**FY2020 Financial Results and 2021 Medium-Term Business Plan Progress**

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**Hisato Kozawa, Senior Vice President, CFO**

**Questioner 1**

**Q:** First, I would like to ask about the financial results for FY2020. Compared to the plan as of Q3 closing, the full year results are overall mostly in-line, but it seems that profit from business activities from Plants & Infrastructure Systems was down ¥15 billion, while Others segment was up. I would like to know the details. In particular, I am wondering if there are any risk factors in your plants businesses that might negatively affect profitability after this fiscal year.

**Kozawa:** First of all, I would like to respond regarding FY2020 results. Regarding Plants & Infrastructure System, to be honest, I don’t think we can say that we made good progress through Q3. Although we had hoped for some improvement in Q4, unfortunately we were unable to achieve our full-year forecast due to restructuring and other expenses incurred by some of our international operations in some of these businesses. We do not have any particular projects that will have a negative effect in FY2021 and beyond.

**Q:** Also, I believe that asset management will continue to have an effect this fiscal year, but the forecast for profit from business activities in the Others segment is negative ¥20 billion. Please explain whether we can assume that this includes some buffer or not.

**Kozawa:** As for the FY2021 outlook for the Others segment, hopefully there will be a buffer. There may be some losses on corporate and eliminations, and we will do our best to deal with them. We will aim to achieve ¥150 billion in profit from business activities.

**Q:** Understood. As for FY2020, is it correct to assume that Plants & Infrastructure Systems revenue was down, but asset management covered the shortfall?

**Kozawa:** Gains from the sale of plants and other factors were almost all recognized by the end of Q3, so the effects of asset management were not significant in Q4. If anything, we believe that improvement in Logistics, Thermal & Drive Systems made a significant contribution from Q3 to Q4.
Q: Thank you. Secondly, regarding SG&A reductions as outlined on page 50 of the presentation materials, based on actual reductions in FY2020, I think you will need to reduce SG&A by ¥60 to ¥70 billion from FY2021 to FY2023. How much reduction can we expect from the measures already implemented?

I believe the Mr. Izumisawa mentioned that additional measures are needed mainly in the Thermal Power business, but I would like a better idea of the situation.

Also, in order to achieve 7% business profit margin in FY2023 as indicated in the Medium-Term Business Plan, SG&A reductions alone will not be enough. Even if Aero Engines and Logistics, Thermal & Drive Systems recover, it seems uncertain whether you can achieve this level of profitability. Especially for forklifts, profits have not recovered much in Q4. Can you tell us about the measures you are taking to achieve 7% business profit margin, including those other than SG&A reductions?

Kozawa: First off, in terms of SG&A, we are aiming for a 20% reduction in FY2023 compared to FY2019 levels, and we have already achieved nearly half of that goal in FY2020. We have already set a budget for this and have been working on it from FY2020 to FY2021, so I think this part of the plan is achievable. From FY2022 onward, we expect to see the effects of the measures described in the presentation materials, such as the integration of Mitsubishi Power. I can’t say we have a 100% clear path there yet, but I think we are steadily implementing our plan.

On the other hand, I believe that there are many areas where we need to take steps to improve not only SG&A but also the businesses themselves.

Regarding COVID-19 recovery, I believe that Logistics, Thermal & Drive Systems has recovered considerably, but the recovery of Aero Engines or Aero Structures Tier 1 will take more time. Most likely the situation will not return to pre-COVID levels even by FY2023. I assume that the situation will continue to be difficult for the time being, especially for Aero Structures. There are 2 other major things that we need to do. First, we need to improve our existing businesses. Logistics, Thermal & Drive Systems is expanding in scale, but in terms of profitability, Plants & Infrastructure Systems is struggling. Of course, there are times when business is good, but there are also struggling businesses in this segment, so we need to steadily implement measures to improve the profitability of those businesses first. Organic improvements alone will not be enough in some areas. This is not limited to Plants & Infrastructure, but we intend to achieve a business profit margin of 7% while also optimizing our business portfolio.
[Questioner 2]  
Q: The profit from business activities forecast for FY2021 for the Aircraft, Defense & Space segment is positive ¥20 billion, but I would like to know about your thoughts on this. I believe SpaceJet-related losses in Q4 of FY2020 were ¥13.1 billion. How much loss do you expect for FY2021?  
Also, I think that production in the Aero Structures Tier 1 business will remain sluggish in FY2021. I think there are other businesses including Defense & Space, but I would like to know how ¥20 billion in profit from business activities can be achieved, item by item.  
Kozawa: First off, SpaceJet development costs for FY2021 are not specified, but the losses related to SpaceJet in FY2020 were ¥116.2 billion.  
If you look at page 17, the waterfall chart of profit from business activities from FY2020 to FY2021, you can see that we expect to improve this by ¥110 billion by minimizing SpaceJet expenses. The difference is roughly the loss expected in FY2021.  
With regard to Aero Structures Tier 1, we have been cutting fixed costs considerably since the middle of FY2020, and we believe that we can enjoy the effects of these cuts from the beginning of FY2021. We believe that we will be able to reduce losses in FY2021 compared to FY2020. However, based on the current production rate, we believe that a deficit is still inevitable in FY2021. Other than that, we expect to generate reasonable profits in the Defense & Space.  

