# Q&A Summary

Event Name: Q1 FY2024 Financial Results Briefing
Date: August 6, 2024
Speaker: Hisato Kozawa, Member of the Board, Executive Vice President, and CFO

**Questioner 1**

**Q**: Historically, Energy Systems business profit has been skewed towards Q4, but the Q1 FY2024 result was ¥50.3 billion, and progress was good. I assume that this was because no one-time expenses were incurred in Q1, but even excluding this impact, profit was quite substantial. Could you please provide some background on this?

**Kozawa**: Profit was indeed quite high in Q1 in Energy Systems, and one reason for this was that no one-time expenses were incurred during the period. Furthermore, the yen depreciated YoY, which provided a benefit amounting to several billions of yen. Another large factor in the improved profit results was that Q1 FY2024 had a higher concentration of projects with relatively higher margins. Regarding full-year business profit performance, if things proceed smoothly, and one-time costs in excess of the original forecast are not incurred, we can expect upside. However, the 12.9% business profit margin achieved in Q1 was quite exceptional, and I think a profit margin around 10% could be a target for the full-year result in this segment.

**Q**: Your full-year business profit plan includes a ¥20 million risk buffer. If you do not need to use this buffer, could we expect upside?

**Kozawa**: I hope that will be the case, but I cannot say definitively that there will be no unforeseen events during the next three quarters.

**Q**: Progress in Aircraft, Defense & Space business profit was good in Q1. Could you let me know how much foreign exchange impact there was in this segment? Also, was there any contribution to segment business profit from revenue increases and/or margin improvements in Defense?

**Kozawa**: There was around positive ¥3 billion in YoY foreign exchange impact in Commercial Aviation. While there was some foreign exchange impact in Q1 FY2023 as well, compared to then, revenue and production volumes recovered slightly in Q1 FY2024, which helped to improve profit margins. Regarding Defense, although I cannot provide exact profit figures, there was positive impact from revenue growth and slight YoY improvements in profit margins.

**Q**: When it comes to YoY profitability improvements in Aircraft, Defense & Space, which made a larger contribution, Commercial Aviation or Defense?

**Kozawa**: In terms of monetary amount, Defense made a larger contribution due to its higher revenue.

**Q**: In Commercial Aviation, there have been reports about Boeing increasing their production plan in terms of units to be manufactured, but is the situation with your deliveries to Boeing better than originally expected?

**Kozawa**: We shipped nine units (sets) of Boeing 787 main wings in Q1. We shipped four units in July, so the production rate is slightly higher now compared to Q1. In terms of our current forecast, the rate might increase a bit more than we had initially anticipated at the beginning of the fiscal year. If the rate increases to five or six units per month, there could be upside.

**Q**: Can we understand that the nine units of Boeing 787 delivered in Q1 were the result of a slightly stronger situation as well?

**Kozawa**: Due to no fault of our own, there were some issues that forced us to limit shipments in Q1, so the unit deliveries figure was actually slightly below our initial expectations.

**Questioner 2**

**Q**: Regarding background or trends behind the very strong order intake in Gas Turbine Combined Cycle (GTCC) in the US, I believe that there were a variety of factors at play, including power demand for data centers and semiconductor factories, increased power demand in the Western and Southern US, and the replacement of coal-fired thermal power plants in the Midwest. Could you share your insights on the background of this strong order intake performance and your expectations going forward?

**Kozawa**: First off, the projects that we booked during these three months were not related to data centers. The projects booked in Q1 were those for which we had already received informal orders several months before, and which progressed to the contract signing phase. The fact that these projects moved smoothly from informal orders to contract execution without significant delays can be attributed to rising expectations that power demand will increase in the future, as well as the intention of power companies to prepare for this anticipated demand growth. Moreover, and this is not limited to the orders we received in Q1, there has been a significant increase in inquiries and for gas turbines, including situations where the customer is concerned about the timing of delivery.

**Q**: Even though order intake in Defense was down YoY, it was still exceptionally high in Q1, and it seems progress was good even versus the full-year plan. Some other companies have raised their Defense guidance, and considering MHI’s Q1 results, do you anticipate any changes in your full-year outlook?

