Q&A Summary

Event Name: Q1 FY2023 Financial Results Presentation

Date: August 4, 2023

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

Questioner 1

Q: Please let me know about the progress in Energy Systems business profit. You explained that the organizational transformation expenses (approximately ¥10 billion) related to European operations which was incurred in Q1 FY2022 was eliminated, causing an upturn in business profit. Separately from this, I believe there were one-time expenses from Integrated coal Gasification Combined Cycle (IGCC) in the amount of a few billion yen booked in Q1 FY2022. However, Energy Systems business profit has increased by ¥25 billion YoY, so I think the result here was better than simply the elimination of one-time expenses. I had assumed that normalized profit in Q1 FY2022 excluding one-time expenses was around ¥10 billion, but the result in Q1 FY2023 was higher than that.

Were there any factors that had a positive effect on profit, or is your base profitability increasing?

Contrastingly, Q1 FY2023 business profit in Energy Systems has not even reached 20% of the full-year forecast. I believe that profit tends to be higher in Q4, but what is your assessment of your progress in Q1?

Kozawa: Overall, no unexpected factors occurred in Q1 FY2023.

In Steam Power, in addition to the positive impact of the elimination of organizational restructuring expenses related to our European operations, the product mix is also improving. Steam Power revenue declined by around ¥15 billion from around ¥100 billion in Q1 FY2022. However, the decline was in new installation projects, while services were flat or increased slightly YoY. Services have higher margins, which resulted in improvement to the overall profitability of the business.

Furthermore, revenue in Gas Turbine Combined Cycle (GTCC) and Aero Engines has increased, resulting in a YoY increase in overall segment business profit in Q1 FY2023.

The progress in business profit versus the full-year forecast as of Q1 was basically in-line with the plan.

Q: You said that order intake in Defense normally tends to be concentrated at the end of the fiscal year. In addition to the large orders booked in Q1 this fiscal year, do you expect orders in Q4 as usual?

Kozawa: Although we booked some large orders especially in April in Q1, I think we will see inquiries and contract negotiations of a reasonable size in Q4 as well. I do not know how much of these we will be able to book, but I believe that if the projects that we are expecting materialize, we will be able to book a substantial amount of orders in Q4. We expect that order intake will exceed our full-year forecast to some extent.

Q: When will the orders booked this year in Defense affect revenue?

Kozawa: I think it will take some more time for the booked projects to affect revenue. The impact on revenue during this fiscal year will be limited, and since revenue is recognized according to the percentage-of-completion method in some projects, revenue will gradually be booked during the next fiscal year and thereafter. Revenue will not increase in a linear fashion. I assume that we will start to see revenue impact in FY2025 and beyond.

Q: There are discussions about improving profit margins in the defense industry, but what is the current situation? Defense order intake has increased significantly, so can you expect to see improvement in profitability soon?

Kozawa: Profitability is tending to increase slightly compared to past levels, although not as much as people are saying. I believe that impact to revenue and business profit will be seen two to three years from now, and profitability will be slightly better than before.

Questioner 2

Q: Can we expect to see improved profitability starting with projects booked in Q1 this fiscal year?

Kozawa: Personally, I hope that this will be the case. To expand on this, there are some areas where profitability at the time of order booking is increasing compared to previous levels, and if things go well, we expect that profitability will improve in the future. On the other hand, while there is no risk in the business of manufacturing and delivering products using technologies for which development has already been completed, there is a certain amount of risk in development projects. We will need to manage projects to prevent mistakes, and I think we have done a relatively good job at managing this so far. If we are able to manage these projects well, our profitability will likely increase.

Q: In the Commercial Aviation Aero Structures business, nine 787 units were delivered in Q1 this fiscal year. The number of unit deliveries included in the full-year forecast announced in May was around the same as last fiscal year. Now that Q1 has ended, please tell us your evaluation of the situation.

Kozawa: As of the full-year forecast announcement in May, we had planned for the same level of deliveries as the previous fiscal year. Boeing's production plan was higher than this, but our intention was to include somewhat conservative figures in our plan. While the results in Q1 exceeded our expectations, unit deliveries have slightly decreased recently. Our current assumption is that the number of unit deliveries for the full year will be slightly higher than the previous fiscal year. However, I do not know if the average production rate will increase to three units per month, for example.

Q: I believe that the number of large frame gas turbine unit orders included in the full-year forecast announced in May was around the same level as the previous fiscal year. You mentioned that GTCC order intake was strong, but did the progress in Q1 exceed your assumptions?

