Q&A Summary

Event Name: 1H FY2024 Financial Results Briefing
Date: November 5, 2024
Speaker: Seiji Izumisawa, Member of the Board, President, and CEO
Hisato Kozawa, Member of the Board, Executive Vice President, and CFO

Questioner 1

Q: Regarding Others, Corporate & Eliminations (OC&E), my impression is that, if there are no asset sales, normally this item would have a negative business profit of a few billion yen. With asset sales, OC&E business profit would be around positive ¥10 billion. Did any special costs increase during 1H FY2024?

Kozawa: We did not book any special costs during 1H, although costs related to up-front R&D investments in our future growth areas and enterprise resource planning (ERP) system development did rise slightly.

Q: Business profit in the Plants & Infrastructure Systems (P&I) segment was strong in 1H. Is there any particular reason for this?

Kozawa: While nothing out of the ordinary is behind this, projects with better margins contributed to the positive results.

Q: Regarding Gas Turbine Combined Cycle (GTCC), Mr. Izumisawa mentioned that you will expand your workforce by 10% and expand production capacity for turbine blades FY2026. By addressing bottlenecks within the supply chain, I understand that it would be possible for revenue to exceed ¥1 trillion. By executing the initiatives you mentioned, how high could GTCC revenue go? Order intake has already exceeded the ¥1 trillion level, so could you provide insight into the forecast for revenue?

Izumisawa: Revenue scale will grow beyond current levels. However, regarding just how much it will increase, there is some variability due to such factors as the mix of services versus new installations, and Japan domestic versus international business, so I cannot give a precise figure. We are aiming to increase production capacity by around 30% in FY2026.

Q: Since you are increasing production capacity by 30%, does that mean you will be able to handle the current level of orders through FY2026?

Izumisawa: I believe that there will be opportunities for order volume to grow a little more.

Q: Are you looking at further increases in order intake?

Izumisawa: If order intake increases further, we may need to expand production capacity even more. We will assess this based on order intake trends moving forward. Currently demand is very strong for fuel conversions in the Middle East and for data centers in North America, so we intend to build up our order backlog and reliably execute on these projects.

Kozawa: Let me add a little color. We are aiming to increase order intake in terms of unit volumes. That said, in terms of the scale of revenue, our supply scope varies significantly from project to project. For example, if we only supply the gas turbine itself without the bottoming portion (the steam turbine plant that utilizes heat from gas turbine exhaust gasses), then the total amount of revenue per project is smaller. Conversely, if installation is included in our scope, revenue increases. Also, the scale of revenue varies depending on the extent of the long term service agreement (LTSA) coverage. In terms of overall revenue scale, to be honest, I cannot definitively say it will rise easily to a consistent level. However, the general trend that we are forecasting is for revenue to continue increasing steadily over the next few years.

Q: During a previous earnings briefing, I recall hearing that you did not yet have visibility for demand for GTCC systems to be used in data centers. Has the situation improved over the last six months?

Kozawa: My impression is that inquiries are increasing. However, there have not been any specific developments, such as finalizing contracts with customers owning data centers. That said, particularly in North America, power demand from data centers is increasing, and utility companies are working to expand power generation capacity. Inquiries for these kinds of projects are progressing steadily.

Questioner 2

Q: You have some products for data centers that span two or more of your reporting segments. You mentioned that there are customer needs for one-stop solutions, but which organization will lead the coordination among segments to provide complete packages including GTCC, chillers, and standby generator products? Also, there is talk of using small modular reactors (SMRs) to address the increasing power demand associated with data centers in North America. What is your view of this situation?

Izumisawa: Inquiries for specific product lines, such as turbo chillers and standby generators, are handled as usual by each segment. However, a dedicated data center-related section within our Growth Strategy Office handles projects where the customer requests a one-stop solution. Furthermore, Green Transformation (GX) Solutions takes charge of projects that combine power supply and carbon capture systems. In these situations, organizations that span multiple reporting segments take the lead.

Regarding SMRs, it is hard to predict how things will go. In order to respond to increasing demand for data centers as well as the growing power demand driven by data centers, we believe that gas turbines are the most suitable solution, at least when taking timing into consideration. Going forward, while alternative power sources may emerge, gas turbines will likely be the only option for the next few years.

Q: Is there a possibility that MHI will supply SMRs and that will lead to growth in your Nuclear Power business? Also, could you potentially sell SMRs outside Japan?

Izumisawa: At this stage, we are not developing full-scale SMR plants. While it would be possible to respond to inquiries for components, for the time being, we are not planning to construct entire plants outside Japan.

Q: Your business profit forecast for 2H in Energy Systems (Energy) and Aircraft, Defense & Space (ADS) appears somewhat low. Are you accounting for specific risks, or is this simply a conservative forecast?

Kozawa: Starting with Energy, we have maintained provisions for the risk of one-time expenses, which were included in the plan at the beginning of the fiscal year. These provisions are not due to any specific concern, but given that there have been instances of unexpected costs in the past, we have kept those provisions in place. That said, progress in 1H was better than expected, and if this momentum continues, we could see some upside.