[Questioner 3]  
Q: My first point is the outlook for the Energy Systems business in FY2021. In FY2021, order intake increased by ¥100 billion and revenue by ¥54 billion compared to FY2020. Profit from business activities increased after deducting nonrecurring items, such as the transfer of MVOW shares and loss provisions in Steam Power. Could you please explain a little more about the background of this?  
Kozawa: Orders are expected to increase by about ¥100 billion, about half of which is expected to be for GTCCs and the other half for Compressors and Aero Engines. We recognize that Aero Engines bottomed out in FY2020, and we expect improvement in FY2021. The compressor business was also sluggish in FY2020 due to delays in contract negotiations and other factors, so we expect these businesses to improve. In terms of revenue, GTCC is expected to increase by about ¥30 billion, and other businesses including Aero Engines are expected to increase by about ¥20 billion. As for profit from business activities, we expect that Aero Engines, which was weak in FY2020, as well as other businesses overall will recover.
Q: In the business plan announced in October last year, you planned to increase Energy Systems after-sales service revenue by 30% in FY2023 compared to FY2020. Could you please give us your comments on the progress and results as well?
Kozawa: After-sales service revenue in FY2020 has grown compared to FY2019. Unfortunately, we did not receive a large number of orders in FY2020, so it is unclear how the comparison between FY2020 and FY2021 will turn out, but we will steadily increase after-sales service revenue with our Energy Transition initiatives, including the recently announced integration of Mitsubishi Power.

Q: Understood. Thank you very much. Secondly, I would like to ask Mr. Izumisawa, in the Energy Transition space, especially in hydrogen and ammonia, the government’s efforts will also accelerate due to the Carbon Neutrality declaration. In the course of contract negotiations and discussions with customers, you may have heard that there are areas where you can expect to move ahead of your initial targets for hydrogen and ammonia or commercialization of ammonia may be faster. It has been a few months since your last presentation, but I would appreciate it if you could explain a little more about the short- and mid- to long-term outlook, and how things are actually going in the field. Thank you.
Izumisawa: Thank you very much. As you pointed out, I think there is a great deal of movement in the Japanese government and in other countries, but from our perspective, one of the things we need to consider is how to reduce CO2 emissions by effectively utilizing existing assets and technologies such as CO2 capture and ammonia. There is another type of development including the Green Fund, in which the Japanese government is making investment in research and development, such as hydrogen production and storage, with a long-term perspective. As for the most recent developments, I feel that there is a lot of activity in the field, including FS, in the area of ammonia, retrofits of existing facilities, and CO2 capture.

[Questioner 4]
Q: First, I would like to ask Mr. Kozawa about SG&A reductions as outlined on page 50. SG&A reductions in FY2020 seem to be mostly explained by the pausing of SpaceJet development. I would like to know a little more about how much reduction was achieved in FY2020, other than SpaceJet. Also, I understand that you will be making gradual reductions toward FY2023, but on the other hand, I am concerned about the fact that SG&A expenses for this fiscal year, the first year of the 2021 Medium-Term Business Plan, are almost the same as in FY2020.
Kozawa: I assume that when you say the difference between FY2020 and FY2021 is small, you are referring to the nearly equal height of the bars on this graph. First off, when we compare FY2019 and FY2020, we see a decrease of more than ¥30 billion in the SpaceJet business and a decrease of nearly ¥20 billion in other businesses. As for FY2020, CRJ business has newly entered our group, and there was an increase in SG&A due to this. That said, we feel that there are more reductions than this graph shows. As for the small difference between FY2020 and FY2021, to put it simply, travel and other expenses were considerably reduced in FY2020, especially due to the impact of COVID-19. We expect these expenses go back up in FY2021, so the reduction will be slightly lower. Moreover, a reduction plan for FY2023 was formulated during FY2020. The slope of the graph also shows that since we are planning to make reductions including process optimizations, much of the positive impact will be realized from FY2022 to FY2023 rather than in FY2021.

Q: 6 months ago, when you announced the results for 1H FY2020, I believe you set a profit growth goal of ¥40 billion in the 2021 Medium-Term Business Plan as a result of reductions in SG&A expenses. Is it correct to assume that this number has not changed at this stage?
Kozawa: No, it has not been changed.

Q: Understood. I would like to ask one more question. Mr. Izumisawa, you mentioned Wind Power Systems, Naval Ships, Machine Tools, and Koyagi Shipyard in the context of 4 major transactions made last year. You have decided to sell Koyagi Shipyard, and regarding the Machine Tools business, although on a small scale, it is a business with long history, so it was a big event that you took such a drastic step. From your employees' point of view, I imagine there must have been more than a little surprise. I would like to know how you explain to your employees the criteria you use as management to review your business portfolio. I think that you must be communicating a different message to your employees other than the standard line that you are withdrawing from businesses that are not profitable for 3 years. I imagine that there is a lot of positive talk going on, such as wanting to invest aggressively in growth areas. Or, conversely, even if a business is profitable now, there may be no expectation of growth in the future, so you may decide to withdraw now. I know this is very sensitive and there are many things you cannot talk about. However, I would appreciate it if you
could tell us something about this.

