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Major questions and answers for the explanatory meeting for business results for the fourth quarter ended March 31, 2023 and medium-term management plan

Date:	Wednesday, April 26, 2023, 17:00-18:30	
Participants:	Masafumi Senzaki	President and Executive Officer, COO
	Keiichiro Shiojima	Vice President and Executive Officer, CFO
	Hidehiko Matsui	Vice President and Executive Officer, CMO
	Eiji Fukunishi	Vice President and Executive Officer, President of Spare Parts & Service Business Unit
	Tooru Sugiyama	Executive Officer, Vice President of Mining Business Unit
	Tatsuya Kubo	President of Corporate Brand & Communications Group

※Some excerpts are included in this report.

＜Business Results＞

1. Market Environments and Earnings Forecast

Q: While you are forecasting record earnings in FY2023, following FY2022, you expect overall global demand in FY2023 to decrease year on year. Is it correct to understand that, while demand will decrease, you will be able to grow by expanding the value chain business and Americas business?

A: Senzaki: It is as you understand. In addition to the potential of the Americas business, we have yet to build up our dealers' inventory in Europe. The resilience of sales is factored into the FY2023 earnings forecast.

Q: What is the current status of business with respect to Russia/CIS?
In FY2023, you are forecasting a year-on-year decrease in revenue from Russia/CIS, but is this due to the impact of foreign exchange rates?

A: Shiojima: As we have reported in the past, we only provide parts & services business to Russia in accordance with laws and regulations. Most of the Russia/CIS revenue (¥30.9 billion) in FY2023 will be from Kazakhstan and other CIS countries, and revenue from Russia will be slightly more than ¥7.0 billion. In FY2023, the only region where revenue will decline on a local currency basis is Russia/CIS.

Q: Why is the growth rate of Africa's revenue in FY2023 so large? Mining revenue from Europe, Africa, and the Middle East is almost flat.

A: Sugiyama: The increase in Africa revenue (+¥11.0 billion year on year) is largely due to mining, with a large order in Zambia contributing to the increase. The weak growth in mining revenue for Europe, Africa, and the Middle East is due to the inclusion of a wide range of countries. Specifically, we expect a decline in Russia/CIS. Kazakhstan is firm, but shipments to Russia have been suspended in accordance with laws and regulations.

2. The Americas Business

Q: What is included in the Americas revenue other than developing own business? The revenue forecast for FY2023 seems incongruous with North America's revenue increase yet Latin America's revenue decrease; why is this?

A: Shiojima: Revenue other than developing own business is OEM sales to Deere. The joint venture with Deere was amicably terminated, and we continue OEM supply.
The revenue forecast for FY2023 includes the impact of lower revenue due to the strong yen. In North America, foreign exchange impact is expected to be -¥15.9 billion year on year. In Latin America, foreign exchange impact is expected to be -¥1.9 billion year on year, resulting in a real increase in revenue on a local currency basis.

Q: Regarding the revenue forecast for FY2023, you previously explained that OEM sales to Deere would gradually decrease. On the other hand, OEM sales to Deere in FY2023 are expected to increase year on year. Could you tell us again about the outlook for OEM sales to Deere?

A: Shiojima: Over the longer span of time, since we will continue to supply only current models to Deere, the outlook remains the same whereby OEM sales to Deere will decrease in line with model changes. However, at present, we have not received any request from Deere to reduce supply.

Q: Based on my estimates from the material, it appears that compact and construction revenue, which is developed independently in North America, will increase by only about 10% in FY2023 year on year. I believe it should increase more. Is this a conservative forecast? Is it reasonable in light of the demand environment?

A：Shiojima: The impact of the strong yen is significant, and we have factored in an overall revenue increase of about 20% year on year, excluding the impact of exchange rates, for developing own business in North America in FY2023. While the situation remains firm, the previous year saw a buildup of parts inventories by dealers, which is expected to slow down. In new machinery sales, further inventory buildup is expected due to the launch of a finance company offering floor plans, etc.

Q: What is the scope for growth in compact and construction sales in North America's developing own business in FY2023? Do we need to worry about parts sales falling?

