[Event Name] The Acquisition of Naval Ships Business from Mitsui E&S Shipbuilding: Strengthening Our Defense Business

[Date] March 29, 2021

[Speakers] Hisato Kozawa  Director, Senior Vice President, CFO
Naohiko Abe  Senior Vice President, Head of Integrated Defense and Space Systems

[Question & Answer]

Questioner 1: I’d like to ask a little more about the details. Please let me confirm the collaboration process. Initially, when MHI started the collaboration, it said that it acquired Mitsui E&S Shipbuilding’s Naval Ships Business. However, in today’s announcement, you mentioned “Naval Ships Business, et cetera,” meaning that you will also be acquiring the Governmental Ships Business. Did you expand the scope of acquisition during negotiations in view of strong synergies? Also, you mentioned that the business was “transferred.” You are using this word with the same meaning as “acquired,” correct? Furthermore, the acquisition price is undisclosed. There was no timely disclosure of the impact on MHI’s financial position. Is it fair to say that the impact would amount to several billions of yen? Could you please share with us any information possible?

Abe: I will answer your first question. The question was about whether the scope of the acquisition expanded into governmental ships during negotiations. The answer is no. Discussions were being carried out about naval and governmental ships together from the outset. There were many cases where we referred to them as “naval ships, et cetera,” in announcements. But there were some instances where we only mentioned naval ships. Either way, governmental ships were included in discussions from the beginning.

Kozawa: Regarding the acquisition price, the price is undisclosed, as stated at the President’s press conference held earlier. However, as you point out, Mitsui E&S Holdings indicated in its timely disclosure material that the transaction will not have a material impact on its earnings. In normal accounting treatment, losses need to be reflected in the current fiscal year’s results when the final agreement is signed, and profits need to be recognized when the deal is closed. That’s the usual procedure. Thus, it means the deal will not result in losses. That’s probably how Mitsui E&S Holdings has handled the transaction. Further, in today’s timely disclosure material, Mitsui E&S stated it would remove roughly JPY2 billion from the amount of net assets. Adjustments will be made until the deal is closed, so there could be slight changes in the final figure. However, we understand the amount will not differ significantly from the level you pointed out, it will not be a figure in a different digit.
**Questioner 1:** Thank you. JPY2 billion is the book value of the assets to be split, correct?

**Kozawa:** It is the difference between the assets and liabilities that will be split, but it’s only a reference value. Please see it as just one rough indicator. The acquisition price will also depend on the valuation of the acquired business.

**Questioner 2:** It was explained that 400 out of the 700 employees at Tamano Works would be transferred. Is it correct to understand that Tamano Works will continue to be operated under this personnel system after the acquisition? Or do you intend to send staff from MHI to Tamano Works?

**Abe:** Basically, we will continue to operate the business staffed with around the same number of people, as stated earlier by Mitsui E&S.

**Questioner 2:** At MHI, you have been restructuring personnel in the commercial ship department. Is it correct to understand that you will not be transferring personnel from the commercial ship business to Tamano Works?

**Abe:** We do not have such plans at the moment.

**Questioner 3:** In the presentation earlier, you showed us images from unmanned aerial vehicles and satellites. Are these examples of applying your defense and space-related technologies?

**Abe:** Yes, that's right. We introduced some of the various development activities we are carrying out at MHI.

**Questioner 3:** Do you intend to target local governments, fire departments, and the Japan Coast Guard in addition to the Ministry of Defense when selling them in the future?

**Abe:** Yes, that's right. Some major companies require these systems too. We are currently expanding applications to those areas as well.

**Questioner 3:** I believe major companies in the defense-related industry in the US could, for instance, become a competitor in defense-related orders. How should we view the competitive environment in such areas?

**Abe:** They’re not necessarily limited to the defense-related industry. For example, startups have rolled out all kinds of drones. Thus, we understand that there will be competitors in a broader range of fields.
**Questioner 4:** Do you have any plans to introduce a division of responsibilities between MHI’s Nagasaki Works and Mitsui E&S’s Tamano Works, such as building destroyers at Nagasaki and auxiliary ships at Mitsui’s Tamano? Or will you be building both destroyers and auxiliary ships at both shipyards?

**Abe:** One of the major advantages of the acquisition is more stable operations. If Nagasaki’s operation rates fall due to not having a destroyer being built at a particular time, we could build auxiliary ships at Tamano. Alternatively, if Tamano’s operation rates fall due to not building auxiliary ships at a given time, we would build destroyers at Nagasaki.