**Kozawa**: Regarding the full-year outlook, it ultimately depends on which projects we will be able to book by the end of the fiscal year. That said, we do see potential upside in Defense compared to our initial forecast.

**Q**: Could I ask you for MHI's thoughts on the reports that the Japanese government will sell missiles to the US government?.

**Kozawa**: My understanding is that there were reports that PATRIOT surface-to-air missiles owned by the Japan Ministry of Defense will be transferred to the US. We are not involved in this, so we do not have detailed information on the situation. Therefore, we also do not know if this will impact us in the future.

**Questioner 3**

**Q**: Regarding GTCC, you mentioned order intake is strong in the US, but the financial results presentation refers to the "Americas," so was the booking of large projects in countries other than the US also included in this? Order intake in Steam Power also increased, so could you let us know about the projects you have booked in this business and provide some background on them?

**Kozawa**: GTCC order intake in the Americas includes projects in countries other than the US, such as an undisclosed country in South America, and another country in North America. As for Steam Power, we booked a substantial rehabilitation project, which significantly contributed to the order volume in Q1. However, this volume of order intake is unlikely to continue.

**Q**: Some time ago, there was talk about MHI booking orders for hydrogen production hub projects in the US. Should we expect any orders related to MHI's participation in the larger of these projects?

**Kozawa**: You do not need to include these projects in order intake assumptions for this fiscal year. In any event, we have not included them in our forecast.

**Q**: Could you let us know about business profit in each sub-segment within Logistics, Thermal & Drive Systems? Regarding Forklifts, I believe there was impact from the suspension of engine shipments. In Turbochargers, have deliveries not have met expectations due to volatility in production numbers?

**Kozawa**: Turbocharges underperformed versus our expectations. A disruption in production and additional costs related to the bankruptcy of a supplier had a negative impact on profit amounting to several billions of yen. In the Forklifts business, unit deliveries decreased, which caused a drop in operating profit at Mitsubishi Logisnext. However, Mitsubishi Logisnext recorded gains from the sale of fixed assets, which are included in our business profit figures. Therefore, within our Logistics Systems (Forklifts) business, we maintained the same profit level as the previous fiscal year or even achieved a slight

YoY increase. Regarding Heating, Ventilation & Air Conditioning (HVAC), there was a decrease in the number of units sold in Europe. In the Engines business, my impression is that profit was slightly down YoY, but this was not a significant change.

**Questioner 4**

**Q**: Regarding the number of gas turbine units booked by your Chinese licensee, seven units were booked in Q1 FY2023, but zero were booked in Q1 FY2024. Could you provide some background on this?

**Kozawa**: If they are unable to book any orders after six or nine months, I will be concerned. However, this is only the result of the first three months of this fiscal year, and I believe it depends on how the projects on their side are progressing. In the case of the gas turbines sold by our licensee, we manufacture the core components and supply them to the licensee. Since our production schedule is quite full at the moment, there could be scheduling conflicts causing delays in orders. This includes some guessing on my part, so we will monitor the situation closely going forward.

**Questioner 5**

**Q**: You mentioned that there may be no need to use the risk buffer if things go well in Q2 and beyond. Could you provide an update on the one-time expenses in the Thermal Power businesses that emerged in the second half of FY2023, as well as the status of the Integrated coal Gasification Combined Cycle (IGCC) plants?

**Kozawa**: There are currently no new developments that would cause one-time expenses. Regarding IGCC, extensive corrective work has been completed, and both plants are now in operation. It is difficult to predict whether there will be any one-time expenses during the full fiscal year. Since only three months have passed so far, and we have nine months left, I believe we still need to expect a certain amount risk.

**Q**: Losses in the Others, Corporate & Eliminations item (-¥12.8 billion) significantly increased YoY. Could you provide some background information, such as whether anything unplanned contributed to this?

