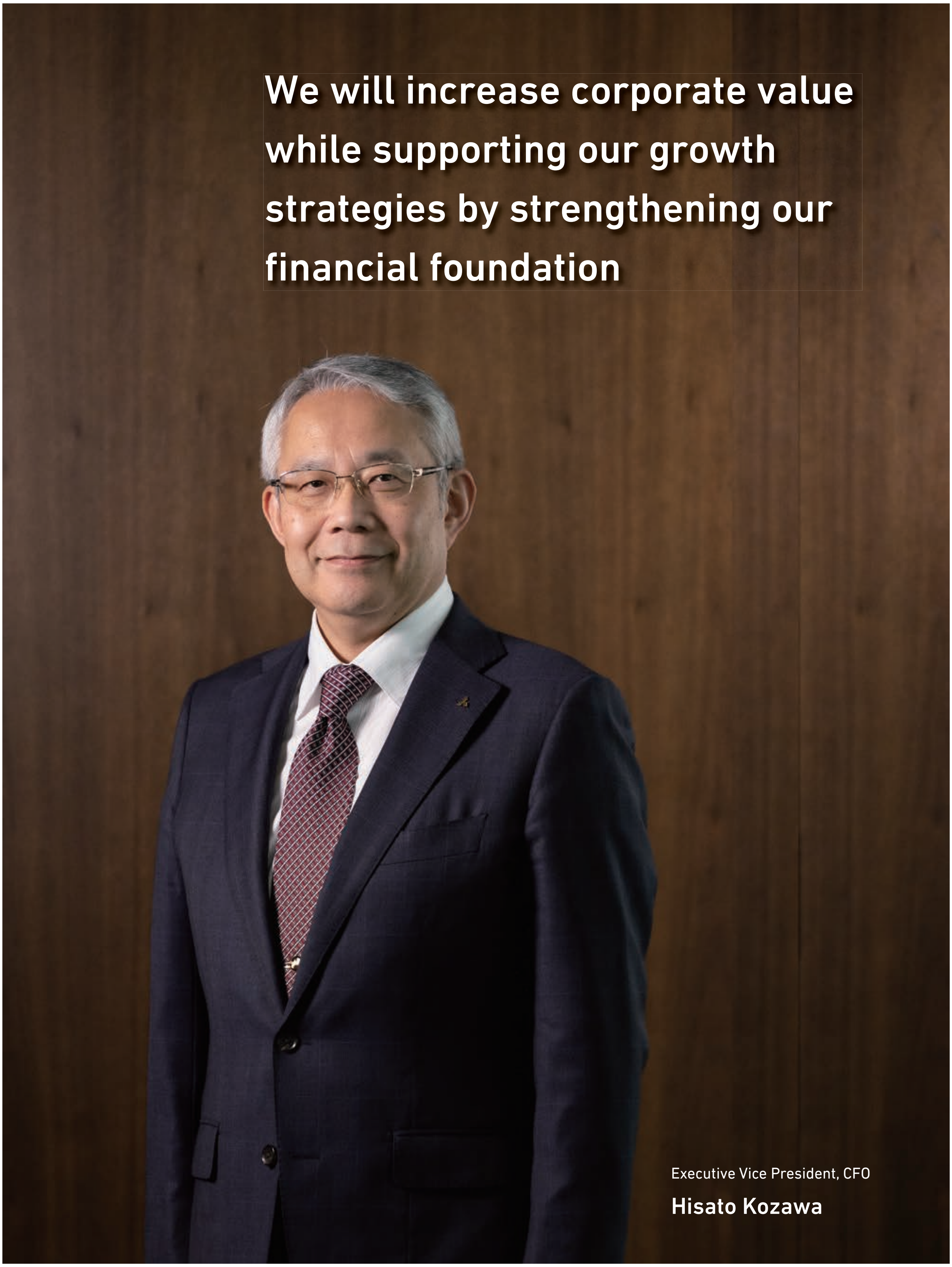
A Message from the CFO



We will increase corporate value while supporting our growth strategies by strengthening our financial foundation

Executive Vice President, CFO

Hisato Kozawa

Changes in our Operating Environment and their Impact on our Businesses

MHI Group's operating environment is changing significantly. As Russia's invasion of Ukraine draws out, companies now need to consider geopolitical risks more than ever before when making decisions.

