Q&A Summary

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Speaker: Eisaku Ito, President & CEO

Hisato Kozawa, Member of the Board, Executive Vice President, and CFO

Questioner 1

Q: Could you clarify your thinking on the impact from tariffs? In the case of gas turbines, you previously explained that, although some components are shipped from your Takasago Machinery Works facility in Western Japan, some are also locally procured, so the risk is manageable. Also, there is a possibility that commercial aero structures for Boeing do not fall under the scope of the tariffs. While fluctuations in demand are inherently difficult to predict, is it correct to assume that the only business to experience impact from cost increases will be Turbochargers, and impact on a company-wide level will not be significant?

Kozawa: Broadly speaking, I think your understanding is correct. However, Forklifts (Logistics Systems) is also expected to experience impact from cost increases. This is because, although forklifts are produced in the US, there is still a certain volume of parts that we procure from overseas. That said, our competitors are also sourcing components from outside the US via similar supply chains, so in terms of the competitive landscape, I do not think our relative positioning will change all that much. Our basic approach is to pursue cost passthroughs. However, assessing whether the impact will be significant inevitably involves some subjectivity, so I will not offer a specific comment now. But we do believe that the majority of the impact will be manageable.

Q: MHI has many businesses – such as gas turbines, Defense, and Nuclear Power – which are relatively resistant to demand volatility. But if I may ask, are there any areas where you are aware of the possibility that tariffs might impact demand?

Kozawa: The gas turbine market will not shift dramatically due to rising costs. Rather, I think industrial machinery and consumer goods-related businesses will experience some impact. However, the impact from tariffs on economic or market trends will likely not be limited to the US, and there could be ripple effects on other regions' economies as well, so it is difficult to make a precise forecast on that front. In terms of the reporting segments that might be more affected, our Logistics, Thermal & Drive systems segment might be relatively more susceptible to such influences.

Q: I get the impression that demand in Gas Turbine Combined Cycle (GTCC) and Defense remains quite strong. What are your thoughts on order intake in GTCC and Defense in FY2025?

Kozawa: Defense order intake was exceptionally high in FY2023 and FY2024. We had expected orders to drop off in FY2024 compared to FY2023, but in the end, they did not decrease by much. Although it depends on the Japan Ministry of Defense, our current perspective is that we will be able to secure a certain amount of orders in our areas of strength during FY2025 as well, although it will be difficult to reach the ¥1.8 trillion level.

As for Energy Systems, the large uptick in order intake in FY2024 was mostly from gas turbines. In some cases, projects that we had initially expected to book during FY2025 were pulled into FY2024. So if you look at the balance between FY2024 and FY2025, I think that explains our order intake forecast for FY2025. That said, we believe that the current strong demand trend in the market will continue, so there is a possibility of upside.

Ito: The gas turbine market behaves differently in different regions. In North America, factors are at play such as electricity demand from data centers and semiconductor plants, as well as demand for the replacement of aging facilities with high-efficiency gas turbines, so we expect stable orders over the next five to ten years. As for Asia and other regions, inquiries are increasing for high-efficiency gas turbines using natural gas as a more practical solution in the push toward Carbon Neutrality.

As for Defense, we are working on proposals for the next Japan Defense Buildup Program. This includes both content that we are preparing internally, as well as studies for which we have received funding from the customer (i.e., the Ministry of Defense). By making proposals with a medium- to long-term, innovative focus, I believe we will continue to receive inquiries for large projects.

Questioner 2

Q: Could you please provide us with a breakdown of the ¥34.6 YoY increase in business profit in Energy Systems shown in the FY2025 earnings forecast? Also, the business profit guidance for Others, Corporate & Eliminations is -¥90 billion, a YoY decrease of around ¥60 billion. Please explain these figures for us.

Kozawa: Regarding Energy Systems, especially gas turbines, we are expecting business profit to increase. Apart from that, we are going to eliminate some excess costs that were incurred in FY2024. Within Others, Corporate & Eliminations, one of the biggest YoY differences is related to gains on fixed asset sales. In FY2024, we booked major gains on fixed asset sales, including the sale of some land at our Honmoku Plant in Yokohama. However, we have no large fixed asset sales planned for FY2025, and this will have a significant impact.

Q: Regarding the breakdown of the -¥90 billion business profit target in Others, Corporate & Eliminations, enterprise resource planning (ERP) system development costs were included in this item in the past. What kind of expenses are you expecting in FY2025?

