Q&A Summary

Event Name: Mitsubishi Heavy Industries, Ltd. 1H FY2025 Financial Results Briefing
Date: November 7, 2025
Speaker: Eisaku Ito, Member of the Board, President and CEO
Hiroshi Nishio, Member of the Board, Senior Vice President, and CFO

Participant 1

Q: I would like to ask for more details regarding the ¥30 billion in one-time expenses recorded in Q2. First, what is the reason for the ¥20 billion loss provision from the South Africa project? You mentioned that this provision is related to costs arising from construction delays caused by the customer. Is this because the likelihood of MHI's bearing these costs has increased, or is there still a possibility that MHI may not be responsible for them, depending on the outcome of the negotiations? Additionally, could you explain the nature of the remaining ¥10 billion in one-time expenses?

Nishio: The ¥20 billion in one-time expenses related to the South Africa project reflects costs incurred at MHI due to construction delays caused by the customer. We will continue discussions with the involvement of third parties. While MHI intends to dispute these costs, we have booked loss provisions for all foreseeable expenses at this stage in accordance with the applicable accounting standards and policies—taking into consideration that the projects have entered commercial operation.

The remaining ¥10 billion represents the cost of implementing corrective work at six domestic boiler plants to address some design defects.

Q: You increased your full-year forecast for Gas Turbine Combined Cycle (GTCC) order intake to ¥2.1 trillion. Are you considering any further additions to production capacity beyond the previously announced 30%?

Ito: The 30% production capacity increase target is only a milestone, and we are exploring ways to shorten lead times and increase throughput from every angle, including the supply chain. We are currently pursuing more than 1,000 improvement items in parallel, and production capacity will gradually increase. Although we have received a large volume of orders, the increase in capacity will create additional space in our production schedule, allowing us to accept more orders and/or reduce delivery times. In order to minimize increases to fixed assets, we have identified areas for improvement starting from fundamental aspects such as process flow, and nearly all plant personnel are engaged in efforts to shorten lead times.

While we intend to make capital expenditures as needed, we will take as lean an approach as possible. At present, after-sales services account for more than 50% of total GTCC revenue, with the majority of this demand coming from hot parts. Because the

demand for these parts can be forecasted based on the state of operations at our customers' plants, we plan to install only the most essential production equipment required to meet those projected needs.

Q: I believe that capacity for the precision casting of turbine blades is currently a bottleneck, but is it correct to assume that this will be steadily resolved going forward?

Ito: That is correct. We are pursuing a range of process improvements for precision casting and are considering the installation of additional production equipment.

Participant 2

Q: I would like to ask about your having maintained the full-year business profit forecast in Energy Systems. This time, you recorded ¥30 billion in one-time expenses, which exceeded the ¥20-billion risk buffer that had been included in your initial forecast. Where will the additional ¥10 billion in business profit come from to offset the difference?

Nishio: The primary factors here are increases in revenue—including contributions from GTCC after-sales services—and improved profit margins. As profitability at the time of order booking continues to rise, we expect margins will increase as revenue is recognized. Results declined YoY in Nuclear Power due to the timing of project execution. However, work is progressing ahead of the initial plan, and we expect performance to improve over the full year.

Q: You lowered your full-year forecasts in Logistics, Thermal & Drive Systems to ¥150 billion in revenue and ¥20 billion in business profit. Is the primary reason for these revisions a decline in demand for Turbochargers?

Nishio: The main factor behind these declines was actually not Turbochargers, but rather Heating, Ventilation & Air Conditioning (HVAC). Due to the prolonged downturn in China's real estate market, sales of residential air conditioners and package air conditioners have fallen short of expectations. Recovery in Turbochargers remains difficult due to a drop in sales to Europe.

Participant 3

Q: Energy Systems booked ¥30 billion in one-time expenses, while Logistics, Thermal & Drive Systems experienced a decline in sales of Turbochargers and HVAC systems. Given these developments, is the business profit forecast of ¥390 billion still achievable?

