

**[Event Name]** Q1 FY2021 Financial Results  
**[Date]** August 2, 2021  
**[Speakers]** Hisato Kozawa, Executive Vice President, CFO

(Responses were based on information available at the time of the presentation.)

**[Questioner 1]**

**Q:** You mentioned that you are generally on track to achieve the annual plan. It's only been 3 months into the new fiscal year, so I assume there haven't been any major changes. However, I got the impression that Logistics, Thermal & Drive Systems is progressing better than plan. Could you tell us about your views on this point, along with a more granular breakdown of progress vs. the plan by segment?

**Kozawa:** The Q1 financial results generally lack surprises. First, regarding Logistics, Thermal & Drive Systems and Plants & Infrastructure Systems, my impression is that results have exceeded our expectations. Within Plant & Infrastructure Systems, the results were especially strong in the Metals Machinery segment during the first quarter. In addition to revenue and profit, the steel industry is recovering robustly now especially in terms of order intake. We are receiving many inquiries from the steel industry, so it seems that Metals Machinery is growing.

On the other hand, the segment that fell below expectations is Energy Systems. In particular, we thought that demand for Aero Engines would recover more, but the business made a lackluster start in the first quarter. There were some delays in revenue recognition, where revenue was not recognized for some maintenance, repair, and overhaul (MRO) services and related businesses due to the inability to procure certain components. However, we hope to recoup these opportunities from Q2 onward.

**Q:** In the Aero Engines, would you say that the lower results vs. the plan are attributable to coincidental factors, rather than the impact of the industry as a whole, which affected some engine revenue recognition?

**Kozawa:** Yes, that's right.

**Q:** My second question is about the status of order intake for Gas Turbines. The Q1 results show an order for one Heavy Duty Gas Turbine unit. This number taken on its own makes it seem that you would need to win a few more orders to meet the plan. Is this an issue of timing, or are there some other factors that are slowing progress toward the plan? Please tell us about the market environment for Gas Turbine orders.

**Kozawa:** I have not heard that there is anything wrong in the Gas Turbines market. There

are cases where it takes some time from when technical selection occurs to when a contract is finalized, and there are instances where several units are ordered at once. So far, orders have been relatively steady. Especially in terms of international projects, we are pursuing contract negotiations for a variety of projects, so we expect recovery from now onward.

**[Questioner 2]**

**Q:** You commented that Logistics, Thermal & Drive Systems had a better start than anticipated. Please provide us with some more details. For example, if you break down the segment into sub-segments like Forklifts and Turbochargers, which had strong results, and which made large contributions to profit? If we look at auto parts manufacturers, the industry is growing, so I would assume that MHI's auto parts business is overshooting the plan. Please give us a little more detail on other sub-segment trends.

**Kozawa:** The main products in the Logistics, Thermal & Drive Systems segment include Forklifts, Turbochargers, HVAC, and Engines. Our automotive products, such as Turbochargers and Car A/C, have not yet recovered to the level of Q1 FY2019.

This doesn't mean that the results are behind the initial plan, but in terms of absolute values, they have not completely returned to FY2019 revenue levels. I believe that this is due in no small part to the production adjustments made by automotive manufacturers. On the other hand, Forklifts and HVAC have already recovered to the point of exceeding FY2019 revenue levels.

For reference, in terms of profit levels, in Logistics, Thermal & Drive Systems as a whole, profit has increased compared to pre-COVID levels during the same period (Q1 FY2019), so we look forward to strong results going forward.

**[Questioner 3]**

**Q:** First, conventional Thermal Power orders have increased considerably on a 3-month basis compared to Q1 FY2020. Could you tell us about the current order environment and the status of contract negotiations, including some thoughts on the environment surrounding coal-fired power, which is changing rapidly?

**Kozawa:** If we look at only the first quarter compared to last year, a relatively large order was received in Steam Power for the new installation of a biomass plant. The greatest contribution came from this order. We hope to grow service-related orders slightly more, but the gap between actual results and initial forecast was not very large.

**Q:** How about coal-fired thermal power? Are orders decreasing?

**Kozawa:** We haven't received orders for new coal-fired power plants, so orders have been for service work only. So far, we have not seen any significant changes compared to Q1 FY2020.