Kozawa: In FY2025, development costs such as for a new ERP system will fall into this category, along with company-wide shared R&D expenditures, as well as development and proposal expenses in future growth areas that have not been assigned to specific reporting segments.

Q: What is MHI's competitive standing in the gas turbine market, where trends differ from one region to the next? Replacements are a major trend in the US, and I am wondering if the more established players in the market may have stronger bargaining power. We are seeing several large projects emerging in Asia and the Middle East, including Saudi Arabia. My impression is that MHI does not have much experience in the Middle East, but are there large opportunities there?

Ito: The customers currently using our gas turbines – particularly the advanced class of gas turbines comprised of large, high-performance models – tend to operate these high-efficiency units continuously as base load power sources at 100% load. That type of usage accounts for a large share of our customer base, and that is one of our strengths. Considering that high-efficiency, high-load operation contributes directly to our customers' own profitability, our competitiveness remains firmly intact. Internally, we are continuing to prepare for what comes next, and we are working hard to maintain that competitive edge. Looking at different regions, in terms of the Middle East, we delivered a large number of gas turbines to Saudi Arabia several decades ago, and we have completed some new plants there recently as well. Furthermore, we are seeing an increase in inquiries from new regions as well, so we expect further growth in this business.

Questioner 3

Q: Please share with us the background for how the FY2025 FCF forecast became -¥200 billion.

Kozawa: This is the rebound from the significant upside we experienced at the end of FY2024 caused by the receipt of advances received. That said, we could receive advances again at the end of FY2025, thereby improving FCF.

Q: How much in one-time expenses were incurred in FY2024 in each business? Also, is there a buffer for one-time expenses included in the FY2025 earnings forecast?

Kozawa: During FY2024, one-time expenses were incurred in the thermal power businesses in Energy Systems. In addition to costs (¥10 billion) that had arisen from overseas projects in Q3, we booked claim-related expenses (¥10 billion) for another project in Q4, resulting in a total impact of -¥20 billion. Aside from this, there were other one-time cost elements – including supply chain disruption in Turbochargers and engine certification issues in Forklifts – which we did not count as one-time expenses in the presentation materials and instead included in “Changes in revenue, improved margins.” As for the FY2025 business profit forecast in Energy Systems, we have included a buffer of ¥20 billion. Moreover, the +¥134 billion in “Changes in revenue, improved margins” factored into the FY2025 guidance includes rebound effects from the losses incurred in Forklifts and Turbochargers in FY2024.

Q: I understand that the approximately ¥40 billion YoY decline in Others, Corporate & Eliminations business profit comes from the winding down of land sales. On top of that, it seems there is another factor causing a negative impact of roughly ¥20 billion to business profit. Is this not a buffer for additional costs, but rather a collection of various development-related expenses?

Kozawa: The profit bridge (see page 24 of the FY2024 Financial Results presentation) shows a -¥65 billion impact from “Changes in gains on fixed asset sales.” Around -¥60 billion of this is included in Others, Corporate & Eliminations, whereas the remaining approximately -¥5 billion is included in other reporting segments. As for the around -¥40 billion you mentioned, I think you may be referring to the rebound from the +¥40 billion in “Changes in gains on fixed asset sales” shown on page 15. This +¥40 billion is the YoY difference between gains on asset sales incurred in FY2023 and FY2024. In terms of the YoY delta between FY2024 and FY2025 related to gains on asset sales, we are expecting -¥60 billion.

Questioner 4

Q: You mentioned that your gas turbine market share fell to second place last year. Presumably, this is because quite a few orders for small and mid-sized gas turbines went to your competitors. Your FY2025 GTCC order intake forecast shows a YoY decrease, so I am concerned whether you will be able to win back some share this year.

Kozawa: It is a bit difficult to calculate first or second place in terms of market share. As our competitors are mostly overseas players, market share is calculated on a calendar-year basis. However, our fiscal year ends in March, and the difference between the calendar year and our fiscal year makes it difficult to offer a simple explanation. Also, the share we achieve varies considerably depending on the timing of order booking, and contract value varies according to the amount of auxiliary-equipment-related work and our scope of responsibility. That said, looking at the situation in the market today, there are no factors that should cause a large drop in order intake, so we are aiming to book a certain number of unit orders above a reasonable threshold.