**Kozawa**: No unplanned items contributed to the losses in Others, Corporate & Eliminations, but the impact from gains on asset sales is included in this item. On the Profit Bridge slide (Q1 FY2024 Financial Results, P9) we reported a YoY impact of negative ¥3 billion from changes in gains on asset sales. Breaking this down by segment, there was negative ¥6 billion in Others, Corporate & Eliminations and positive ¥3 billion in Logistics, Thermal & Drive Systems. Therefore, a significant part of the negative ¥7.3 billion YoY change in Others, Corporate & Eliminations business profit is explained by changes in gains on fixed asset sales. Furthermore, investments have increased slightly YoY in our electrification business – one of our future growth areas – which is included in the Others category.

**Q**: During Q1, you withdrew from the newspaper printing press business. Will there be more business portfolio restructuring during the current medium-term business plan?

**Kozawa**: Yes, we are planning for more actions in this regard. We are currently considering various options.

**Questioner 6**

**Q**: Regarding the balance sheet, interest-bearing debt increased by ¥300 billion from the end of FY2023. How much of this increase was due to the depreciation of the yen?

**Kozawa**: Because we have very little foreign currency-denominated debt, foreign exchange impact on interest-bearing debt is negligible. Looking at the YoY changes to the balance sheet, the gross increase in cash and cash equivalents was ¥148 billion, which when excluding the effect of exchange rates was just under ¥140 billion. Moreover, inventories increased by over ¥100 billion. These two factors account for most of the increase in interest-bearing debt.

**Q**: Are you not increasing borrowings to spend on future growth investments?

**Kozawa**: In general, we tend to have negative free cash flow in Q1. This typically results in an increase in borrowings, and most of this is managed through commercial paper and other short-term debt.

**Q**: You mentioned that GTCC is performing strongly and the production schedule is full. Considering your current production capacity, do you foresee the need for additional capital investments? If revenue were to exceed the plan in this business, would there be any issues on the production side?

**Kozawa**: We have been making investments to increase production in a systematic fashion. That said, production capacity is not something that we can address with internal capital expenditures alone; we also need to enhance the capacity of the entire supply chain. Additionally, even if we do make capital investments, it takes years to see an increase in actual production output. Therefore, at the moment, instead of focusing on investments in the immediate future, we are covering the increase in production volume by extending operating hours and improving efficiency to reduce lead times.

**Q**: Is there no need to worry about production capacity issues?

**Kozawa**: We do not book orders that exceed our production capacity. Gas turbines are not produced and shipped immediately upon receipt of orders. We accept orders that fit within our production capacity and schedule. If we anticipate being busy over the medium to long term, we will make investments to increase production capacity.

**Q**: Will there be any impact from the decision not to approve the restart of Japan Atomic Power Company's Tsuruga Nuclear Power Plant Unit 2?

**Kozawa**: If restart approval had been granted, we would likely have received orders for related work. Going forward, we will respond based on Japan Atomic Power's subsequent decisions and actions. Moreover, the Japan Nuclear Regulation Authority's decision was specific to Tsuruga Unit 2, and we do not anticipate any impact on other nuclear power plants or projects.

**Questioner 7**

**Q**: How much did Q1 business profit exceed your internal expectations?

**Kozawa**: My impression is that business profit exceeded our expectations by around ¥10 billion. Approximately ¥6 billion of this upside was due to the depreciation of the yen beyond our JPY/USD exchange rate assumption of ¥145. The remaining ¥4 billion represents the net increase in underlying profit, but opinions may differ on whether this was simply due to timing factors, and I believe that timing had a significant impact. Particularly in the Energy Systems segment, many relatively high-margin projects were included in Q1, so I do not think this situation will continue.

**Q**: My impression is that Aircraft, Defense & Space has exceeded expectations. What are your thoughts?

**Kozawa**: Aircraft, Defense & Space indeed exceeded expectations in Q1 on its own. The favorable impact of foreign exchange rates I mentioned earlier includes not only Energy Systems but also Aircraft, Defense & Space and other areas, and is based on the average rates used for revenue recognition.