Nishio: We believe that ¥390 billion in business profit is achievable at this point. Although we aim to offset the negative impact from the planned sale of Mitsubishi Logisnext, the current forecast remains at ¥390 billion due to the booking of one-time expenses.

Q: In the second half of the fiscal year, business profit in Aircraft, Defense & Space is expected to increase in absolute terms, while profit margins are projected to decline. Is this due to an anticipated rise in costs, or is this simply a conservative forecast?

Nishio: Profit margins in Commercial Aviation tend to decline during the second half of each fiscal year. There are no significant factors expected to cause a large dip in profit during the second half of this year.

Q: I believe you are considering M&A in the data center sector, but which areas are you looking at for acquisitions?

Ito: We are looking at businesses providing electrical systems and IT tools to data centers as potential acquisition targets. Rather than pursuing a single large transaction, we are considering acquisitions across multiple areas.

Participant 4

Q: At the recent GTCC Business Briefing, you projected gas turbine demand to reach approximately 70 GW/year between 2025 and 2027, followed by a decline to around 40 to 50 GW. Is this your business division's view? If you consider the 30% increase in production capacity as simply a milestone, then can we not expect gas turbine demand to remain strong? Mr. Ito, how do you view future demand, particularly in North America, the Middle East, and Asia?

Ito: The forecast provided during the GTCC Business Briefing is in line with my own view. The projected demand of 70 GW/year seems slightly too high when compared to the 40 to 50 GW seen previously. Although there is some uncertainty surrounding electricity demand from data centers, I believe there will be steady demand for the replacement of existing GTCC plants—many of which were built in in the late 1980s—and aging coal-fired thermal power facilities.

Outside the U.S., a number of projects are taking shape, particularly in East Asia—including Japan—and Southeast Asia. Additionally, in the Middle East, countries exporting gas tend to follow two patterns: those that convert gas into high-value-added electricity for domestic development, and those that transmit electricity to other countries. I expect gas turbine demand to grow substantially in these nations.

Furthermore, new demand is likely to emerge in Central Asian countries, which are experiencing high electricity demand similar to the time just before Japan's postwar period of rapid economic growth. Overall, demand for gas turbines is expected to remain strong—not only due to specific regional needs, but also because of the ongoing requirement for conventional power generation.

Q: You revised your free cash flow forecast for FY2025 from negative ¥200 billion to breakeven. Actual results in FY2023 and FY2024 also exceeded expectations, and the situation in FY2025 seems very solid. While I understand that dividend payments are substantial, I think greater consideration should be given to shareholder returns.

Nishio: The improvement in free cash flow is primarily driven by an increase in advances received in GTCC and Metals Machinery. Since we are moving into the phase of utilizing these advances as work progresses, we are not currently in a position to make significant adjustments to the capital allocation plan set forth in our 2024 Medium-Term Business Plan.

Participant 5

Q: It appears that you increased your profit margin forecast for GTCC compared to six months or a year ago. Is this primarily attributable to a higher after-sales services revenue ratio, or is it the result of recording revenue from projects with high margins at the time of order booking? Also, is the increase in the full-year revenue forecast in GTCC due to accelerated revenue recognition driven by your ITO* initiative?

Nishio: Although the after-sales services ratio will tend to fluctuate in the short term, we do not anticipate a sharp increase. This is because order intake for new installation projects remains strong, and as revenue from these projects is expected to grow going forward, the after-sales services ratio will not immediately increase. The key driver of improved profit margins is the significant increase in the profitability of new installations at the time of order booking. Since current orders are scheduled for delivery in 2029 or 2030, increases in revenue arising from higher gas turbine production will take some time to materialize.

*Innovative Total Optimization (ITO): A management strategy and methodology aiming to unlock MHI Group's maximum potential, achieving sustained growth through Group-Wide Optimization and Reach Expansion.

Q: Given policy shifts in Japan—such as efforts to enhance the country's defense capabilities, the proposed revision of the five export categories under the Three Principles on Transfer of Defense Equipment and Technology,* and the accelerated timeline for reaching a defense budget equivalent to 2% of GDP—did you leave the full-year order intake forecast in Defense & Space unchanged because of uncertainty in the future outlook? Is it correct to assume that profitability will remain high in the Defense business?

