PRESIDENT'S MESSAGE

Sustained Growth Through Structural Reforms and Global Diversity

Shunichi Miyanaga

President and CEO

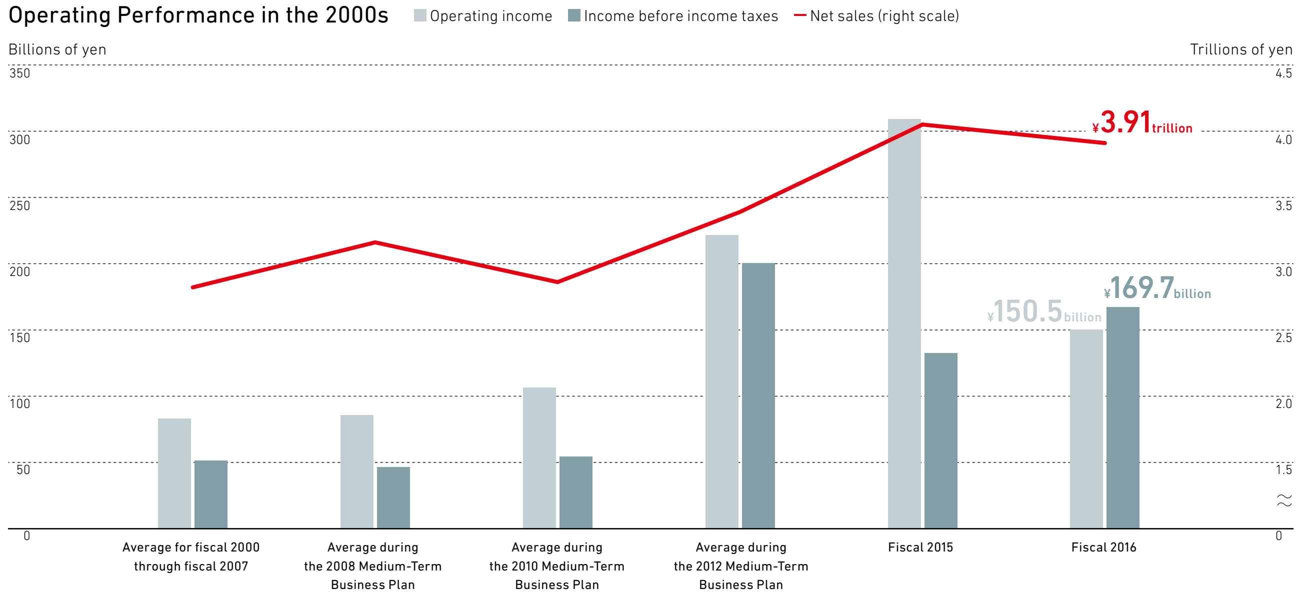
What We Have Achieved in Structural Reforms So Far

Since launching our 2012 Medium-Term Business Plan*1, we have carried out a large-scale program of structural reforms and reform initiatives which continue today. To give some background as to why such reforms were needed, we must look back to the 1990s. Until then, MHI Group had continued to grow thanks to domestic demand, driven by the growth of the Japanese economy. However, with the collapse of the "bubble economy," Japan's economy slipped into a prolonged phase of slow growth, and as a consequence our own growth dropped off. In response, we attempted to find breakthrough solutions, but through the first decade of the new millennium we were unable to implement radical measures to turn around businesses with worsening earnings and languishing domestic investment.

As the domestic market for our products reached maturity and demand dropped off, MHI Group had to shift its sights to overseas markets in an unprecedented way to return to a positive growth trajectory. As expected, we faced a completely different level of competition in overseas markets compared to the Japanese market. The risks were greater as well, and for that reason it became imperative that we undertake reforms in our management policies, business execution practices, and business administration processes. We also needed to rethink our corporate culture itself. Clearly, companies that have a strong presence in the face of global competition are those that benefit from scale merits as they skillfully manage their risks.

*1. The plan spanned the three-year period from fiscal 2012 to fiscal 2014.

Operating Performance in the 2000s



PRESIDENT'S MESSAGE

With that in mind, we put in place structures that would enable us to compete against overseas competitors, starting with our 2012 Medium-Term Business Plan (which I helped to formulate as Senior Executive Vice President and then Head of the Presidential Administration Office). We set two overriding targets: scale expansion and profitability enhancement. Specifically, we consolidated what had been separate business headquarters and regional offices to a structure consisting only of business headquarters. Furthermore, we reorganized the business headquarters into larger "business domains." This restructuring move gave us greater freedom in using our management resources and enabled us to make timely investments of resources into areas offering high growth potential and profitability. The outcome was business growth and expansion. We also launched a business evaluation system under which we: a) classified business positions according to business maturity (nascent, prime, or mature) and profitability/financial soundness; and b) set return requirements and optimized our allocation of invested capital commensurate with those positions. In this way, we retooled our business portfolio and improved our profitability.