**Q:** My second question is about the status of Aero Structures Tier 1 business as detailed on page 24. Could you tell us your outlook on orders from Boeing heading into the fall and winter? In particular, I believe deliveries of 787s to final customers have been temporarily suspended. Is there anything that you can share with us regarding the timing of delivery resumption or its pace?

**Kozawa:** We believe that orders for 787s will decline slightly in the second quarter. We hope that orders will subsequently recover.

As for 777s, we are mainly seeing demand for freight aircraft, and we think that orders will continue at the current level.

#### **[Questioner 4]**

**Q:** My first question is about the overall financial results. I believe that, as seen in components procurement and the sharp rise in logistics costs, unusual things are happening in supply chains around the world. You mentioned that results were in line with the plan, but if we focus on the aspects related to costs, were costs also in line with the plan, and do you hold the same view for Q2-4? Please tell us about your thoughts on the degree of impact.

**Kozawa:** As you have pointed out, it is a fact that there is a certain degree of cost impact from copper, nickel, iron, and other commodities that have seen rising prices recently. The latest costs are reflected in the Q1 results, and although there has been some impact, we think that these cost increases can be absorbed based on our current full-year outlook.

**Q:** Has the impact mainly come from rising costs? Has there been any impact from delivery delays from suppliers or on production due to procurement shortages?

**Kozawa:** Regarding components procurement, there has been some impact from the shortage of semiconductors, for example. However, we have dealt with these issues in various ways such as by securing replacement products, and we have managed to avoid any major impact.

Moreover, regarding logistics, there have been some instances where the procurement of containers has been a little slower than expected, but so far this has not had any major impact.

**Q:** Is it correct to understand that the shortfall in Aero Engines was not due to a delay in market recovery, but rather due to a delay in revenue recognition in some MRO projects? As for the situation of Aero Engines in Q1, please confirm whether you expect recovery as planned over the full year, although there may be some uncertainties around the increase in vaccination rates and variant strains of COVID-19 from Q2 onward.

**Kozawa:** The shortfall versus our forecast in the first quarter was due to the impact of a delay in revenue recognition in MRO services. This shortfall is expected to recover from Q2 onward.

On the other hand, regarding components and other products that are consumed during operation, we currently expect a certain degree of recovery to the level of our initial outlook driven by the recovery of air travel demand, especially regional travel, from Q2 onward.

That said, aside from the topic of Aero Engines, it is difficult to predict the impact of the resurgence of COVID-19 infections due to variant strains, which we are seeing right now around the world. People around the globe find it difficult to make forecasts regarding this matter. The situation of COVID-19 infections is, therefore, a slight risk.

**Q:** Lastly, I would like to ask about Turbochargers. Earlier, you mentioned that there have been some delays caused by semiconductor shortages. What kind of discussions have you had with customers regarding the level of recovery from Q2 onward? Please give us your short-term perspective on this topic. In addition, in terms of the medium- to long-term impact, the EU has issued a ban on sales of gasoline vehicles starting in 2035. Although this is well into the future, could you comment on what kind of countermeasures are being taken at MHI?

**Kozawa:** I am not fully aware of the near-term trends in automotive manufacturing from Q2 onward, but our annual plan wasn't formulated with an aggressive forecast to begin with, so we think results will generally trend in line with the plan.

Also, regarding the longer-term outlook, it is especially difficult to predict the lifespan of gasoline vehicles. On the other hand, production of gasoline vehicles is not expected to stop in the next 2 or 3 years. If production were to continue until 2035, it is possible that new engines would be released 1 or 2 more times.

Moreover, in terms of the corporate strategy of MHI as a whole, we are working to apply the technology that we have developed for turbochargers to other products that can be used in the electrification space as well. In this way, we hope to make an effective shift in our product lineup.

**[Questioner 5]**

**Q:** My first question is about Energy Systems. On page 20, where it shows Energy Systems profit from business activities, the progress vs. the plan in the first quarter is always highly volatile, but are there any noteworthy points other than the delay in revenue recognition in Aero Engines? Perhaps you expect progress from Q2 onward or progress in accordance with the plan, but is there a possibility that, for example, after-sales services of Gas Turbine Combined Cycle (GTCC) power plants are skewed toward the second half? It appeared to me that the progress on profit was a little slow, so please share with us some additional information about segments other than Aero Engines.

