A Message from the CFO

We aim to further enhance corporate value by continuously improving our business portfolio.

Hisato Kozawa
Executive Vice President and CFO

Review of the 2021 MTBP

When we formulated the 2021 Medium-Term Business Plan (MTBP) in FY2020, our performance had declined due to the COVID-19 pandemic. This was preceded by significant losses related to SpaceJet in FY2019. Consequently, the market had a negative view of MHI, and some credit rating agencies downgraded our rating.

As CFO, I recognized that restoring our financial health was our most important priority, so I focused on formulating and executing the 2021 MTBP accordingly. First, we sold fixed assets and strategic shareholdings, using the proceeds to pay down interest-bearing debt. As a result, we were able to substantially reduce debt and improve our debt-to-equity ratio, thereby enhancing our financial soundness.

Another major priority was to strengthen profitability. We set specific targets, such as a business profit margin of 7% and a return on equity (ROE) of 12%. Although we fell slightly short of these targets, we made significant gains in profitability-related indicators.

On the financial side, therefore, we made good progress in restoring profitability under the 2021 MTBP and improved financial soundness beyond our initial expectations, laying a solid foundation for expanding investments in future growth areas under the 2024 MTBP.

Evolution of Financial Indicators over Time

	FY2020 (Result)	FY2023 (Result)	FY2026 (Plan)
Revenue	¥3.7 tr	¥4.6 tr	≥¥5.7 tr
Business Profit	¥54.0 bn	¥282.5 bn	≥¥450.0 bn
Business Profit Margin	1.5%	6%	≥8%
ROE	3.1%	11%	≥12%
Total Assets	¥4.8 tr	¥6.3 tr	¥6.3 tr
Total Asset Turnover	0.8	0.8	0.9
Debt/EBITDA Ratio	4.7x	1.7x	≤1.7x
Dividend per Share[1]	¥7.5	¥20	¥26

1 Historic dividends shown here retroactively adjusted to 1/10 original value to reflect 10-for-1 stock split effective April 1, 2024

Basic Financial Policies of the 2024 MTBP

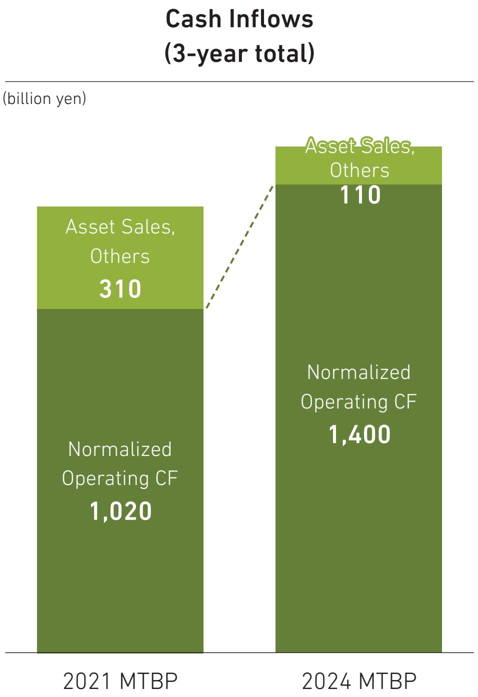
Under the 2024 MTBP, we have the set the following numerical targets: revenue of ¥5.7 trillion or higher, business profit of ¥450 billion or higher, and ROE of 12% or higher. Regarding shareholder returns, we adopted the dividend on equity (DOE) ratio as a new key performance indicator (KPI) under our dividend policy aimed at steadily increasing dividends over the medium and long terms. Recognizing that our cost of equity is approximately 8%, we have set a DOE target of 4% or higher, with the aim of consistently returning more than half of our capital costs to shareholders.