As a result of these various initiatives, in fiscal 2016 our orders received and net sales both achieved 30%–40% growth compared to fiscal 2011, each increasing by approximately ¥1 trillion. Additionally, our profit levels also improved significantly. Throughout this period we continued to make major investments and for seven consecutive years (fiscal 2010–2016) we successfully secured positive free cash flow, a major achievement symbolizing our corporate transformation.

> For details on medium-term operating performance, please see the **Eleven-Year Financial and Non-Financial Data on page 28.**

Actualized Risk and Impending Challenges

These achievements notwithstanding, today we face risks of a different nature and larger scale than ever before as a result of globalization and our entry into new business areas. It is clear that gaps have emerged between the targets we set when formulating the 2015 Medium-Term Business Plan*2 and our current situation. A prime example is our large-scale cruise ship construction project. We initially accepted orders in the belief that, based on our track record, we were fully up to the task. Ultimately, however, we lacked sufficient knowledge and expertise to match the facilities and specifications required for large-scale cruise ships in Western markets. As a result we struggled with the construction and incurred significant losses. Another example is the MRJ project*3, our bold initiative to develop Japan's first domestically built passenger jet in half a century, which was spurred by expectations that MRJ-related business will become one of our core strengths in the future. However, in January 2017, as a result of having to modify the aircraft's design in order to meet the latest safety standards, we were forced to push back the delivery schedule of the first production unit from mid–2018 to mid–2020.

Performance Forecast for Fiscal 2017

Billions of yen

FY	2016 (actual)	2017 (previous plan)	2017 (revised forecast)
Orders received (Overseas sales ratio)	4,275.6 (48%)	5,500.0 (64%)	4,500.0 (55%)
Net sales	3,914.0	5,000.0	4,150.0
Operating income (Operating income ratio)	150.5 (3.8%)	450.0 (9.0%)	230.0 (5.5%)
Profit attributable to owners of parent	87.7	200.0	100.0
ROE	5.1%	10.2%	5.5%

Reasons for revision

Mitsubishi Hitachi Power Systems (Thermal power business)	–350.0
Land transportation systems	–220.0
Commercial aircraft	–200.0
Primetals Technologies (Metals machinery)	–120.0
Compressors	–110.0
Total orders	–1,000.0

Another issue is the growing uncertainty that has surrounded the global economy in recent years. Factors include substantial declines in oil prices, subsequent economic downturns in oil-producing nations, reluctance to make large-scale investments in energy-related infrastructure and, in the case of Japan, the strengthening of the yen. Meanwhile, an imbalance has come to the fore between our business scale and fixed costs, attributable to factors such as slower than expected progress with post merger integration (PMI) at Mitsubishi Hitachi Power Systems, Ltd. (MHPS) and other joint ventures, as well as decreased production demand for commercial aircraft. Concurrently, LNG carrier costs have fallen. As a result of these combined factors, our operating income in fiscal 2016 dropped roughly 50% from the previous year, to ¥150.5 billion. For this reason, we have inevitably shelved achieving the targets we had set for fiscal 2017, the last year in our 2015 Medium-Term Business Plan: namely, net sales of ¥5 trillion, operating income of ¥450 billion, and profit attributable to owners of parent of ¥200 billion.

> For details about factors behind changes in operating profit in fiscal 2016, please see the **CFO's Message on page 16.**

*2. The plan spans from fiscal 2015 through the current fiscal 2017.
*3. MRJ: Mitsubishi Regional Jet

Current Status of Large-Scale Risks and Their Countermeasures

Despite these disappointments, the outlook is now improving, with the most risk-laden projects drawing to a close and the remaining issues affecting the MRJ business becoming clearer.

The second and final cruise ship in the beleaguered project referenced above was delivered in April 2017, bringing that project to an end. Going forward, based on the findings of our internal evaluation committee, we will limit cruise ship operations and projects to those that can be handled by our own personnel and supply chain. In addition, we will take the knowledge of highly complex ship engineering acquired through this project and apply it to our other businesses to help us achieve technological differentiation.

Furthermore, regarding the arbitration case relating to the San Onofre Nuclear Generating Station in California, in March 2017 an award was passed down that in large part accepted our claims, bringing that issue to a close.