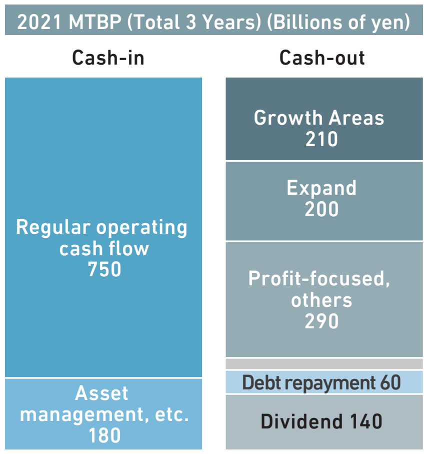
Moreover, 2022 saw a global pivot in financial and monetary policies. As countries move to correct their extreme monetary easing policies, the impact from this adjustment is one factor driving severe fluctuations in the foreign exchange markets. Looking at the U.S. dollar to Japanese yen rate, whereas the annual fluctuation range for the five-year period from 2017 to 2021 was around 10 yen, in 2022 this was almost 40 yen, reflecting highly volatile market conditions. Compared to 15 years ago, when the U.S. dollar fell sharply due to the Global Financial Crisis, today we are better able to control our exposure to foreign currencies. However, 2022 proved to be a year in which management was forced once again to be conscious of foreign exchange fluctuations.

Recently, we have also been paying particular attention to inflation. Starting with rising natural resource prices, supply chain disruptions due to the effects of the COVID-19 pandemic have affected the prices of a wide range of goods and services. Additionally, labor costs have risen against the back drop of worsening labor shortages. Japan is also finally starting to see signs of inflation after a long deflationary period. These changes to the operating environment have affected the management of MHI Group in a variety of ways. Regarding our macro-level approach to business management, the global trend toward decarbonization endures. We will continue to focus on the two pillars of our growth strategy, the Energy Transition and Smart Infrastructure, in response to this trend. Additionally, amid rising concerns for national security in Japan, we expect defense budget increases and revisions to nuclear energy policies, from which we will likely benefit due to our strong competitiveness in these areas. On a micro-level, we are working to pass through cost inflation to our sales prices in order to share the cost burden with our customers, particularly in Logistics, Thermal & Drive Systems. The positive results from these efforts became apparent in the second half of FY2022, and we believe that in FY2023, our performance will benefit even more clearly from these price increases.

FY2022 results were on the whole in line with our expectations, despite pressure to respond to changes in the operating environment and the booking of certain one-time items, such as losses from power plant projects outside Japan. Order intake increased in Energy Systems and Logistics, Thermal & Drive Systems. Notably, in Energy Systems, our Gas Turbine Combined Cycle (GTCC) business gained the top share in the global gas turbine market in 2022 thanks to strong orders during that period. Revenue reached a record high, mainly due to services growth in GTCC and Logistics Systems, as well as recovery in demand for Aero Engines. Business profit increased year-on-year across all segments, reflecting success in our core strategy under the 2021 Medium-Term Business Plan (MTBP) to strengthen profitability, which we feel is gaining traction.

Financial Indicators Over Time

	FY2018	FY2020	FY2023
Revenue	¥4.1 trillion	¥3.7 trillion	¥4.3 trillion
Business profit margin	5%	1.5%	7%
ROE	7%	3.1%	11%
Total assets	¥5.1 trillion	¥4.8 trillion	¥5.5 trillion
Interest-bearing debt	¥0.67 trillion	¥0.9 trillion	¥0.8 trillion
Equity	¥1.7 trillion	¥1.4 trillion	¥1.9 trillion
Debt/Equity ratio	0.4	0.6	0.4
Equity ratio	34%	28%	34%
Dividend per share	¥150	¥75	¥160



* Adjusted from previously disclosed materials for the portion realized in advance in FY2020.

2021 MTBP Progress and Our Approach to Growth Investments

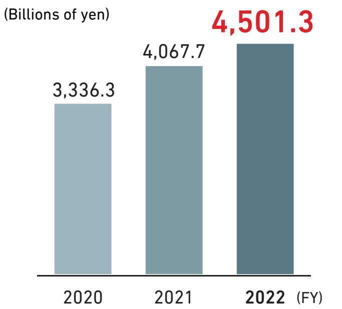
With our earnings forecast for FY2023 – the final year of the 2021 MTBP – we showed our confidence in achieving our targets despite the impact of inflation and the other factors I mentioned previously. As our initiatives to expand services businesses and optimize pricing bear fruit, we will also seize new domestic opportunities that have emerged in Nuclear Power and Defense.