A : Shiojima: Excluding the impact of foreign exchange rates, we expects an increase of more than 10%. We are feeling a positive response locally, and there is no sign of a decline in orders.

A: Matsui: Orders from dealers remain strong. Dealers' inventories have not yet been fully built up. In particular, new machinery still needs to be supplied.

3. Selling Price and Increase in Cost

Q: What is your future policy regarding price increases? Do you feel the need to raise prices further, and have you factored in further price increases in your forecast for FY2023?

A: Matsui: Since the previous fiscal year, we have been working to pass on higher material costs to the selling price. In terms of material costs alone, we expect to recover the cumulative cost increase in the current fiscal year. However, if shipping and other freight costs are included, we recognize that we have not yet recovered the full amount. Due to the backlog of orders and other factors, not all of the 8% price increase will be realized in FY2023, but, as announced in the release, the 8% price increase will be implemented one after the other.

Q: A simple division of the FY2023 selling price change (by companywide revenue) yields a figure of about 2.6%. Although there appear to be backlogs of orders and products not subject to price increases, there is a large discrepancy from the announced 8% price increases. Are the year-on-year changes in the selling price of ¥34.2 billion in FY2023 conservative? Do you expect an even higher figure internally?

A: Shiojima: There is a time lag in the realization of price increases. Price increases will be mainly for new machinery, and we have factored in highly reliable figures accumulated from group companies. The focus is on Japan, the Americas, and Europe, but, on the other hand, it will be difficult to raise prices in China.

Q: Even if you achieve an 8% price increase in the main region, it would still amount to about ¥34.2 billion.

A : Shiojima: In that sense, I see it as a solid prospect.

Q: How much are the shipping and other freight costs among "Comparison of consolidated income"? Is the FY2023 forecast positive year on year? Material costs are expected to be quite high in FY2023, but what specific materials are driving up costs?

A: Shiojima: Shipping and other freight costs for FY2022 were expected to be -¥15.0 billion year on year in Q3, but actually settled at around -¥12.0 billion year on year. Containership costs have settled down, but costs for RORO ships remain high due to space constraints, especially for routes from Japan to Europe. We have factored in shipping and other freight costs of -¥4.6 billion year on year in our forecast for FY2023. The increase in material costs was almost in line with the Q3 plan. However, we expect that the cost will continue to remain high in the future. A major factor is the increase in fuel costs. As a result, domestic suppliers are strongly requesting price increases. In FY2023, we plan to increase material costs in light of this situation.

Q: Can the price increases cover all the cost increases, including those in FY2023?

A: Shiojima: Yes. At this point, we are forecasting a ¥34.2 billion year-on-year increase in selling price, but we intend to further increase the price while seeking the understanding of our customers. The price increases to date have covered the increase in material costs to some extent, but have not yet covered the increase in shipping and other freight costs. We would like to cover the cost increase by introducing new models and raising prices further.

A: Kubo: The 8% price increase will not all be realized in the current fiscal year, and some of the increases will cross over from one year to the next. The timing of the price increase will vary by region as new models are introduced, and in some regions it will be difficult to raise prices. If we only look at new machinery sales, price increase is progressing at about 5%. We will continue to promote price increases with the goal of raising prices by 8%.

Q: From April 2024, overtime caps will be applied in the transportation and construction industries. How do you think suppliers and others will be affected by the reform of work styles, such as difficulty in securing human resources and increased costs?

A: Senzaki: The steel price increase has calmed down, but demand for price increases is intensifying for other products. Rising energy costs are another pressing issue and the next issue is labor costs. It is important to secure human capital domestically and globally, including suppliers. We need to respond to this issue through self-help efforts to the extent possible. We would like to pass on to selling price any cost increases that we cannot handle on our own.

＜Medium-term Management Plan＞

Q: This is a challenging figure with respect to the 13% adjusted operating income margin target in the medium-term management plan. What are the drivers of improvement? Also, what is your approach to capital allocation?