**Kozawa:** In Energy Systems the progress of profit and revenue vs. the full-year plan is slow, but that does not mean we will fall short of the plan for revenue. There is a tendency for results, including revenue, to be skewed considerably toward the second half.

This doesn't just include after-sales services of Gas Turbines, but it applies to Steam and Nuclear Power. Revenue tends to be skewed toward the second half, so we expect it to rise sharply from Q2 through the second half.

**Q:** In that case, is it true that there have been no noteworthy overshoots or undershoots in segments other than Aero Engines during Q1?

**Kozawa:** Yes, that's right.

**Q:** My second question is about Aircraft, Defense & Space. I assume you didn't disclose the development costs of SpaceJet because the annual amount is small, but if you divide the annual budget by four, you reach an amount of several billion yen per quarter. When excluding this from the segment's total profit from business activities of ¥3.5 bn, normalized earnings excluding SpaceJet appear to be on par with or slightly less than last year.

I believe this is partly due to fluctuations on a quarterly basis. That said, although revenue in Commercial Aviation is roughly on par with Q1 FY2020, has there been an impact from cost reductions compared to last year? Logistics, Thermal & Drive Systems has produced profit, so I would like to know if proactive efforts have been made in the Aircraft, Defense & Space segment. Alternatively, it may be because of profits being generated in a different way than last year in the Defense & Space segments. Could you please give us some additional information on this point?

**Kozawa:** We have decided not to disclose the figures for SpaceJet starting with this report. That said, a comparison of the results from Q1 FY2020 excluding SpaceJet and results for Q1 FY2021 excluding SpaceJet shows that profit is roughly at the same level or slightly lower.

As for the comparison with the previous fiscal year, in terms of Aero Structures Tier 1,

the reality is that profit was roughly on par with Q1 FY2020 despite a slight decline in revenue.

The increase in negative P/L impact compared to FY2020 came from the Space segment. Although there were launch vehicle launches in Q1 FY2020, the absence of launches so far this year has had an impact on profit. Other than that, I believe there were no major changes.

**[Questioner 6]**

**Q:** Regarding the waterfall chart on page 13, which shows the change in profit from business activities, "Others" is shown as having a positive impact of ¥8.8 bn. You mentioned improvements in project profitability earlier. Could you break this down a little further?

**Kozawa:** It's difficult to break this down further, but as for the factors behind the increase, one of them is fixed cost reduction and the other is project profitability. Although the situation differs for each segment, we have seen an increase in the average level of project profitability, especially in Plants & Infrastructure Systems, as compared to FY2020.

**Q:** Which segments in particular?

**Kozawa:** One example is Metals Machinery.

**Q:** Is the rise in material costs that you mentioned earlier offset by factors included in "Others"?

**Kozawa:** Yes, this is included in project profitability.

**Q:** How much of an impact do you expect from material costs over the full year?

**Kozawa:** I do not have the figures with me right now, but for example, there has been several billion yen of impact from rising copper prices in the HVAC segment.

**Q:** Do you think that the costs can be offset each time, even from a more conservative standpoint than your original forecast?

**Kozawa:** We had already factored in an increase in costs to a certain extent in our original plan, so I don't think that there is a large impact compared to the plan. Although the rising costs are categorized under "Others" in this waterfall chart, I hope you will understand that the ¥8.8 bn increase in profit also includes the negative factors up to now.

**Q:** Regarding Gas Turbines order intake, you said that you have not heard any negative news as contract negotiations have increased internationally. However, could you give us some examples of the regions where customer interest is increasing or the types of projects that are being considered? I'd appreciate any additional information, even on a qualitative basis.

**Kozawa:** Orders have relatively been strong in the U.S., other parts of North and South America, and Asia. These are markets that we have been focusing on for a long time, and we continue to forecast a consistent amount of new contract negotiations in these regions.

**Q:** Has there been any impact from COVID-19, especially in Asia?

**Kozawa:** As a practical matter, there have been slightly more delays than expected in contract negotiations due to the recent surge in infections in Southeast Asia.