As for ADS, results in 1H were very strong, partly due to the depreciation of the yen. While the 787 has not been heavily affected, as there is an ongoing strike at Boeing and other models or indeed the business as a whole face risk, we have a very cautious outlook. That said, just now there has been news that the strike has been resolved, so there is a possibility that there is less risk than the current forecast. In the case of foreign exchange rates as well, we have been slightly careful considering the upcoming US presidential election. Therefore, we can expect a little more upside in the ADS segment.

Questioner 3

Q: Your competitors have commented that order prices have improved significantly. I recall that Mr. Kozawa previously mentioned that the reason orders from China were low in Q1 was because you were being selective with which projects to book and you were allocating slots in your production schedule elsewhere. Looking back over the past year, do you feel that your sales prices have also been increasing?

Kozawa: Because demand has been quite strong, order prices have been rising. Although there has been impact from inflation on the cost side, the projects we are currently booking have higher margins overall compared to a few years ago.

Q: I believe that, in the past, your business model in GTCC was predicated on new installations not generating much profit with most profit coming from after-sales services. Although I am sure that things differ from project to project, do new installations now yield a reasonable amount of profit? Or do you have to wait a while before seeing substantial profit contributions? Other companies are raising their profit guidance for GTCC, and many companies say the big driver for this is new installations. Should we expect something similar at MHI?

Kozawa: When I said profitability is improving, I was primarily referring to new installations. I cannot specify specific numerical ranges, but we are seeing a significant improvement compared to a few years ago. Please understand that, going forward, booking orders for new installations will not be a negative factor for us.

Q: As the Middle East shifts from oil to gas, will we see many base load J-series turbine projects, which are a strength of MHI's? Moreover, I recall hearing previously that MHI looks to minimize engineering, procurement, and construction (EPC) risk in the Middle East by focusing on equipment supply. Is that still your approach? Finally, I do not know what your market share is in the Middle East, but my understanding is that GE Vernova has a strong foothold in the US. Can we expect that MHI will be able to increase your global market share while North America and the Middle East drive demand?

Kozawa: Most of the inquiries that we are receiving are for our J-series, and this will likely become our primary model in the Middle East. There are inquiries for other models, but we consider the J-series to be our greatest strength. On the topic of EPC risk, our basic policy is to provide equipment and technical services, but there are also cases where our local Group companies add some scope.

Regarding market share, we currently have a certain position in North America, and our share is also high in China. As for the Middle East, my impression is that Siemens Energy has secured multiple large contracts there. However, our J-series turbines are highly rated in a variety of specifications, and we plan to leverage this to further increase our market share.

Questioner 4

Q: In Q1 FY2024, business profit exceeded internal targets by around ¥10 billion due to contributions from foreign exchange rates and high-margin projects. Now that 1H is over, could you provide a breakdown of what factors affecting profit exceeded or fell short of your internal projections?

Kozawa: Allow me to provide some rough figures. Business profit in 1H exceeded our expectations by approximately ¥20 billion, and around ¥12 billion of this came from foreign exchange effects. We had originally assumed a rate of ¥145 per US dollar, but the actual average rate was closer to ¥153, and this ¥8 difference positively impacted profit. The remaining ¥8 billion was due to favorable project margins.

Q: You mentioned that you plan to increase your workforce in Defense by 40% by FY2026. Could you explain how you plan to achieve this? I imagine that hiring mid-career talent and new graduates, as well as reallocating personnel from other divisions during restructuring could be options. Also, please let me know how feasible this target is.

Izumisawa: We are on track to achieve our targets for new graduate recruitment, including from high schools, technical colleges, and universities. That said, we have found mid-career recruitment, especially for mid-level experienced staff, to be challenging. We are considering reallocating personnel within the group as needed to make up for remaining shortfalls.

Questioner 5

Q: GE Vernova announced in October that it had booked three H-class gas turbine turbines for Kansai Electric Power Company in Japan. Should we be concerned about MHI's competitiveness in Japan? You mentioned that customers in North America are rushing to get gas turbines delivered, which is causing order prices to rise. Conversely, is price competition in Japan intensifying?

Kozawa: Ideally, we would like to capture the entire Japanese market, but that is not feasible. We have not seen any decline in our competitiveness within Japan. As for pricing, while I do not know our competitors' bid prices, we are offering fair prices in the Japanese market.

Izumisawa: In Japan, there are upcoming long-term power auctions, so all companies need to secure slots in their production schedules to align with customer expectations. It is not the case that we are not booking orders because price competition is tight. Rather, the ability to secure production slots in accordance with customer requirements has become the key to competition here.

Q: Regarding the review of underperforming businesses and portfolio optimization, I read in a recent news article that restructuring of unprofitable businesses was nearly complete at MHI. However, in Q2, the Logistics, Thermal & Drive Systems (LT&D) segment posted a business profit margin below 4%. While there may be some challenges in the operating environment, please let us know if there are any areas—and this is not limited to LT&D—on which you plan to focus as regards portfolio optimization and/or underperforming businesses during 2H.