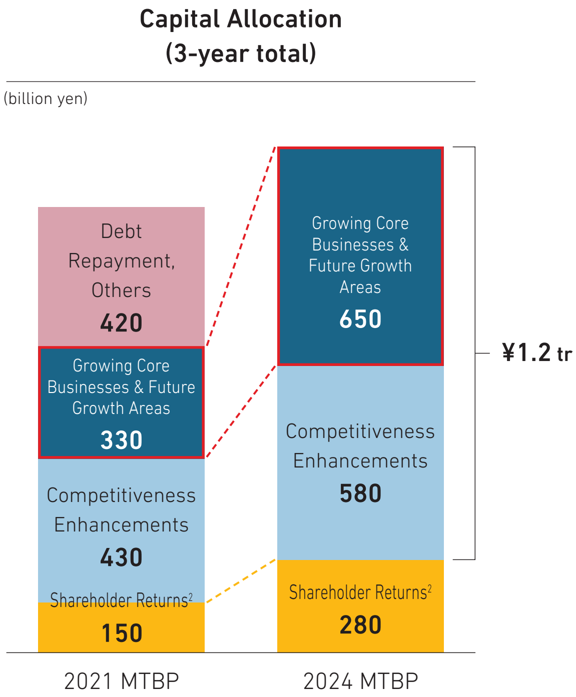
In the three-year period of the 2021 MTBP, we generated ¥1,330 billion in cash inflows (¥1,020 billion from normalized operating cash flow and ¥310 billion from asset sales and other sources). Of this, we allocated ¥420 billion to repayment of interest-bearing debt. As investments in our businesses, we allocated ¥330 billion to growing core businesses and future growth areas and ¥430 billion to enhancing the competitiveness of our other businesses. In addition, we returned ¥150 billion to shareholders.

Under the 2024 MTBP, we will build on the profitability that we strengthened under the 2021 plan. Specifically, we project total cash inflows of ¥1.51 trillion (¥1.4 trillion from normalized operating cash flow and ¥110 billion from asset sales and other sources). Of this, we will allocate ¥650 billion to growing core businesses and future growth areas, ¥580 billion to enhancing the competitiveness of our other businesses, and ¥280 billion to shareholder returns.

Compared with the 2021 MTBP, we will increase investments by 60% or more under the new plan. We trust that stakeholders will see this as a clear demonstration of our commitment to aggressively pursue strategic up-front investments to drive future growth. We also aim to nearly double shareholder returns compared with the previous plan. While this capital allocation includes a certain amount set aside for business acquisitions, the actual scale of such cash outflows could vary significantly. We intend to maintain strict financial discipline by responding appropriately to fluctuations in demand for capital.

Capital Allocation Plan





2 Includes dividends to non-controlling interests

Must-Achieve Target: ROE of 12% or Higher

In FY2023, the final year of the 2021 MTBP, we strove to reach an ROE of 12%, a major target under that plan. However, due to an increase in shareholders' equity stemming from foreign exchange effects and the mark-to-market valuation of securities and other assets, we posted an ROE of 11%, falling just short of the target. Under the 2024 MTBP, we are targeting an ROE of 12% or higher. In terms of capital efficiency, we also monitor and evaluate performance using metrics such as return on invested capital (ROIC). However, we place particular emphasis on ROE, which is a key indicator directly linked to our stock price and price-to-book ratio (PBR). Given current market expectations and valuations, our ROE is not yet at a satisfactory level. Nevertheless, management is determined to enhance corporate value by focusing our efforts on achieving an ROE of 12% or higher.