As to the MRJ project, the development phase, which encompasses numerous flight tests, is gradually coming to an end. We are now progressing toward the final hurdle of acquiring type certification (safety approval), while initiatives are underway to improve future business viability. In November 2016 we launched a new MRJ Business Promotion Committee under the direct oversight of the CEO. Through the efforts of this committee, decision making pertaining to important matters and Groupwide support are being carried out with appropriate speed. In striving to enter the full-scale commercial aircraft business, we continue to face the anticipated difficulties;

> For details about future directions in the commercial ship business, please see **Business Segment Overview, Industry & Infrastructure Domain, on page 37.**

but looked at from a different angle, because of the high entry hurdles for this field, it is unquestionably a business which is expected to continue to grow in the future. We intend to do everything possible to make up for the delays experienced until now, and to grow the MRJ business into a major pillar of our operations.

In order to respond to the expanding risks that accompany increasingly large-scale and complex projects, we launched a new Business Risk Management Division in April 2016 and also established a "Business Risk Management Charter" which provides the core risk guidelines for the Group. We also created the Business Risk Management Committee headed by the CEO. In my role I will be deeply involved in the committee's operations, taking the lead in developing a risk management culture and strengthening risk entry point management. Active exchanges are now underway between highly experienced experts in risk management and the business segments, and as the number of personnel with experience in risk management increases, we expect a further buildup of relevant expertise within the Group.

> For details about future directions in the MRJ business, please see **Business Segment Overview, Aircraft, Defense & Space Domain, on page 41.**

> For details related to risk management, please see **Risk Management on page 51.**

Fiscal 2017, The Year We Complete Our Structural Reform Agenda

In 2013 we shifted to a domain-based structure, and subsequently made a thorough review of our organizational structure to foster growth as a global enterprise. In April 2017 we then reconfigured our domain structure to incorporate improvements that the review process had deemed necessary. This reorganization was aimed at further Group synergies to strengthen our global competitiveness and engineering operations, and drive radical reforms in our commercial aircraft and commercial ship businesses.

Specifically, from our original four domains—Energy & Environment, Commercial Aviation & Transportation Systems, Integrated Defense & Space Systems, and Machinery, Equipment & Infrastructure—we reorganized into three new domains: Power Systems, Industry & Infrastructure, and Aircraft, Defense & Space. This was achieved by reallocating our strategic business units (SBUs) that handle business for individual products.

Domain Restructuring

Billions of yen

	Net sales	Operating income
Energy & Environment	1,470.4	110.5
Commercial Aviation & Transportation Systems	515.3	-51.9
Integrated Defense & Space Systems	470.6	27.9
Machinery, Equipment & Infrastructure	1,438.0	72.5

Billions of yen

	Net sales	Operating income
Power Systems	1,448.4	108.1
Industry & Infrastructure	1,747.0	50.0
Aircraft, Defense & Space	703.4	0.9

Note: Operating performance figures are actual for fiscal 2016.

For details on domain restructuring, please see the **Business Segment Highlights on page 30.**

Operations in the Power Systems domain center on the thermal power generation business of Mitsubishi Hitachi Power Systems, Ltd. (MHPS) and the technologically affiliated businesses of aero engines and compressors. Through these business alignments we are seeking synergies within the turbo machinery business as a whole and reinforcement of our after-sale servicing operations. We are also striving to improve MHPS's earning capacity via consolidation and reorganization of the company's bases and through greater use of IoT and AI.

The Industry & Infrastructure domain essentially carries on the business previously conducted within the Machinery, Equipment & Infrastructure segment, with new emphasis on expanding earnings through improved portfolio management of its various machinery and equipment businesses and the creation of global niche products. In addition, by consolidating into this domain those businesses heavily oriented toward EPC (engineering, procurement, construction)—businesses in commercial ships, chemical plants, transportation systems, etc.—we will be able to integrate and strengthen our engineering operations going forward. In our commercial ship business, by forming alliances with dedicated shipbuilders, we will pursue synergies between MHI's engineering strengths—primarily our energy efficiency and environmental protection technologies—and the construction capabilities of our alliance partners.

The new Aircraft, Defense & Space domain oversees business handled by the earlier Integrated Defense & Space Systems segment, as well as operations in commercial aircraft and the MRJ that were subsumed within the Commercial Aviation & Transportation Systems segment. By transferring the latter businesses, we now strive for synergies within aircraft operations and more effective use of management resources. At the same time, to carry out reforms in our commercial aircraft business's supply chain, we will strengthen use of the shared technology framework launched in April 2016 to integrate Companywide technologies, marketing, procurement, etc. Specifically, we have shifted our commercial aircraft procurement functions to the Value Chain Headquarters, and we are now seeking new suppliers while implementing reforms in our procurement processes. Additionally, it should be pointed out that upon its launch, the Aircraft, Defense & Space domain was not placed under the charge of an appointed head officer; rather, this domain is directly managed by the CEO, a result of the MRJ business being placed under the CEO's oversight. Because businesses in this domain are all developed over long periods of time, under the new structure we will target the early formation of strong foundations for such development as well as the stabilization of segment earnings.