Izumisawa: Regarding our portfolio of businesses, we do not make decisions based on short-term performance, such as during a single quarter. Rather, we manage the portfolio while continually asking ourselves whether we can improve business profit margins and, if so, how. When I mentioned our having reached a milestone in portfolio optimization, I was referring to the period from the 2018 Medium-Term Business Plan (MTBP) through the 2021 MTBP, during which we made a certain amount of progress in divesting and consolidating a variety of underperforming businesses. However, market conditions have continued to evolve, and we will continue to assess the best path forward for businesses that face profitability or volume challenges. At this stage, no specific decisions have been made.

Questioner 6

Q: During both 2Q on its own and 1H as a whole, you achieved an 8% business profit margin for the first time in several years. Since tailwinds from foreign exchange rates contributed to this, I do not think this achievement was due to underlying strong performance. From Mr. Izumisawa and Mr. Kozawa's perspective as CEO and CFO, could you give me examples of some businesses you believe still need improvement, if any?

Izumisawa: We have only recently started to reach an 8% business profit margin. The LT&D segment, excluding Engines, is facing some challenges, and margins tend to drop during economic downturns. This may be partly due to structural issues and partly due to volume concerns. To put it plainly, I see improving the business profit margins in each strategic business unit (SBU) within LT&D, excluding Engines, as a key issue. I am currently in discussions with each of our Group companies in LT&D regarding how we might raise profit margins even in the current weak economic environment and, ultimately, whether we can achieve profitability on par with our competitors when the economy recovers.

Kozawa: I completely agree. Allow me to add some color. Also, please note that these comments are not meant to suggest that MHI will take any specific actions in these areas. The situation in Japan where many small businesses are operated by different companies in the same industries will need to be addressed in some manner going forward. This is not simply a matter of MHI divesting or acquiring businesses. Rather, from the perspective of creating a positive impact on the Japanese economy as a whole, I feel this is an area where various companies, including ourselves, will need to consider the best approach and work together on future initiatives.

Q: During the 2024 MTBP period, you mentioned that you plan to make active investments. However, recently, investments in new energy areas like hydrogen and ammonia seem to be lagging. Have there been any internal discussions about slightly easing up on the speed of investments? If that were the case, investment costs would decrease, which would boost profits and possibly allow for more substantial shareholder returns under the new DOE framework. Could you let me know if there have been any internal discussions about this?

Izumisawa: Under the 2024 MTBP, we have clearly signaled that we will invest in our growing core businesses and future growth areas. I believe that investments are progressing largely in line with the plan in Defense and GTCC. That said, regarding investments in the Energy Transition, we had expected to make investments in business development. However, fewer projects than expected have moved to the final investment decision (FID) stage, and this has caused a lull in this kind of investment. However, technology development requires a significant amount of time and money, and we have no intention of slowing down in this area. For example, we are working together with ExxonMobil to optimize carbon capture techniques and develop amine absorbents. To reiterate, in Defense, GTCC, and Nuclear Power, we intend to proceed with investments as planned, or in some cases even increase investments beyond our initial plans. In the Energy Transition, investments in business development have stalled somewhat, but while we wait for things to pick up again, we will continue with R&D investments and demonstration efforts such as proof of concept (PoC) projects in order to build strategic partnerships. Also, compared to when we announced the 2024 MTBP, we are starting to feel a bit of a tailwind in investments related to data centers, and we need to consider the best approach there. This area is developing more quickly than expected, and we need to carefully evaluate where to focus our investments going forward.

Q: Since you have not changed your profit guidance, do you not intend to increase shareholder returns?

Kozawa: I always feel a desire to increase shareholder returns, but at this point, it would be premature to make any firm statements on this topic.

Questioner 7

Q: Regarding the Profit Bridge shown on page nine of the presentation materials, I assume that “Changes in one-time expenses” refers to the PW1100G Engine Program. Is it possible that there were other one-time losses or gains—such as those related to the domestic or international GTCC business—that might have offset each other and thus are not shown on this page? Please confirm if there were any additional costs.

Kozawa: I cannot say that there were absolutely no one-time costs, but in 1H there were none of the kind that we would normally disclose during an earnings briefing.

Q: Your plan shows profits decreasing from 1H to 2H. Are you are not expecting any additional one-time expenses? Also, if you do not need to use the ¥20 billion risk buffer, will you have upside equivalent to the same amount?

Kozawa: Results in each segment may vary, but personally speaking, I expect further improvement beyond that.

Q: The order intake guidance for Defense appears unchanged from the previous announcement. If that is the case, order intake in Defense will not increase much in 2H. Have you simply not changed the full-year forecast, and is there a possibility that orders will increase?

Izumisawa: Regarding Defense order intake in 2H, there is some uncertainty related to the Japanese government's supplementary budget. There is still potential for this to increase depending on government policy going forward.

Q: In Defense, is profitability at the time of order booking improving?

Izumisawa: The government has announced various measures to improve profit margins, and margins are indeed increasing steady.

Note regarding forward looking statements:
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