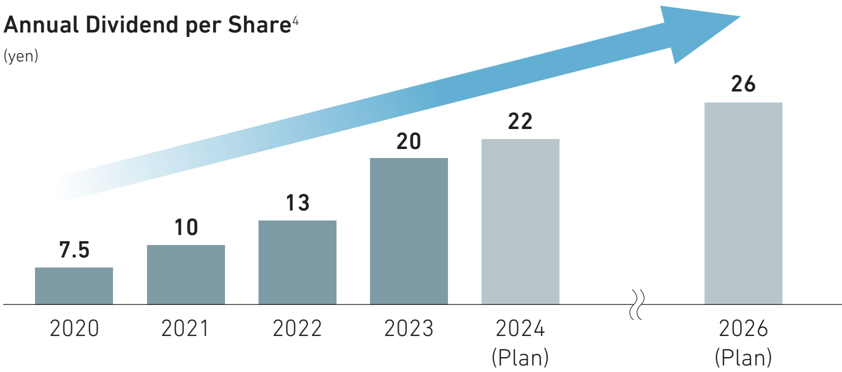
Adoption of DOE-Based Dividend Policy

In the 2024 MTBP, we have adopted a dividend policy based on the DOE ratio[3]. We recognize that dividends are the foundation of shareholder returns, so adopting the DOE ratio enables us to clarify our criteria and rationale for determining future dividend amounts.

As a dividend policy, many companies use a set percentage of net income (dividend payout ratio) as the basis for determining dividend amounts. At MHI Group, we have used a dividend payout ratio of 30% as our guideline for some time. However, because net income fluctuates widely from year to year and there are often discrepancies between forecasts and actual results, a payout ratio offers lower predictability for future dividends. There are various ways to address this problem, such as committing to a progressive dividend with specific targets. However, observing the trends of other companies that have implemented progressive dividends, they typically set time limits of around three to five years, making it challenging to establish this approach in the long term. Taking these points into account, we considered ways to both increase dividends in line with profit growth while paying stable dividends with high predictability, and came to the conclusion that a DOE-based approach would be better. In calculating the actual dividend amount, it is reasonable to use shareholders' equity excluding foreign currency translation adjustments and other items, such as unrealized gains and losses (other comprehensive income, or OCI) to increase predictability without being subject to short-term market fluctuations. The standard we use is 4% or more of OCI-adjusted shareholders' equity.

For FY2024, we currently plan to pay a total full-year dividend of ¥22 per share, up ¥2 year-on-year, and ¥26 per share in FY2026, the final year of the 2024 MTBP. Looking further ahead, when we reach the next stage of improved profitability and asset efficiency, we will consider raising the DOE benchmark.

Annual Dividend per Share[4]
(yen)



Targeting ≥4% DOE

- Adopt DOE based on shareholder capital (excl. OCI)
- Planning a ¥22 full-year dividend in FY2024, a ¥2 increase over FY2023
- Planning a ¥26 full-year dividend in FY2026

3 DOE: Dividends paid ÷ Shareholders' equity (excluding OCI)
4 A stock split was enacted on April 1, 2024. To facilitate comparison, dividends through FY2023 are shown here retroactively adjusted to reflect the stock split.

Efforts to Improve Asset Efficiency

Although our debt-to-equity (D/E) ratio (the ratio of interest-bearing debt to net assets) at the end of the 2021 MTBP period was satisfactory, we believe there is still room for improvement given the overall size of our balance sheet. Due to the unavoidable disruptions in the supply chain caused by the COVID-19 pandemic, we were forced to maintain higher levels of inventory and raw materials, which caused our inventory assets to increase. Additionally, the yen's depreciation led to an increase in the valuation of foreign currency-denominated assets. In a sense, these assets can also be viewed as a source of potential risk.

With this in mind, the 2024 MTBP is ambitious because it focuses on increasing profits without expanding total assets. To achieve this, our business units will work to reduce asset volumes by shortening production lead times, optimizing inventory levels, and improving payment terms. In parallel, our finance and accounting departments will take the lead in managing overall operations with a focus on improving asset efficiency.

Stock Valuation

When I became CFO in 2020, our stock price[5] was approximately ¥2,500, market capitalization was around ¥800 billion, and a PBR was 0.6x–0.7x. Upon entering the position, my initial targets were to reach a market capitalization of ¥1 trillion (at a share price[5] of around ¥3,000) and then achieve a PBR of 1x or higher (with a share price[5] of around ¥4,000 relative to shareholders' equity at the time). If possible, I also would have liked to reach a market capitalization exceeding ¥2 trillion. Currently, our PBR exceeds 2x, reflecting a market valuation that surpasses our initial expectations.

