–FY2016 Accumulated FCF (excluding extraordinary factors*1): **Approx. ¥1,600 billion**

New business and risk management	Shareholder return (dividend)	Achieving sound financial position
Approx. ¥810 billion	**Approx. ¥210 billion**	**Approx. ¥570 billion**
	(Including dividends for non-controlling shareholders)	

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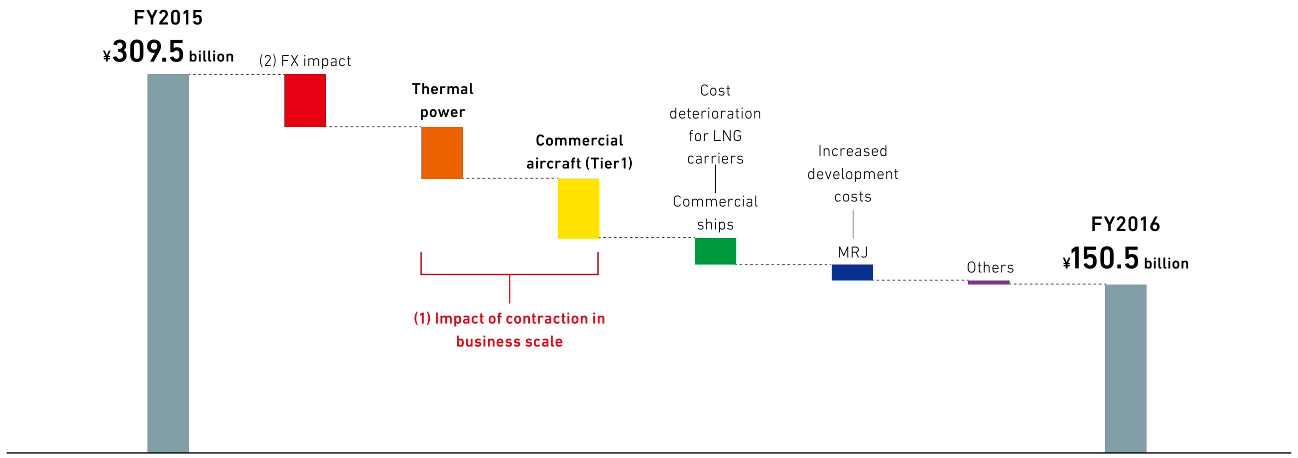
Imbalance between Business Scale and Balance Sheets / Fixed Costs

This progress aside, in fiscal 2016 a new issue came to the fore. In our quest for MHI Group to develop a strong presence in the global market, we have simultaneously pursued business scale expansion and higher profitability; and in the process, we have built up a corporate structure toward our targeted business scale of ¥5 trillion. This has resulted in the expansion of our balance sheets and fixed costs. Meanwhile, due to the sluggish global economy and longer time needed to complete domestic coal-fired power plant projects, the time span from order receipt to booking to sales, which was originally about 2 years, has generally expanded to around 2.5 or even 3 years. This means that orders which would normally have been booked to sales in fiscal 2016 partially carried over to fiscal 2017 or later. As a result, sales in fiscal 2016 were sluggish, leading to imbalances between net sales on one hand, and balance sheets and fixed costs on the other. This was a key factor in the erosion of our earnings for the year. In response, for the time being we will strive first to squeeze our balance sheets and fixed costs, targeting higher earnings even at our current business scale.

Operating Income



(1) Decline due to imbalance between business scale and balance sheets/fixed costs, following delayed post merger integration (PMI) at major joint venture (JV) businesses. Other factors included decreased activity in commercial aircraft (Tier1) business.
(2) Forex movements mainly affected the 'Commercial Aviation & Transportation Systems' and 'Machinery, Equipment & Infrastructure' segments.

Creating Value from Balance Sheets Through Asset Management

In addition to reducing this "waste" from our balance sheets as described, we are further stepping up efforts to squeeze our balance sheets and make them more efficient from a perspective different from before. Principally, we aim to create value from our balance sheets through effective asset management. "Asset management" in this sense doesn't mean simply selling off properties and undertaking equivalent exchanges. It consists of finding new and unprecedented value from pre-existing assets in parallel with cash generation, through collaboration with other companies, asset shuffling, and other measures.

