CFO Message

A Letter from the Chief Financial Officer

While aligning environmental measures with business strategies, we are capturing new market opportunities and enhancing corporate value

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Review of Fiscal 2023

In fiscal 2023, the period ended March 31, 2023, Hitachi Construction Machinery faced significant challenges. At the start of the fiscal year, the lockdowns in Shanghai halted the supply of resin components and sheets, tanks and other items. Disruptions in the supply chain led to shortages of semiconductors and engine parts. Facing these challenges head on, while coordinating with suppliers and making internal adjustments, Hitachi Construction Machinery managed to maintain production and supply on an unprecedented scale for the fiscal year, meeting robust demand.

Despite soaring material costs and rising transportation expenses overseas, Hitachi Construction Machinery brought new machinery models to market at the right time and covered the increased costs with added value pricing strategies. Furthermore, we made smoother-than-anticipated progress on independent expansion in the Americas, a priority measure that commenced in March 2022. Coupled with higher sales in the mining and value chain businesses, as well as the depreciation of the yen, sales revenue increased 25% year on year to ¥1,279.5 billion in fiscal 2023, while adjusted operating income grew 45% to ¥135.7 billion, both setting new record highs.

With fiscal 2023 being the final year of the previous medium-term management plan, management decided to address current points of concern, such as revisions to the pension system, and make a fresh start with the new medium-term management plan.

We achieved the financial targets of our previous management plan, attaining an adjusted operating income margin of 10.6% versus the target of at least 10%, and an ROE of 11.0% versus the target of over 10%.

Unfortunately, cash flow deteriorated due to an increase in working capital associated with a surge in volume. As a result, the net D/E ratio ended up at 0.6, missing our target of 0.5 or lower. Management will prioritize efforts to improve cash flow and rectify this issue on the balance sheet.

Changes in Capital Structure and Subsequent Joint Business Expansion

There were two significant changes in fiscal 2023, comprising independent expansion in the Americas and a change in the principal shareholder, where Hitachi Construction Machinery became independent of the Hitachi Group and welcomed Japan Industrial Partners, Inc. and ITOCHU Corporation as new shareholders.

When we belonged to the Hitachi Group, we benefited from a cash pooling system that gave access to open-ended transfers of funds, which was quite useful. However, with proactive financing from Japanese banks and other banks that we do business with, Hitachi Construction Machinery was able to quickly refinance its borrowings. Ratings agencies also gave high marks for Hitachi Construction Machinery as a newly independent company. We feel both of these changes were viewed by investors in a positive light.

As our first round of collaboration after the capital tie-up with ITOCHU Corporation, we established a finance joint venture in North America to handle construction machinery sales financing.

In North America, dealers are the main sales channel, and payments for construction machinery are often split up and paid in installments over a long period. Construction machinery manufacturers must be able to offer dealers and customers quick credit checks and competitive financing options tailored to their needs.

Specifically, we offer a retail financing menu that packages together residual value leases and after-sales services, as well as a rent-to-purchase program wherein new vehicles are initially offered on a rental basis that, after a certain period, switches over to a sales transaction, with the amount of total rental payments deducted from the vehicle sales price. These are part of our floor plan financing options designed to help dealers maintain inventories.

Minimizing accounts receivable that could otherwise grow larger in step with increasing sales volume offers the biggest financial benefit of all, namely the ability to utilize funds for other investment opportunities.

Financial Strategy for Independent Expansion in the Americas

One of our first investments in the Americas business is for reinforcing the structure at Hitachi Construction Machinery Americas. With a focus on sales and service departments, we plan to increase the number of employees from 160 as of March 2023 to 240 by March 2024 in order to precisely home in on market needs across North, Central and South America. In addition, our Atlanta headquarters was expanded with new training facilities and a Command Center to support the ConSite service solution. Hitachi Construction Machinery is also anticipating investment aimed at expanding the mining business through the establishment of a support center and the strengthening of its parts remanufacturing factory as well as the parts supply system as a whole.

While our intention is to fund these planned investments primarily with operating cash flow, we are also in a growth phase under the current medium-term management plan. If the need arises for an unplanned large-scale M&A deal, management will be keen to pursue the deal, even if it means increasing borrowings. Please note that our new medium-term management plan, which covers the period up to fiscal 2025, does not take into account the construction of the new full knock-down production base in the Americas.

The company's domestic plants are currently operating at full capacity. As there is spare capacity at our Chinese plants, we will shift production of some small- and mid-size products to China. The freed up production capacity in Japan will then be redirected towards expanding production for the Americas. Management assumes domestic plants will help supply operations in the Americas until our sales revenue target of ¥300 billion is achieved through independent expansion in the region.

Furthermore, if Hitachi Construction Machinery were to construct a new plant in the Atlanta vicinity, costs would likely increase because products headed for the West Coast would have to cross the Rocky Mountains. Mirroring the strategy with our Oosterhout plant in the Netherlands, management is considering a scenario where the machinery bodies are supplied from Japan and small-scale plants on the East and West coasts handle only assembly.

Financial Strategy under New Medium-term Management Plan

During the course of the new medium-term management plan, Hitachi Construction Machinery plans to invest ¥400 billion in total in the Group. Of this amount, approximately ¥100 billion will be allocated to investments in the Americas, including for the purchase of operating assets for rent to customers. Because management anticipates a need for large-scale investments in growth under the new medium-term management plan to support the expansion of the Americas business, which is in a growth phase, as well as the mining business and the value chain business, we will place emphasis on our cash generation capabilities, for example by improving operating cash flow, with the aim of securing funds for reinvestment.

First, the company aims to increase FFO (operating cash flow before working capital adjustments) by expanding its Americas, mining, and value chain businesses.

Also, to demonstrate capital efficiency improvement and growth-oriented management both internally and externally, the company has set quantitative targets for the EBITDA margin, operating cash flow margin and ROIC in the new medium-term management plan.

On the other hand, as the scale of business expands, Hitachi Construction Machinery needs to control the bloating of working capital that can result from growth in accounts receivable and inventories. The company plans to closely monitor regional demand trends and order backlogs while meticulously keeping inventory at appropriate levels at each Group company. Through these efforts, we aim to improve the cash conversion cycle (CCC) without letting debt increase that easily, with the intention of effectively generating and reinvesting cash.

By rapidly securing cash this way, management aims to improve profit margins and capital efficiency. Ultimately, this will eventually lead to better returns for shareholders.

Regarding the dividend payout ratio, the company has set a target for stable and consistent payouts in the 30% to 40% range, and management will deliberately work to improve the dividend payout ratio in stages during the course of the new medium-term management plan.

Under its new medium-term management plan, the Hitachi Construction Machinery Group will focus on the development of environmentally friendly products, such as electric excavators and fully electric dump trucks. On the other hand, by leveraging ConSite to maintain and extend the service life of machinery and by offering units for rental as well as for sale as used vehicles, Hitachi Construction Machinery aims to continuously earn revenue while tracking the condition of construction machinery until it is decommissioned. This value chain will in itself contribute to a circular economy and help the global environment. The vision of Hitachi Construction Machinery Group entails aligning business strategy with environmental measures, seizing upon new market opportunities and increasing corporate value.