Of course, I acknowledge that our current success is not solely the result of our own efforts, as changes in the operating environment have also provided tailwinds. Going forward, I also feel that the capital markets are paying attention to us and expecting us not only to achieve our business plan but also to exceed our targets. If we can meet these expectations and produce results in a tangible and understandable manner, I believe we can further solidify our reputation in the market.

5 Stock price before the April 1, 2024, stock split

New Business Portfolio Management Approach with a Financial Perspective

In the 2024 MTBP presentation materials, we explained our business portfolio management approach using three categories: growing core businesses, future growth areas, and competitiveness enhancement businesses. This is a crucial point for driving the future growth of MHI Group. As I mentioned earlier, we intend to allocate funds to growing core businesses and future growth areas in a focused manner.

When it comes to competitiveness enhancement businesses, however, I expect that there will be variations in how funds are actually allocated, even within the same category. Accordingly, we will consider and enact appropriate business operations based on the operating environment and profitability of each business unit. This process may

▶ For more information, please refer to "Special Feature: 2024 Medium-Term Business Plan" (PP26-37).

Examples of Recent Portfolio Changes

Business	Other Party	Transaction Type	Date of Transaction	Current Status
Thermal Power	Hitachi, Ltd.	Joint Venture (major investment by MHI)	February 2014	Integrated into MHI
Metals Machinery	Siemens AG Hitachi, Ltd. IHI Corporation	Joint Venture (major investment by MHI)	January 2015	Primetals Technologies (wholly owned subsidiary of MHI)
Machine Tools	Nidec Corporation	Divestment	August 2021	Nidec Machine Tool Corporation (subsidiary of Nidec Corporation)
Naval Ships	Mitsui E&S Co., Ltd.	Acquisition	October 2021	Mitsubishi Heavy Industries Maritime Systems Co., Ltd. (wholly owned subsidiary of MHI)
Power Generator Systems	Mitsubishi Electric Corporation	Joint Venture (minor investment by MHI)	April 2024	Mitsubishi Generator Co., Ltd. (equity-method affiliate of MHI)

require acquisitions or divestitures of certain businesses. We often view mergers and acquisitions (M&A) as being focused on simply buying and selling companies. However, there are also valuable opportunities for collaboration with other companies or forming joint ventures. Our approach is to identify the best management styles and enhance competitiveness by effectively integrating our strengths with those of other companies, while always keeping in mind who the "best owner" is. This approach aligns perfectly with MHI Group. Taking this approach to its logical conclusion, even if a business in our Group is generating good profits, the "best owner" concept suggests that if another company could generate even greater profits by taking control of it, we should choose that option. We will always look for ways to increase total corporate value.

MHI Group: Constantly Taking on New Challenges and Evolving

MHI implemented a 10-for-1 stock split, effective April 1, 2024. By lowering the price per trading unit, we aim to make it easier for investors—especially retail investors—to invest in MHI, thereby expanding our investor base.

I believe that a company's value is reflected in its stock price. In that sense, delivering solid, measurable results is absolutely essential for increasing corporate value. In addition, it is becoming more and more important for stakeholders, including shareholders and other investors, to view MHI Group as a growing company that is indispensable to society. Therefore, we are committed to our daily business activities with the aim of fostering such expectations and becoming a corporate group that meets them.

In our previous medium-term business plans, it was standard practice to treat each business unit equally when explaining our company to external parties. In the 2024 MTBP, however, we framed our approach to plan achievement using the three categories mentioned previously to make our message clearer to investors. That said, these categories are not set in stone, and there may be a certain amount of shuffling within them in terms of the positioning of each business. Business portfolios evolve with the times. Even if we could achieve the "perfect" portfolio, which is highly unlikely, it would only last for a brief moment. With this in mind, MHI Group will stay constantly attuned to the changing times as we continue to invest in future growth areas and develop new businesses.