Kozawa: The number of large frame gas turbine units booked is shown on page 19 in the Appendix of the financial results briefing presentation materials. Our order intake was three units in Q1. These orders were in line with expectations both in terms of the projects themselves as well as the timing of booking, and we have no intention of revising the forecast at this time.

Also, the number of unit orders through our China licensee was also in line with our expectations. We were a little concerned about China's economic trends, but demand is as strong as ever, and we have been able to steadily secure orders.

Questioner 3

Q: Regarding the full-year forecast announced in May, although you booked one-time expenses in the amount of ¥74 billion in the previous fiscal year, I believe that you expected business profit recovery in FY2023 due to the reduction in these one-time expenses to be only ¥54 billion, which accounts for some risk of one-time expenses in the current fiscal year. Could you provide us with an update on the possibility of any one-time expenses now that Q1 is over?

Kozawa: In Q1, the elimination of one-time expenses incurred in the previous fiscal year proved to increase profit by the same amount, so we believe it was a relatively smooth start to the year.

We are working to prevent the occurrence of unexpected one-time expenses, but it is hard to tell you how things will go in the future. Although I cannot say for certain, as of the end of Q1, we expect that one-time expenses will be within the range forecasted in May.

Q: Are there any businesses experiencing impact from the recent slowdown in capital investment and deteriorating market sentiment in China? If there are, please tell us the extent of the impact on your businesses and your outlook.

Kozawa: I can only answer about the part that directly affects MHI. In Metals Machinery, I have the impression that investment has slowed somewhat, although not markedly so.

Previously, demand in China was strong, but compared to that, we feel that it is on a slightly downward trend.

Another area is our automotive-related businesses. Turbochargers for the Chinese market continue to decline compared to past levels, and I believe that this is due to China's emphasis on electric vehicles.

Q: Could you share with us the expected impact on MHI from the additional expenses announced by RTX (formerly Raytheon Technologies) for the PW1100G-JM engine?

Kozawa: It is difficult to explain this clearly, but if we calculate based on the $500 million in FY2023 cash flow impact that RTX has disclosed, the impact on our company would be around $15 million to $20 million. However, this is on a cash basis, and the amount of impact on the P&L would be different from this. I think that the P&L impact would be slightly less than the hit to cash flow. That said, we have not been able to verify the accuracy of the $500 million amount, so I cannot say how much it will affect our company.

Questioner 4

Q: Looking at Mitsubishi Logisnext's disclosures, I believe that the Forklifts business made a large contribution to the increase in business profit in Logistics, Thermal & Drive Systems. I would like to know about the size of profit improvements in each of the sub-segments. You said that profit decreased in Turbochargers, but around how much impact was there from this?

Kozawa: The contribution to profit growth in terms of major businesses was Logistics Systems (Forklifts), Heating, Ventilation, and Air Conditioning (HVAC), and Engines, in that order. Turbochargers saw a slight decline in profit.

Q: How much risk do you see from electronic component shortages? Does the situation continue to be serious?

Kozawa: I think the situation has improved quite a lot. However, there is still some concern about the timing of the receipt of these parts, so currently we are maintaining larger inventories of electronic components. The shortage of electronic components will not have a significant impact on the current fiscal year's performance.

Q: You mentioned the expectation of more Defense orders in Q4. In which areas are you expecting to receive orders?

Kozawa: MHI provides equipment for use in all operation areas: land, sea, and air. As we are a leading company in front-line equipment, we have expectations for this business. It will depend on whether the projects currently being planned materialize, but I believe that, in the sea area, there may be some naval ship projects, and in the air, we may continue to see orders for defense aircraft and missile systems.

Questioner 5

Q: Please let us know the current situation at the IGCC plants.

Kozawa: The IGCC plants are currently undergoing improvement work, the content of which is in keeping with our initial assumptions. The work is now proceeding steadily in line with our original projections. There were no major developments during Q1.

Q: Regarding IGCC additional expenses, in Q1 of this fiscal year was around the same amount of additional expenses booked as in Q1 FY2022, i.e. a few billion yen?

Kozawa: No additional expenses have been booked for IGCC.*

*This is a correction to the response made at the briefing on August 4.

Q: I believe discussions have begun for the new medium-term business plan, which begins next year. I would like to know about unused land at your Japanese manufacturing bases. I think you are proceeding with sales of dormitories and other real estate, but is there excess land at your factories? Also, what are you planning to use the funds obtained through these asset management activities for?