We will actively invest in growth areas. On the topic of the Energy Transition, the Inflation Reduction Act (IRA) was passed in the United States in August 2022, providing tax incentives and subsidies for projects aiming to shore up energy security and address climate change. This law is expected to accelerate the launch of decarbonization-related businesses, primarily in North America. By accurately interpreting these trends, we seek not only to provide products, but also to contribute to creating mechanisms for practical implementation of these solutions. Recently, we have seen a marked increase in orders arising from growing demand for gas turbines that can easily be converted to hydrogen fuel in the future. There has also been an increase in inquiries and feasibility studies regarding the combination of GTCC with CO_2 capture technologies. In the area of Smart Infrastructure, we are actively pursuing the launch of new businesses. In FY2022, these efforts included validation testing of logistics center automation products and energy-saving and decarbonization solutions for data centers.

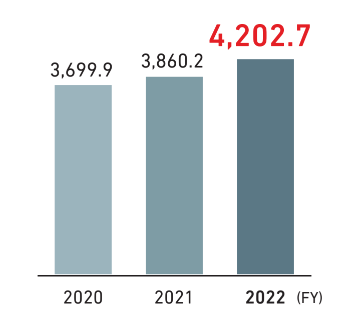
We also need to actively pursue M&As and invest in start-ups in order to move our growth area initiatives forward and ensure future commercialization and profit creation. In FY2021 and FY2022, unfortunately, we did not make as much progress in our investment activities as originally intended, partly due to the impact of COVID-19. However, since the beginning of FY2023, we have continuously made investments to sow the seeds of future business expansion, including the acquisition of shares in an American company, Concentric LLC.

FY2022 Financial Results

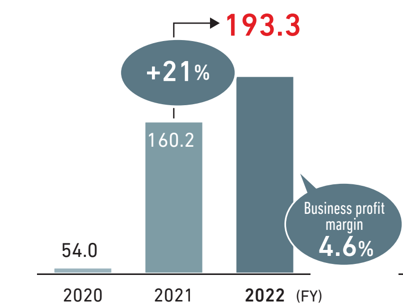
Orders Received



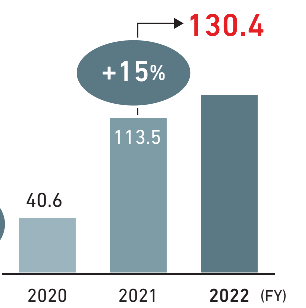
Revenue



Profit from Business Activities



Profit Attributable to Owners of Parent



EBITDA
¥331.1 billion
(+¥38.7 billion YoY)

EBITDA margin
7.9%
(+0.3% YoY)

Free Cash Flow
¥35.3 billion
(-¥266.5 billion YoY)

Operating Cash Flow
¥80.8 billion
(-¥204.6 billion YoY)

Interest-Bearing Debt
¥742.4 billion
(+¥7.4 billion YoY)

Net Interest-Bearing Debt
¥394.7 billion
(-¥25.9 billion YoY)

ROE
7.9%
(+0.2% YoY)

Dividends
¥130/share
(+¥30/share YoY)

Basic Approach to Financial Strategy

Many of Japan's listed companies have an overall price-to-book ratio (P/B ratio) that is lower than 1. This means the market capitalization – the value to the capital markets – of many companies is lower than their equity's book value – their value in accounting terms. The Tokyo Stock Exchange and the Financial Services Agency have pointed this situation out as an issue that bears addressing. MHI's share price has been trending upward since 2022, and as of June 2023, our P/B ratio is higher than 1. However, in 2020, at the time when I was appointed CFO, our P/B ratio was at a low level around 0.7. Naturally, we do not have direct control over our share price, but in order to maintain and increase it, we will need to gain credibility in the market and raise its expectations of us. To achieve this, it will be vital to have convincing management strategies while steadily achieving our earnings targets and consistently delivering a certain level of profitability and capital efficiency.

On the topic of consistently securing a certain level of profitability and capital efficiency, it is important to consider how good we are at efficiently using our assets to conduct business and deliver earnings. Our balance sheet assets need to be evaluated for efficiency and managed so that those with low performance are replaced with high-performing ones. To this end, I am focusing on improving return on assets (ROA). In FY2022, our ROA (vs. pre-tax profit) was only 3.6%, but we intend to raise this rapidly to over 6%.