**Questioner 4:** Thank you. Is it correct to understand that you will continue to build FFM, which is currently being built, at both Nagasaki and Tamano?

**Abe:** Yes. That understanding is correct.

**Questioner 5:** The presentation material earlier showed a figure with the projected revenue after the acquisition illustrated as a gradation. I believe the current annual revenue of the defense and space business is approximately JPY500 billion. Do you have any future targets?

**Abe:** We aim to increase revenue by around 10% to 20% over the next 10 years.

**Kozawa:** To follow up on what he just said, the basic revenue source of this business will continue to be the national defense budget. It is probably unlikely to see a significant expansion in the defense budget. Thus, please understand that growth will be constrained within those boundaries. However, there could be orders that we receive from overseas. There could also be new collaborations going beyond what we announced this time. Those scenarios could create further room for growth. In consideration of those factors, we aim to raise the annual revenue of the defense and space business as a whole by 10% to 20%.

**Questioner 5:** Okay. Does that mean you roughly estimate annual revenue in the defense and space business to grow by 10% to 20% by around 2030, from about JPY500 billion at present?

**Kozawa:** We might be able to expand it a bit more if the growth is steady. But we can’t provide a specific answer because there are many uncertainties.
Questioner 5: Okay. Earlier, you mentioned 10% to 20%. Is it correct to understand that this is the target for the next 10 years?

Kozawa: We cannot say for certain if that would be the target for the next 10 years or five years. If possible, we would like to achieve it within four to five years. However, it does not mean that there is a concrete strategy to achieve that at this point.

Questioner 6: You mentioned that the acquisition of the business from Mitsui E&S would lead to improved efficiency. However, my understanding is that it would be difficult to achieve a significant increase in the profitability of the naval ship business. Please tell us your views regarding these matters.

Abe: There are two aspects to improving efficiency. One of them is digital transformation, which is a word being used in many places. We aim to digitalize all processes from design to manufacturing. In manufacturing, we will review workflows and procedures. Mitsui E&S will handle the manufacture of ship hull blocks. We intend to cooperate with Mitsui E&S in automating these businesses, which have conventionally been labor-intensive.

Questioner 6: Thank you. Is there a possibility that this would improve profitability?

Abe: Yes, there is a solid possibility.

Questioner 7: I have two questions. In the press conference earlier, the President mentioned that it would be fairly difficult for Mitsui E&S to fill shipyards with the commercial ship business. What kind of impact will there be on MHI’s commercial ship business, such as equipment, technology, synergies, and strategy, as a result of acquiring Mitsui E&S’s Ship Business?

Kozawa: I believe he said that Mitsui E&S have been making adjustments between commercial ships and auxiliary ships with regard to the large fluctuations in operations. At MHI, we have basically divided the commercial ship lines from the defense-related lines, which are mainly centered on destroyers, ever since adopting the aircraft, defense, and space domain structure. That said, there are some complementary aspects between the lines. Our Ship Business has a scale of over JPY100 billion, so we think it can sufficiently absorb peaks and troughs in operations. The major framework of the defense budgets doesn’t change significantly from year to year. However, the year when auxiliary
ships are ordered tends to differ from when destroyers or other ships are ordered. Based on this perspective, we think it is possible to absorb fluctuations in the Ship Business, which has conventionally been large, by handling both destroyers and auxiliary ships.

**Questioner 7:** Thank you. I have one more question. I believe the plant and equipment will remain under the ownership of Mitsui E&S and you will be signing rental contracts. What kind of effects or advantages will this have for MHI?

**Kozawa:** The arrangement is such that the land and equipment owned by Mitsui E&S Holdings are rented by Mitsui E&S Shipbuilding. The rough idea is that MHI has inherited those terms and conditions as-is. We will be taking over the Tamano Business, but it doesn’t mean that MHI will use all of the Tamano shipyard. We will only be using a limited area related to the acquired business. We believe it would be unnatural if the land for that limited area were to be intentionally carved out and divested to us. However, some equipment will be slightly adjusted with a view toward ease of management. We do not have the impression that there are direct advantages or disadvantages.

**Questioner 8:** Earlier, you said that there is room to grow in terms of overseas projects. I believe MHI has aimed to receive orders for submarines in Australia before. How much will you be focused on overseas projects in the future?

**Abe:** Overseas projects related to equipment transfer are, in particular, bound by the condition it contributes to the safety of Japan. As such, we understand that discussions will proceed in coordination with the government. We are a private-sector company, so we aim to start by building as much of a track record as possible.

Separately, there are also governmental ships not classified as equipment transfer, which we would like to proceed with in various ways.

[END]