Izumisawa: Thank you for your frank questions. As you mentioned earlier, I do not believe in optimizing our business portfolio based only on numbers. Of course, we consider the position of each business in the MHI portfolio, but we also have to look at the business as a whole and the people who work there. When looking for a partner to work with, we also consider the perspective of whether the business would be better served by that company or our company, or whether it is useful to society.

In my experience, in the past when I decided to divest a certain business, the main reason was that, product lineup and sales channels of the business would expand further by handled by the other party. It turned out to be a very successful transaction. Now that business has grown significantly, and our former employees are thriving.

In cases where keeping a business in MHI Group would not lead to growth or situations where we cannot invest resources ourselves, I prefer to look for an acquiring party that would be able to grow the business proactively.

As I mentioned earlier, we look at the situation from 2 perspectives: the positioning of the business within MHI Group, and the situation in which the business could best grow. We often communicate information about the latter perspective to our employees.

Q: In the case of Hitachi, it seems to me that they use an approach based on the keyword “Digital” to their business portfolio decisions to some extent, but what about MHI? Rather than following a standard set of criteria, it seems that you approach this as a form of individual assessment.

Izumisawa: I think that the major trend for us will be to focus on the Energy and Mobility areas. Nuclear Power and Defense are a bit unique, but I think one way to do this is to strengthen businesses that support people’s lives and mobility.

[Questioner 5]

Q: My first question is about the Energy Transition. I think in the 2021 Medium-Term Business Plan announced in October last year, you said that you would generate ¥50 billion in revenue from new energy-related businesses by FY2023 and about ¥300 billion in revenue by FY2030. I think this revenue is mainly from CCUS and hydrogen. Regarding the ¥50 billion in revenue in FY2023, we see growing interest from the Japanese government and others. For example, if we look at page 35, we can see that projects in various countries are accelerating, so I think there is a possibility that revenue related to the Energy Transition, especially CCS, will exceed the FY2023 target. What do you think about this?

At the same time, on page 34 of the presentation materials, which outlines CO2
capture developments, a picture of the Petra Nova project is used. I understand that Petra Nova is currently on hold. What do you think will happen to Petra Nova’s CCS project going forward? Please tell us about these 2 points.

Izumisawa: As for the first point regarding whether there will be an upswing in revenue or not, we are currently receiving numerous inquiries not only for utility scale power generation facilities but also for the industrial sector. This is because the combustion of most things produces CO2, so realistically there is no other way to reduce emissions but to capture CO2. I think there will be some more development in CO2 capture. Hydrogen is difficult to handle as a fuel, so it is not clear if it will soon become widespread, but I think there is a great opportunity for ammonia, given that existing assets can be effectively used through modifications.

As for Petra Nova, my understanding is that development has been paused for reasons other than CO2 recovery technology.

Q: I think Petra Nova is getting a lot of attention because of the emphasis you put on it in October of last year. Development on this project has been suspended, but should we assume that it will not have a significant impact on your CCS strategy?

Izumisawa: No, I don’t think it will have significant impact. I believe that the positive trend in CO2 capture will continue as there are many similar projects in the pipeline.

Q: As for the revenue target for FY2023, as you explained earlier, inquiries not only for utility scale power generation facilities but also for the industrial sector are increasing, so can we assume that there is a possibility of an upward swing?

Izumisawa: We have increased headcount in this area and hope to grow revenue, but we need to see if these inquiries result in projects that come to fruition.

[Questioner 6]
Q: What is the background behind the zero free cash flow forecast for the current fiscal year? Last year, you had planned for negative ¥400 billion, but the actual result was negative ¥270 billion. Even though free cash flow will recover this fiscal year, the forecast is still zero. Could you tell us about the situation with advances received in the last fiscal year as well as working capital reduction efforts?

Kozawa: The FY2021 plan for free cash flow is zero. To be honest, last fiscal year, we were in the phase of reducing contract liabilities (advances received, etc.) as the
projects progressed and unfortunately this trend will not change in FY2021. This is because we had originally received a large number of advances for new coal-fired thermal power plants. Given the current situation, we are forced to continue consuming advances received in the absence of new orders. The base for cash flow continues to be difficult. On the other hand, we will work to reduce inventories and working capital that have accumulated in FY2020, so we hope to show improvement in this area. At this point in time, we are not in a position to make very aggressive plans, so we have set the number to zero. Of course, we would like to improve on this, and we are considering ways to do so, including on the asset side.

Q: Thank you very much. Is it correct to assume that the reduction in the number of new coal-fired thermal power projects will have a negative impact on cash flow over the next few years, rather than just this year or next year?

Kozawa: I can’t explain the terms and conditions of individual contracts, but we believe that cash flow regarding coal-fired thermal power will normalize around FY2022.

[END]