Nishio: Since it is uncertain what impact the accelerated timeline for a defense budget at 2% of GDP may have on orders for the defense systems MHI provides, we have left our order intake forecast unchanged for now. However, we do see potential for upside.

Looking ahead, we expect further modest improvements in Defense profit margins in the next fiscal year and thereafter, driven by the rising share of revenue from new contracts—which will already account for 70% during this fiscal year.

*Three Principles on Transfer of Defense Equipment and Technology: A policy adopted by the Japanese government in 2014 which limits Japan's defense equipment exports to systems used for rescue, transportation, vigilance (warning), surveillance, and minesweeping.

Participant 6

Q: Profitability at the time of order booking has improved in GTCC due to the tight supply-demand balance. Going forward, MHI will increase your production capacity by more than 30%, and your competitors also have similar plans. In light of this, how long do you expect prices to continue to increase due to the tight supply-demand dynamic? From the next fiscal year onward, do you expect margins to improve by raising prices beyond cost inflation?

Ito: Although production capacity is expanding across the industry, we anticipate that prices will remain elevated for the foreseeable future. This is due not only to strong electricity demand from data centers, but also from the construction of new conventional power plants and the ongoing need to replace or upgrade aging facilities. Demand is expected to grow in emerging markets as well. While materials and construction costs are rising, there is a disparity between regions where utilities can pass on higher costs by increasing electricity rates, and those which cannot. As such, margin improvements will largely depend on regional supply-demand dynamics.

Participant 7

Q: Given the balance between net income, depreciation, and capital expenditures, is it not fair to expect free cash flow around positive ¥200 billion? What are your thoughts on the free cash flow forecast?

Nishio: I agree that a free cash flow forecast of breakeven appears conservative. However, we are transitioning to the phase of utilizing advances received—which have contributed significantly to the recent improvements in cash flow—and we anticipate increases in working capital requirements driven by growth in the Defense business. Given this situation, it is my view that we should approach the free cash flow outlook for FY2026 with a degree of caution.

Q: Is it correct to assume you will not significantly increase capital expenditures?

Nishio: That is correct. While capital expenditures are expected to rise—particularly in Defense—the amount to be borne by MHI will be relatively limited, as the necessary funding will be provided by the Ministry of Defense.

Q: You recently decided to sell Mitsubishi Logisnext. Will you continue revising your portfolio of businesses through the lens of whether you are the best owner for each asset? Could some potential targets for review be Car Air Conditioners, Residential Air Conditioners, or Aero Engines? What criteria are guiding your assessment process?

Ito: Allow me to provide an example to illustrate our approach to the portfolio of businesses. Heat pump technology in our HVAC business has versatile applications across multiple business areas. By integrating heat pumps into power plants, we could potentially harness waste heat to boost output and increase overall efficiency. This exemplifies how our proprietary technologies can deliver new value to customers, and we are proactively exploring ways to leverage core technologies across diverse applications to unlock opportunities for growth. Furthermore, in business which have long struggled to generate high profitability, we are investigating whether existing products can be enhanced with additional functions to appeal to entirely new customer segments. In parallel, we are considering how to create new value propositions that would—for example—appeal to the remaining 90% of customers in markets where our share is only 10%. Each of our Strategic Business Units (SBUs) is examining these kinds of opportunities, thinking creatively and outside the box. We will pursue R&D and capital expenditures to develop businesses which may currently have slightly low margins but for which we are able to formulate specific growth strategies during the exploratory process I just mentioned. In the case of businesses where we do not see a clear path forward, we will assess whether another owner might be better positioned to maximize their potential.

Ultimately, we believe that the optimal approach to portfolio management as a manufacturer involves not only carving out or selling businesses, but also transforming the underlying nature of the businesses themselves. We are currently exploring a range of strategic options in line with this approach.

In response to U.S. tariff policy, the Company is pursuing mitigation strategies focused on cost passthroughs. As of the date of this release, the Company expects any impact on performance to be limited in nature.

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