A : Senzaki: The drivers will be the Americas business, value chain, and mining. In this medium-term management plan, the focus is particularly on the Americas business. We will make a solid profit in the Americas and hold up the value chain business as a banner for solution provider. If we cannot provide solutions, we will not be able to increase our presence in the Americas. The company is already providing support for dealers in the form of agile development support tools. With the keywords of the Americas business, value chain, and mining, we aim to achieve an adjusted operating income margin of 13%.

A: Shiojima: Regarding the capital allocation approach, 1/3 of operating cash flow will be used for maintenance and strengthening investments, 1/3 for prior investments such as DX investments, and 1/3 for shareholder returns and debt payment of interest-bearing debt to maintain financial soundness.

The consolidated dividend payout ratio was previously “30% or more,” but, under the new medium-term management plan, we have raised the target to “stable and continuous implementation with a consolidated dividend payout ratio of 30% to 40%.”

A: Kubo: The capital allocation approach is described on P.45*2 of the presentation materials.

Q: The new medium-term management plan does not set a revenue target, but can the adjusted operating income margin target of 13% be achieved on the assumption that revenue will increase to some extent? Or can it be achieved only by improving the mix?

A : Senzaki: The demand environment in the medium-term management plan is based on the assumption that it will remain the same as it is now. However, the demand environment has changed significantly, and, even in this environment, we are required to increase profitability. Regarding the revenue target, since the Americas business is a big challenge for us, we have included growth potential by setting a target to increase revenue of the Americas business to more than ¥300.0 billion through own business development.

Q: Please tell us about initiatives to reduce environmental impact. To incorporate non-financial targets into financials, Scope 3 reduction targets would be more realistic if there were numerical targets for electrified products, AHS, ICT construction machinery, and so on. Please tell us a little more about this.

A：Senzaki: First, we are considering expanding our lineup of electrified construction machinery. This is already underway in Europe, and development will proceed outside of Europe as well, depending on market needs. However, since there is no demand in emerging countries, it will be necessary to respond with a mix of fuel efficiency improvements and other factors.

A：Sugiyama: AHS is being developed at a coal mine in Australia, and its accuracy is improving considerably. It is now capable of running a mix of manned and unmanned machinery, and we will promote its commercialization as soon as possible. In the future, we hope to expand sales worldwide. In terms of electrification, we have already sold a cable-type mining excavator. A fully battery dump truck is also under development, and we hope to take on a variety of challenges during the new medium-term management plan period.

A: Kubo: The POC of the fully battery dump truck will begin to be introduced by the end of FY2023. Electrified products for compact machinery will be developed to reduce cost. A fuel cell and hydrogen fuel engine drive will be developed for over 20 tons.

Q: Compared to the past medium-term management plans and previous Hitachi Construction Machinery, what would you like to emphasize as having changed, and what would you like to focus on differently?

A：Senzaki: The current medium-term management plan puts solution provider at the forefront. The keywords are “succession and evolution.” In the Americas business, we will continue our efforts that we have made so far, and we will properly enter the doors that have been opened. The value chain business has achieved great results, and we would like to further expand its scope. We will provide solutions based on these businesses. Our strength is our 70-year history of carefully manufacturing machinery. We provide solutions by combining hardware and software to meet customers’ needs, such as productivity, safety improvement, and life cycle cost reduction. We hope to reach a certain goal in the current medium-term management plan. Human capital will continue to be important. The key to this medium-term management plan is to firmly develop human capital as a global company.

Q: How much cash flow do you aim to obtain over the next three years? It is difficult to maintain an operating cash flow margin ratio of 10%. There is the idea of using people, goods, and money without lowering the D/E ratio.

A : Shiojima: The target operating cash flow margin ratio is a statement of our intention to earn the source of R&D and capital investment. Although it will be difficult to maintain an operating cash flow margin ratio of 10%, we will maintain it exactly this fiscal year to secure an operating cash flow of about ¥130.0 billion. This will continue for the next three years. Previously, we planned to allocate 1/3 of the operating cash flow to debt reduction, but we have increased the amount to investment in the growth phase.