Chief Financial Officer

CFO Message

We will take a new step forward, ensuring a balanced allocation among high-growth potential, financial stability, and shareholder returns.

Vice President and Executive Officer, Director
CFO, President of Financial Strategy Group
Hitachi Construction Machinery Co., Ltd.
Keiichiro Shiojima

[Key Strategies for Capital Allocation]

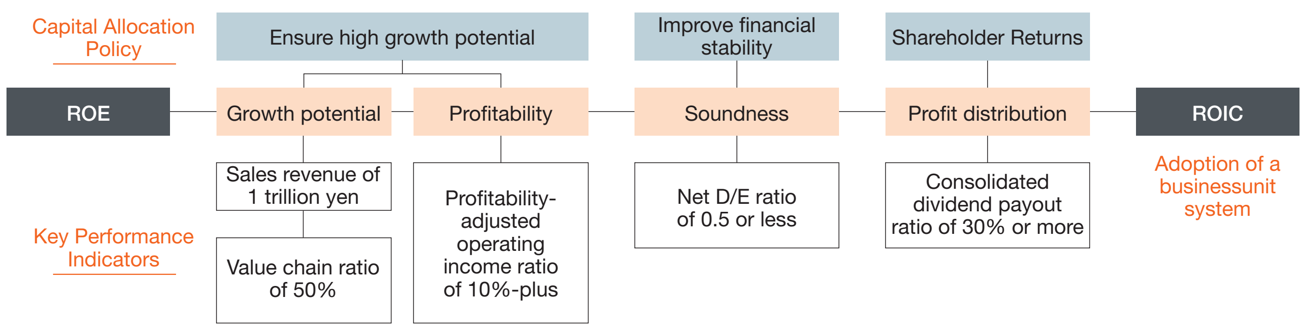
Aiming to Increase Corporate Value Through Balanced Allocation to Growth Potential, Financial Stability, and Shareholder Returns

In fiscal 2021, two major events impacted group management. The first was the dissolution of our long-standing joint venture with Deere & Company of the U.S., and the start of restructuring and independent development of our business throughout North, Central, and South America. In conjunction with this development, we intend to invest aggressively over the next three years to expand our product lineup and engage in new research and development. The second event was the reduced shareholding of Hitachi, Ltd. in our company and our welcoming new partners. We recognize that we are now in a situation in which we should maintain and improve our credit rating by executing a well-balanced allocation of funds in line with our basic policy of securing high growth potential, improving financial stability, and returning profits to shareholders.

No changes have been made to the KPIs defined in our medium-term management plan, Realizing Tomorrow's Opportunities 2022, which began in fiscal 2020. However, in fiscal 2022, we began a review of our existing organizational structure by function and introduced a business unit system that integrates design, manufacturing, sales, and services by product. In transitioning to this structure, we evaluated the profitability, soundness, and stability of each business unit. As well, we have recently implemented ROIC management, which considers the fixed assets and working capital of each business unit to be invested capital.

Our guideline for R&D investment has been 3% of sales revenues, and we invested 2.5% of sales revenues in R&D in fiscal 2021. We expect this level to increase in the future. But as we plan to increase top-line revenues, R&D investment is likely to be slightly above 3% for the time being. We also believe there is room to consider revising the guidelines and indicators in the next medium-term management plan.

Emphasizing Capital Efficiency and Engaging in Cash Flow Management



[Financial Activities for Fiscal 2021 and the Challenges Ahead]

Cash Flow Management Emphasizing Capital Efficiency

In terms of financial performance in fiscal 2021, we achieved group revenue of 1 trillion yen, and we believe market conditions have clearly recovered from the impact of COVID-19. In terms of earnings, we recorded an extraordinary gain from the dissolution of the joint venture with Deere in the second quarter. Since then, we improved profit margins in real terms, including gains from plant operations. As a result, we achieved a double-digit adjusted operating income ratio in the fourth quarter. With respect to cash flow, working capital, largely compressed in the previous fiscal year, expanded due to increased production for the North, Central, and South American markets.

As we seek to expand markets in fiscal 2022, we will again focus on cash flow. Controlling working capital in a stable manner will be an important issue. Since financing is the mainstream method of sales in the North, Central, and South American markets, we intend to use off-balance sheet arrangements for asset growth. Our efforts here will include collaboration with ITOCHU Corporation as a financing partner to avoid a large financial impact as sales expand.

Current issues include increased procurement risk due to the Shanghai lockdowns and other factors. In addition, logistics disruptions have resulted in a significant increase in balances related to inventory in progress and inventory awaiting shipment. Controlling these intermediate inventories has been an issue for the group for some time, and this issue will become even more important during our market expansion phase. Here, we intend to increase the precision of our order projection system and engage in detailed inventory optimization. The dissolution of the parent-subsidiary public listing relationship with Hitachi, Ltd. has also increased the importance of cash management, and we will focus our efforts on cash-efficient management.

[Business Unit System and ESG Management]

Expanding ESG Investment From a Medium- to Long-Term Perspective and Measures to Stabilize Earnings Further

Currently, we are transitioning to a business unit system. There are several objectives for this transition, but from a financial perspective, we believe it will contribute to improving profits. Two important factors in improving profits are raising the marginal profit ratio and controlling fixed costs. We are already working on controlling fixed costs, and when market conditions faltered during the COVID-19 pandemic in fiscal 2020, we applied the brakes sharply to fixed costs, saving about 17 billion yen on a consolidated basis and about 12 billion yen on a non-consolidated basis. At the same time, we believe there is still room for improvement in marginal profit ratio. As products become more diversified and multifunctional, costs tend to balloon. However, by adopting a business unit system, we can examine the marginal profit ratio closely and take measures as appropriate, such as product consolidation. We also believe that this transition will strengthen our marketing function, while we expect a positive impact on profits as we develop high-margin products that incorporate customer needs to a higher degree than ever before.

Since fiscal 2020, we have been assessing risks and opportunities related to climate change, attempting to quantify financial impacts. If we do not reduce CO_2 emissions, costs such as the depreciation of renewable energy facilities or carbon tax burdens will increase. These amounts will not be minor, and we have assessed several items as having an impact exceeding 0.5% of revenue. Based on these results, the Capex Committee established an investment framework for carbon neutrality. The committee is currently reviewing capital and R&D investment projects, prioritizing these projects over others. We are also considering the issuance of Green Bonds to finance these investments.

[Shareholder Returns]

The Future of Our Group With New Partners and a Unique Growth Strategy

We paid a 110-yen dividend for fiscal 2021, which was a record-high for the company. Our dividend payout ratio returned 31%. For the time being, it is essential that we invest aggressively in growth and maintain financial soundness. In this way, we will continue aiming for a consolidated dividend payout ratio of 30% or more for the foreseeable future. Eventually, we hope to find opportunities for higher levels of shareholder returns.

We believe that one of the main concerns of shareholders and investors who invest in our company is weighted average cost of capital (WACC*). As stock prices in the construction machinery industry fluctuate widely, WACC values are inevitably high. Therefore, we established a consolidated ROIC target of 9% or higher.

Going forward, we will continue to uphold the Hitachi brand, even as we begin working with new partners, Japan Industrial Partners, Inc. and ITOCHU Corporation. We will accelerate our management strategy, including the independent development of North, Central and South America businesses. At the same time, we will strengthen our value chain business, aiming for even greater growth.

I ask you, our shareholders, to look forward to the future of the Hitachi Construction Machinery Group.

*WACC: Weighted Average Cost of Capital. Ratio of cost required to raise funds.