To give an example, in February 2017 we spun off the real estate operations of Ryoju Facility and Properties Co., Ltd., a wholly owned MHI subsidiary, and sold 70% of the new company's shares to West Japan Railway Company (JR West). We did so in the belief that through collaboration with JR West, which considers real estate one of its core businesses, higher value can be anticipated from the transferred assets. Meanwhile, in March 2017 we sold our Head Office Building in Yokohama. Our plan is to rebuild our Dai Ichi Tamachi Building in Tokyo to serve as a strategic base consolidating our business promotion and support functions. By shuffling our assets this way, we aim to gain greater utility from our office assets in the Tokyo metropolitan area, and to garner higher added value and profitability through expansion of total floor space.

Through these approaches, in fiscal 2016 we generated approximately ¥197 billion in cash, comprising ¥79 billion from real estate assets and ¥118 billion from investment securities. In our 2015 Medium-Term Business Plan, we had set a target of creating cash flow—operations in real estate and investment securities combined—of ¥200 billion over the course of three years. Having achieved ¥197 billion through fiscal 2016, we will aim in fiscal 2017 to come up with further innovative approaches for generating greater value and cash flow.

Reinforcing Our Regular Earning Capacity and Financial Foundation in the Short-to-Medium Term

In fiscal 2010 MHI launched a "strategic business evaluation system" under which the Company has been reviewing how it allocates management resources. From the perspective of profitability, I believe that considerable progress has been made in optimizing our business portfolio; however, going forward we must maintain keen awareness of where society's needs exist. Beyond simply growing businesses that offer robust revenues while reducing capital investments into businesses with low profitability, we have now reached a stage where we must consider how we can change our portfolio to respond to society's demands. In order to develop business on a global scale, there will surely be occasions when we will have to take up major new challenges: for example, entering into new businesses or pursuing M&A opportunities. As CFO, I would like to see the Company in a position to utilize about ¥1 trillion in preparation for such needs. To achieve such a position, I strongly believe that carrying out cash flow management and maintaining a sound financial structure are key objectives.

As mentioned before, in fiscal 2017 and beyond we will continue to further squeeze our balance sheets to enable us to move forward, on the strength of our own efforts, without being subject to external factors. We will take effective measures for the short-to-medium term. First, as an issue requiring an immediate response, we will strive to curb unnecessary cash outflows. While pursuing enhanced efficiency, systemization, and outsourcing of routine work, we will maximize use of our Group resources and internalize work currently performed externally.

Second, as a short-term undertaking, we will strive to achieve greater efficiency throughout our production systems. In addition to consolidating and reorganizing our production bases and optimally reallocating our internal resources, we will improve our productivity by reviewing our business processes, as a way of improving our cash conversion cycle.

In parallel with this, in the medium-to-long term, we will also take steps to generate revenue and cash flow from our balance sheets by making broad use of our diverse assets, and not merely using them internally. This will involve not only tangible fixed assets but also technologies, intellectual property, and expertise.

By steadily carrying out measures such as these, I hope to make our balance sheets—a burden until now—a source of revenue as quickly as possible.

Dividend Policy

From my vantage point as CFO, I believe the ideal situation any company should aim for is what I call a "1:1:1" proportion. This means an equal balance between the three constituent factors of business scale, scale of assets, and market value. At MHI, our scale of assets currently exceeds our business scale, and our market value is significantly smaller than both of these. As such, what we need to do first is reduce the scale of our assets, increase our earning capacity, and boost our operating and net income levels. Furthermore, for increasing our market value, I believe that shareholder returns should be one of the most important considerations. As I noted earlier, since fiscal 2010 we have accrued close to ¥1 trillion in free cash flow from business income, etc.; and of that amount we have allocated roughly ¥210 billion—around 20%—to shareholder returns. Although this is by no means a particularly high ratio, as a company in the process of undertaking robust management reforms, I hope to increase our shareholder value over the medium-to-long term by strengthening our financial structure through use of retained earnings to expand our business scale, preparing for potential risks and creating new businesses for the future.

Our intention of course is to pursue a dividend policy that accords prime weight to shareholder returns by boldly implementing management reforms and raising our ROE. In the near term, however, in light of our investments into growth businesses and the like, we aim to distribute dividends at a payout ratio of 30%.

Based on that position, in fiscal 2016 we disbursed an annual dividend of ¥12 per share, unchanged from the previous year. Once our corporate makeup reaches the appropriate proportions, we will be able to achieve our vision as a leading company that is fully able to compete in the global arena. We appreciate the continued understanding and support of our shareholders and investors as we progress towards that goal.