Improving ROA naturally requires increasing returns, and as I mentioned before, this requires appropriate control of assets. We will improve the composition of our assets to achieve a lean balance sheet by controlling the size of inventory assets, trade receivables, and other components of working capital using such indicators as cash conversion cycle (CCC) and by selling off inefficient assets including strategic shareholdings and low-yield real estate.

Business Portfolio Management

MHI Group operates a wide range of businesses, and our approach to business portfolio management is based on an in-house evaluation method that we call the Strategic Business Assessment System. We assess the performance, profitability, and efficiency of each of our Strategic Business Units (SBU). With the results of these assessments, we can have better discussions on recalibrating and optimizing our business portfolio through the strategic allocation of management resources, aiming to achieve an optimal configuration. Our approach to management, which uses this system as a standard for decision-making, has taken root in our organization since it was implemented over 10 years ago. I am proud of the progress we have made in clearing out problematic businesses, but to achieve further capital efficiency gains, we need to move on to the next stage.

By this, I refer to the “best owner” approach to management, which means considering whether MHI Group is better able to increase the value of a business than another company. I believe that an effective means of creating a stronger portfolio is to review each business considering whether MHI is really the owner that can maximize an SBU’s growth in areas such as product line-up, market presence, technological advantages, and business model, even if that SBU has already achieved a certain level of growth, profitability, and efficiency.

Approach to Capital Allocation and Shareholder Returns

In our 2021 MTBP, we cited return on equity (ROE) as an important financial indicator. In FY2022, our ROE was 7.9%, but we are planning to increase this to 11% in FY2023. First, we aim to reliably achieve double-digit ROE in order to earn a certain level of valuation from the capital markets.

One approach to raising ROE is to apply leverage by reducing net assets and increasing interest-bearing debt, but we have a relatively conservative capital structure, with a debt-to-equity (D/E) ratio of 0.4 as of the end of FY2022. We are managing this based on our current balance of interest-bearing debt and profitability, giving weight to the impact on our fund-raising activities, such as external credit ratings. We see another option of gradually applying leverage as our profitability improves in the future.

Regarding shareholder return, we are aiming for a dividend payout ratio of around 30%, and we are forecasting a record high annual dividend of 160 yen per share in FY2023. That said, we believe that it is important for dividends to be stable in order to respond to the medium- and long-term expectations of our shareholders and investors. Therefore, rather than looking at the dividend payout ratio, which depends on the profit and loss of only a single fiscal year, we think it may be better for the dividend policy to incorporate dividends on equity (DOE), which is the return on the balance of equity and dividend yield. We are considering this in formulating the next medium-term business plan. While MHI has the option of share buybacks to provide returns to shareholders over the short term, we would only go forward with such an action after considering factors such as our financial position, the market environment, and our investment plan at the time.

Enhancing Corporate Value

I have been CFO for three years now. Over this time, we have been faced with a host of issues, including the global COVID-19 pandemic, and we have brought our full capabilities to bear in order to address them. Earnings have begun to stabilize, and with interest-bearing debt kept at an appropriate level, there is an increasing sense that we have achieved good financial stability. Looking forward, building stable earnings capacity is the highest priority for gaining further trust from shareholders and investors. Organic improvements such as launching new technologies and products and increasing productivity are of course important, and we will continue to do so. Furthermore, in parallel, we also need to revise our assets, including entire businesses, to create a portfolio with the potential to generate more profits and cash – in other words, to strengthen our balance sheet. I believe that this is my primary mission as CFO. In FY2022, MHI made the extremely difficult decision to discontinue development on SpaceJet. While we recognize that there were arguments both for and against that decision, we are certain that it was the correct choice to avoid harming our corporate value in the future.

Throughout the years, we have continued to provide the world with products and technologies in response to society's evolving needs. We have followed this path in line with the Three Principles of Mitsubishi Group and Our Principles, MHI's core philosophy rooted in the Principles. We are working to help realize a carbon neutral world, the largest issue that the entire world shares in common today. To that end, we will provide a variety of solutions to achieve a sustainable Energy Transition under our MISSION NET ZERO initiative. I am proud of this effort, which I believe is the best contribution to society that MHI Group can make. Moreover, as a leading Japanese company, we are also able to assist Japan in the realm of national security, another pressing issue. As indicated by our tag line, "MOVE THE WORLD FORWARD," MHI Group will continue to grow sustainably and increase our corporate value by contributing to solutions for the world's most pressing issues.