Ito: In our case – and this applies to both this fiscal year and the next – the production capacity at our factories is being fully utilized. On the other hand, our competitors have much larger plant capacity, and because they are using unused space to produce small and mid-sized gas turbines, our production capacity has become the bottleneck, and this is affecting our current market share. Our utility customers tend to run their gas turbines at high efficiencies and utilization rates. So we are receiving a lot of inquiries for state-of-the-art large frame gas turbines, and we have a pipeline of projects that extends several years into the future. Based on our competitors' data, they seem to be handling more models for mid-peak or peak-cut operation, which is resulting in their showing large market shares. While we may be second place in terms of total market share, I understand that we still hold the top position in the advanced gas turbine segment.

Kozawa: If you just compare FY2024 and FY2025, it may seem that order intake is declining, but when we increased our FY2024 forecast three months ago, we did not think that we would achieve as high a result as we did. So you can consider the variance between FY2024 and FY2025 as a transient effect. However, it is possible that orders could move between FY2025 and FY2026 as well, meaning that order intake could go up or down.

Q: Mr. Ito mentioned that, because you took certain measures in FY2024 in the businesses where you are pursuing competitiveness enhancements, you expect to begin seeing results during FY2025. However, when I look at this year's plan, particularly in Plants & Infrastructure Systems and Logistics, Thermal & Drive Systems, the profit margin levels do not seem to reflect much improvement when considering revenue and marginal profit results in FY2024. Specifically what kind of turnaround measures are you implementing, and how will these be reflected in this year's performance?

Ito: With regard to Logistics, Thermal & Drive Systems, we experienced the impact from some supply chain disruptions, but we have since secured an alternative supply chain and are now able to resume production. Also, in regions where we saw inventories accumulate, we have steadily taken small, measured steps, including adjusting production volumes. Moreover, we are making improvements to our approach to procurement in order to generate volume-based cost reductions, as well as addressing manufacturing-related challenges on our shop floors with technology-focused solutions, among other initiatives. Our efforts are beginning to bear fruit, and I believe this will start to be reflected in our financials. Moreover, whereas previously we would respond individually to each customer inquiry as it came in, but have made it possible to respond quickly by implementing digital tools and IT solutions to automate and standardize responses. While some of these tools may not be fully ready this fiscal year, we expect to see some benefits emerge gradually going forward.

Kozawa: To follow up on the comment that marginal profit does not seem to be improving, I would like to offer some clarification. The average exchange rate used for revenue recognition in FY2024 was ¥150/US$, whereas the rate assumption of our FY2025 guidance is ¥145/US$, a slight appreciation YoY. As such, Logistics, Thermal & Drive Systems in particular will experience some negative impact to marginal profit rates.

Q: When you speak of portfolio management, is there any intention to acquire or divest businesses?

Ito: Under our approach to portfolio management, we classify our businesses into three categories: growing core businesses, future growth areas, and businesses where we will enhance competitiveness, and we aim to manage each category according to its specific characteristics. Furthermore, within the competitiveness enhancement category, we are working to enhance existing products and technologies with digital technologies in order to generate new added value. We are also seeking to combine existing products and technologies with technologies from other product lines to create entirely new capabilities. Through these types of combinations, our products and services will evolve, and our customer base will also shift over time. While we are thinking about our portfolio from this perspective, we are also including the option to divest businesses if we determine that their best owners lie outside MHI Group, as we have explained over the last several years.

Kozawa: Regarding acquisitions and divestments within the portfolio of businesses, there is not much that we can say publicly right now, but the FY2025 earnings forecast does not include the impact of any actions in this area.

Q: I take your comment to mean you are not ruling out acquisitions or divestments in the portfolio. Is that right?

Kozawa: Please allow me to refrain from commenting.

Questioner 5

Q: The FCF forecast for FY2025 is -¥200 billion due to a rebound from the previous year, but even taking that into account, the over ¥300 billion in FCF achieved during FY2024 was an impressive result. And when you add the FY2024 FCF result to the FY2025 forecast, you still reach +¥140 billion. Can we understand that an improvement in MHI's fundamental cash flow generation capacity is behind this? Traditionally, when revenue expands, working capital increases as well. So I would like to know whether, including improvements in cash conversion cycles such as through the receipt of advances received, your underlying cash flow generation capacity is now fundamentally stronger.