Fiscal 2017 is the third and final year of our 2015 Medium-Term Business Plan, and will be a year in which the overall structural reform agenda will be brought to fruition. Although some follow-up measures relating to the MRJ will carry over into fiscal 2018, we intend to complete our Groupwide structural reforms and remedial measures for dealing with problematic businesses all within fiscal 2017. Then, starting in fiscal 2018, we hope to achieve a dynamic shift to a new phase of sustained growth.

> Please see **Business Segment Overview, Power Systems Domain, on page 32.**

> Please see **Business Segment Overview, Industry & Infrastructure Domain, on page 36.**

> Please see **Business Segment Overview, Aircraft, Defense & Space Domain, on page 40.**

Becoming an Organization Capable of Sustained Growth by Adapting to Change and More Diversity

MHI has a history stretching back more than 130 years. Managing a complex conglomerate is perhaps more complicated than managing a dedicated manufacturing business, but there are aspects in which being a conglomerate offers distinct advantages: our ability to respond to social changes or diversity needs, for example.

Today, I believe we must seek new ways to thrive as a global conglomerate for machinery and engineering while integrating our recent experiences and measures to respond to the significant and dramatic changes we expect in our industry and, more broadly, in the world going forward.

As mentioned previously, MHI has traditionally achieved growth in the domestic market in tandem with Japan's economic growth. Today, there are still areas within the Japanese market where our products and technologies can thrive, and going forward we will continue to strengthen those areas. However, at the same time we need to allocate more of our management resources into products and businesses that have growth potential in overseas markets. As innovations take place in many different fields, particularly ICT, it will be crucial for us to flexibly incorporate the most up-to-date technologies and expert knowledge into our engineering business—our area of foremost strength—and into the technologies that form the core of our products. In other words, we need to be an organization capable of two things: maintaining technologies cultivated over a long period of time, while being highly flexible and in step with changes in the world around us.

To grow our business overseas, beyond the "global" perspective, it is also essential to take a local perspective attuned to each specific region. In fiscal 2018 we are due to relocate our global headquarters functions to Tokyo's Marunouchi district. With this relocation we will focus on strengthening our global management structure while delegating authority to and clarifying the responsibilities of each local base. In this way we aim to seamlessly combine global management with local management and regional characteristics.

For MHI to continue to create value while meeting society's needs, in addition to developing the organizational structure outlined above, we will also need the right people. As it becomes increasingly difficult to prolong the lifespan of—i.e., demand for—a product over long periods, it is also becoming more important to have human resources who can swiftly understand and adapt to society's evolving needs. To develop human resources that can take the lead in moving the organization forward and overcoming new challenges, it is necessary to create an environment conducive to continuous human resource development. This means communicating and sharing with employees what goals the Company is pursuing, identifying ways to achieve these goals, and encouraging employees to build experience in taking on and overcoming challenges in multiple fields.

Through our agenda of ongoing structural reforms, we have now laid the groundwork for taking our next big step. In our next medium-term management plan we will continue to give our best in making progress toward a phase of sustained growth, including the growth of our human resources and knowledge base.

> For details on human resource development, please see **Creating a Management Foundation That Responds to Global Society: ESG Initiatives, Material Issue 2: The Use of Global Human Resources, on page 22 and 24.**

Please watch the video on the website below.
> http://www.mhi.com/finance/mr2017

BOARD OF DIRECTORS

As of July 1, 2017

1. Chairman of the Board
Hideaki Omiya

2. President and CEO*1
Shunichi Miyanaga

3. Director, Executive Vice President (CFO*2, Head of Business Strategy Office)
Masanori Koguchi

4. Director, Executive Vice President (CTO*3)
Michisuke Nayama

5. Director, Full Time Audit and Supervisory Committee Member
Seiji Izumisawa

6. Director, Full Time Audit and Supervisory Committee Member
Toshifumi Goto

7. Director
Naoyuki Shinohara
(Professor, The University of Tokyo, Policy Alternatives Research Institute)

8. Director
Ken Kobayashi
(Chairman of the Board, Mitsubishi Corporation)

9. Director, Audit and Supervisory Committee Member
Nobuo Kuroyanagi
(Senior Advisor, The Bank of Tokyo-Mitsubishi UFJ, Ltd.)

10. Director, Audit and Supervisory Committee Member
Christina Ahmadjian
(Professor, Hitotsubashi University Graduate School of Commerce and Management)

11. Director, Audit and Supervisory Committee Member
Shinichiro Ito
(Chairman of the Board, ANA Holdings Inc.)

*1. CEO: Chief Executive Officer
*2. CFO: Chief Financial Officer
*3. CTO: Chief Technology Officer

Introduction
Management Strategies
Value Creation through Our Business
Corporate Governance