**Q**: There was a spread between business profit and pre-tax profit of around positive ¥20 billion Q1. In your full-year forecast, this spread is projected to be negative ¥20 billion. Based on the current situation, from now through Q4, do you expect the spread between business profit and pre-tax profit to be negative ¥20 billion?

**Kozawa**: The favorable spread in Q1 was largely due to the impact of the exchange rate at the end of the period. If we adjust to the current exchange rate of around ¥145/USD, much of this benefit disappears, and approximately ¥15 billion of the positive spread below business profit goes away. Going forward, considering that other finance costs will be recognized, and given the current exchange rate situation, I do not have a particularly positive outlook on this issue, although it is uncertain whether the spread will reach negative ¥20 billion by the end of the fiscal year.

**Q**: Gas turbine order intake is increasing, but is the exchange rate a tailwind for these orders? Also, is political instability in your end-users' regions a risk factor?

**Kozawa**: Because we are not booking orders assuming an exchange rate of ¥160/USD, my understanding is that foreign exchange effects are not inflating our order intake results. Also, while I cannot say that there is no country risk, we are handling our projects with extreme caution.

**Questioner 8**

**Q**: I would like to ask about the sustainability of the strong order intake in GTCC. You mentioned that projects booked recently are not related to data centers, but do you have visibility as to whether GTCC or Nuclear Power will be involved in data centers? Furthermore, if you start booking orders related to data centers, should we expect order intake to increase even more?

**Kozawa**: We believe it to be a fact that power demand is significantly stronger than previously forecast. In Japan, the most recent Strategic Energy Plan assumed that energy savings would reduce power demand, but lately power demand has been increasing. Power demand is significantly increasing outside of Japan as well, potentially driven by such factors as the spread of electric vehicles (EVs). Consequently, securing power sources is becoming a critical issue. While increasing renewable energy is definitely part of the solution, there is the challenge of how to cover the variability of renewable energy output, and there is growing demand for stable, uninterrupted power supplies in a variety of regions. Data centers are a typical example of what is driving this demand. Within this context, gas turbines and nuclear energy have emerged as realistic and effective options to solve this issue. On the other hand, in the case of nuclear energy, it can take nearly 10 years for a new plant to reach completion and start generating power. Therefore, I feel that gas turbines are in high demand as a short-term solution to secure stable power supplies. It is difficult to predict how long this demand will last, but we have seen an increase in inquiries, and I believe that this situation is likely to continue for some time. However, due to capacity constraints, order intake and revenue will likely grow only gradually.

**Q**: Order backlog in Energy Systems is very large. How many years' worth of backlog do you have in GTCC?

**Kozawa**: Allow me to refrain from speaking about our production schedule in this setting. However, I will say that the backlog has been increasing not only due to the booking of new installation projects but also from long-term maintenance and service contracts. Therefore, it is not easy to express the backlog purely in terms of years.

**Q**: Considering the recent increase in GTCC order backlog, I imagine that revenue will grow in the future. Should we expect a gradual improvement in profitability as well due to experience curve effects, or should we anticipate a mix of both high- and low-margin projects?

**Kozawa**: Profitability in the GTCC business as a whole will be influenced by the balance between new installations and the service business. However, new installations are expected to yield better margins than in the past. As the services portion will gradually increase in volume going forward, we anticipate a gradual improvement in margins over the medium term.

**Q**: Among the possible power sources for data centers, it seems that there is a preference for nuclear energy in markets outside Japan, and I believe that demand for nuclear power, including small modular reactors (SMRs), will increase overseas. If this were to be the case, would there be any opportunity for MHI? Also, can we expect orders for data center-related large scale nuclear power projects in Europe and the US, such as for steam generators?

**Kozawa**: If the construction of pressurized water reactors (PWRs), particularly in Europe, moves forward, we can expect to receive orders for some of those components. We have manufactured steam generators for the French market for a long time, and we expect this to continue. That said, the monetary amount of this business is not large. SMRs are receiving a lot of attention, and several companies are working to commercialize this technology, but my impression is that progress has been slower than anticipated.

**Note regarding forward looking statements:**

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