**Q:** During the FY2020 Financial Results briefing, you mentioned there had been a considerable increase in inquiries particularly for CCS. Is there anything you can share with us regarding the progress being made on this front?

**Kozawa:** Regarding Carbon Capture, we have not seen a dramatic increase in contract negotiations, but the number of inquiries has increased very much, and we have significantly increased our resources to respond to them. This may not be something that has an impact on the business this fiscal year, but we may be able to expect results over the next few years.

**Q:** Has there been an increase in inquiries for modular CO<sub>2</sub> capture systems compared to FY2020?

**Kozawa:** The situation is different for each type of system. There is a model for power utilities, and we are also promoting a simplified, modular version. Inquiries for Carbon Capture as a whole are increasing.

#### **[Questioner 7]**

**Q:** Regarding Aircraft & Space, profit from business activities was ¥3.5 bn in the first quarter. I assume that SpaceJet fixed costs are recognized almost equally in each quarter. But in terms of Aero Structures Tier 1, should we expect profit to gradually improve from the second quarter onward? Should we consider any particular downside risk from the middle of the fiscal year?

**Kozawa:** The P/L results of Aero Structures Tier 1 cannot be expected to improve significantly during the current fiscal year, and the same can be said of SpaceJet. I don't

think there will be any major divergences insofar as we expect that the level will be roughly the same as the first quarter in both segments.

Revenue in Defense & Space will grow toward the end of the fiscal year, which we expect will boost profit to the level of the annual plan.

**Q:** Regarding the loss from business activities in Q1 amounting to ¥8.2 bn in the “Others” segment, the forecast is for this loss to reach ¥20 bn by the end of the fiscal year. Initially, you explained that this annual loss of ¥20 bn includes a certain degree of buffer. How should we understand the loss of ¥8.2 bn in Q1 in comparison to the annual forecast of ¥20 bn?

**Kozawa:** The annual plan also includes the sale of land, which is already underway, and the gain from this will be booked during or after Q2. Therefore, over the full year, we think it is highly likely that the total loss will be in line with our forecast of ¥20 bn.

#### **[Questioner 8]**

**Q:** There were various things mentioned today about Plants & Infrastructure Systems. Regarding the order status and profitability of Metals Machinery, order intake has remained at an elevated level once again this quarter, as was the case in Q4 FY2020. Could you give us an idea of whether things will continue in this way in the future? If possible, could you also tell us how much order intake is accounted for by China and India?

Third, I have the impression that profitability is improving. I believe international operations fixed costs were reduced, especially through restructuring, but I also think it is attributable to an increase in service revenue. Please tell us a little more about the status of after-sales services in Metals Machinery, namely if revenue is mostly from new construction and about how much of revenue is accounted for by services.

**Kozawa:** In terms of order intake, we believe it would be a bit difficult for full-year revenue to be four times the amount of the first quarter, given that Q1 revenue exceeded the forecast. However, from Q4 FY2020 through Q1 this year, steelmakers are showing some appetite for investment, partly due to the rise in steel prices. Also, we are currently seeing moves by companies to invest in decarbonization and adopt new technologies. I believe that our steelmaking process fits that investment appetite to a certain extent. We believe order intake over the full year this fiscal year can probably exceed FY2020 levels. As for the regional breakdown, we have received a certain amount of orders in China and India. My impression is that orders have been relatively increasing in Europe since Q4 FY2020.

As for Metals Machinery services, the volume varies from one year to the next, but to



give you a rough picture of the situation, services account for approximately 20% of revenue. The profit margin is higher for services than new installations, as you have pointed out.

**Q:** I recall reading press releases about orders from Austria or Sweden. Do you expect to receive orders related to decarbonization this year as well?

**Kozawa:** I believe that you are referring to a press release about the completion of a hydrogen reduction steelmaking pilot plant with an Austrian steelmaking company. This is not something that will result in orders immediately, but customers have been approaching us about building plants that would make it easier to introduce such processes in the future. I believe we have been able to effectively connect customer inquiries to actual orders, and customers have appropriately evaluated the potential of our zero-carbon steelmaking technology.

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