Kozawa: While it is difficult to evaluate the two-year total FCF of ¥140 billion, our performance in FY2024 was indeed strong, and over the last few years, we have been able to generate considerable results. In FY2024, there was the special factor of advances received associated with some last-minute orders. While that played a role, we are now on the way to being able to produce a consistent amount of cash flow. In particular, operating cash flow is increasing. Although there may have been some one-time factors at play, our achievement of +¥500 billion in operating cash flow in FY2024 was quite a milestone in my view.

Q: Are there any specific factors behind the large change that resulted in an increase in operating cash flow, aside from the impact of advances received?

Kozawa: One large factor is that we are now able to generate profit consistently. This improvement in business profit has also caused an increase in other profit items, including net income. Also, we have been working hard to control inventory levels by improving productivity and shortening lead times. Our efforts to control items that tend to expand as revenue increases are beginning to show results.

Q: In FY2024, the profit margin in Energy Systems increased to 11%. And while revenue is expected to rise slightly in FY2025, the business profit margin forecast is 13%. Could you provide some background on this margin improvement and how you see margins evolving going forward?

Kozawa: We are currently working on a number of initiatives across our business areas. Specifically, in GTCC, services volume has increased significantly, and compared to previous levels, profitability of new installations at the time of order booking is also improving. As these projects begin to generate revenue, we expect to see positive impact on profitability. I cannot say definitively whether profit margins will keep climbing indefinitely, but we are at a point where we can consistently maintain profit margins above 10%, as long as we execute projects with no large customer claims.

Questioner 6

Q: Regarding the amount of gains on fixed asset sales, was it ¥60 billion in FY2025, and is the FY2025 assumption ¥0?

Kozawa: It was around ¥70 in FY2024, whereas we are projecting around ¥5 in FY2025.

Q: You have been working to optimize the balance sheet over the past several years. Assuming cash flow performance stabilizes, could you not increase your current dividend payout ratio (30%)? As Mr. Kozawa has said on several occasions, there is also the idea that you could utilize debt more strategically. As we head into the handover to future CFO (and current CoCFO) Mr. Nishio, please let us know if you have any message for us on this topic.

Kozawa: Our current dividend policy is a dividend on equity (DOE) of 4% or higher. If you do the math, this year's payout still ends up being around 30% of earnings, so it is true that the payout has not changed much. Anyway, that is the conceptual framework behind our dividend policy. Looking ahead, our biggest priority will be making sound investments, and I think we now have the capacity to make good use of debt. If we still find ourselves with surpluses beyond that, we may consider a share buyback in the future.

Q: MHI, KHI, and IHI have all seen significant changes in earnings performance and stock prices in recent years, and a good deal of this has been driven by favorable tailwinds. That is not to say your companies have not changed, but I feel that all three of you have benefited from tailwinds in the operating environment including increasing defense budgets. Over the next few years, I think we are entering a period where the differences between these companies will start to emerge more clearly. I would like to know Mr. Ito's thoughts on this.

Ito: I will go into more detail at our 2024 Medium-Term Business Plan Briefing, but one thing I can say now is that we are going to pursue optimization across our organization. Given that MHI has many business domains, our goal is to consolidate common elements and take advantage of the fact that capabilities and techniques developed in one business can be applied to many different products and businesses across the Group. By promoting this kind of cross-functional integration, we aim to eliminate inefficiencies and raise profit capacity.

Another point is to add new functionality to existing technologies and products. We have many products, technologies, and techniques within our Group, and by adding these to existing businesses, we aim to serve an exponentially larger number of customers, to deliver bold new value, and to make significant contributions to society. I believe that especially our businesses with lower market shares hold large growth potential, and that is an area I want to properly address.

Regarding our future growth areas, while developments in the Energy Transition and Carbon Neutrality are lagging behind schedule, we plan to continue R&D based on the principles of 3E + S (Energy security, Economic efficiency, Environmental protection, and Safety) with a steady and careful approach, while focusing on improving economic efficiency and energy security in particular. For example, in areas such as hydrogen production and carbon capture, we aim to develop the world's most economically viable solutions.

Regarding our growing core businesses, it is important to continue increasing the reliability and performance of our gas turbines, and we are also aiming to expand into new geographies. As for Defense, we are preparing proposals for the next Japan Defense Buildup Program. I believe our growing core businesses hold substantial growth potential as well.

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Note that the earnings forecast contained herein includes neither upside nor downside risk from US tariff policy impact.

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