Kozawa: It is difficult to provide specifics at this point, but we considering the sale of assets including unused land at our Japanese manufacturing bases. The level of surplus is different at each plant. For example, our Takasago Machinery Works is currently fully utilizing its land. In the past, there was some unused land at Hiroshima Machinery Works, but we have continued to sell it gradually, and I do not believe there is much surplus right now. However, some of our factories have unused land, so we are in the process of examining these issues one by one.

As for the use of the gains on asset sales, over the past few years we have used some of these funds to pay down debt. We are considering utilizing these funds for our growth investments in the development of Energy Transition and Smart Infrastructure as well as for M&A.

As announced in a press release in July, we have decided to acquire Concentric, an American company whose main business is the maintenance of batteries and other equipment. The monetary amount of the acquisition is undisclosed, but it is not insignificant. We are continuing to sell our strategic shareholdings and other securities this fiscal year. The uses that we are considering for these funds are as I mentioned.

Q: Is there more discussion of addressing issues in each business than in the past?

Kozawa: I think that internally such an atmosphere is developing.

Questioner 6

Q: In Q1, gains on asset sales had a negative impact of ¥4 billion. Could you please explain this?

Kozawa: This ¥4 billion was the decrease in business profit from our asset management activities, which are mainly related to gains on sales of real estate, in FY2022 compared to that in FY2023. Although there was a certain amount of sales in Q1 this fiscal year, gains on sales of real estate in Q1 in the previous fiscal year were ¥4 billion greater, resulting in a YoY decrease of ¥4 billion.

Furthermore, if you include sales of securities, which do not affect the P&L, cash inflows were higher in Q1 FY2023 than in Q1 FY2022, which had a positive effect on cash flow.

Q: In Q1, price optimization in response to materials cost inflation had a positive impact of ¥14.0 billion on business profit, whereas the full-year forecast issued in May includes a positive impact of ¥20 billion. Considering the progress made in Q1, can we expect further upside in the future?

Kozawa: Through the first half of FY2022, the negative impact of materials and other cost inflation was larger than the positive effect of price optimization. However, since the second half of FY2022, deliveries of products with increased pricing grew considerably, and we started to see the benefits of price optimization. As such, during the first half of this fiscal year, the scale of YoY improvement will be large, only to shrink in the second half. According to our latest estimations, we expect that the positive contribution to business profit will exceed the full-year forecast of ¥20 billion issued in May.

Questioner 7

Q: Regarding profitability in the Defense business, you mentioned that profit margins have not yet improved as much as people are saying. However, Japan's Ministry of Defense is talking about a maximum of 10% for quality, cost, and delivery (QCD) evaluation and a maximum 5% cost variability adjustment rate for a maximum total of 15%. I think MHI is unlikely to receive a low QCD rating. Can you tell us specifically how much you see profitability improving?

Kozawa: It is difficult for me to answer your question. I cannot provide specific figures.

Q: The Defense Buildup Plan for the five years between 2023 and 2027 has been released by the Ministry of Defense. How much in Defense order intake do you project that MHI will be able to secure under this plan?

Kozawa: I believe that the amount of order intake may vary considerably from year to year. Our current impression is, if we exceed our disclosed forecast for order intake in the current fiscal year, we will probably see orders decrease slightly in the next fiscal year.

However, revenue is a different story. We assume that revenue will grow to some extent and will reach a reasonably high level in 2026 or thereafter.

Q: If the currently high levels of order intake in GTCC and Nuclear Power remain flattish in the future, would you say that Defense will be the driver MHI's topline growth over the next five years?

Kozawa: While I would not exclude other businesses, I believe Defense will be one of the drivers.

Q: Will Defense not be the top driver?

Kozawa: You could say that Defense will be the top driver when considered from an organic perspective.

Note regarding forward looking statements:

Forecasts regarding future performance as outlined in these materials are based on judgments made in accordance with information available at the time they were prepared. As such, these projections include risk and uncertainty. Investors are recommended not to depend solely on these projections when making investment decisions. Actual results may vary significantly due to a number of factors, including, but not limited to, economic trends affecting the Company's operating environment, fluctuations in the value of the yen to the U.S. dollar and other foreign currencies, and Japanese stock market trends. The results projected here should not be construed in any way as a guarantee by the Company.

End of Document