

Management's Discussion and Analysis

Basic policy on compliance

The HCM Group defines compliance as understanding of the codes of conduct and taking actions with a high degree of ethics, honesty and fairness, in addition to observing laws.

The HCM Group's compliance promotion structure is headed by the Compliance and Risk Management Division, which is in charge of compliance activities for the entire HCM Group. Meetings of the Compliance and Risk Management Division are convened regularly to review, plan, and evaluate the results of various compliance measures. Meetings also deliberate on the effectiveness of measures for preventing the recurrence of misconduct.

We establish a Compliance Promotion Officer and Compliance Manager at each Group company and promote activities in coordination with the Compliance Promotion Center of HCM's Legal Department. Furthermore, we have two types of whistle-blowing system in place to promote compliance awareness among employees; namely, the Compliance Hot Line and Global Alert Line. In FY2018, there were 69 reports filed. Among these, about 20% were related to harassment while 30% were related to violations of laws or regulations during the course of business operations. None of the details communicated or reports filed pose major risk to the HCM Group.

Compliance·Risk management structure



Basic structure of risk management

When engaging in corporate activities, there are risks of encountering natural disasters, accidents, or legal violations. Based on this awareness, the HCM Group address risk management under the lead of the Compliance and Risk Management Division. We always assess risks, and strive to prevent those risks, or to minimize influence when it occurred. As a way to avoid risk overseas, we continuously monitor for incidents and disasters and issue appropriate instructions to employees traveling on business and expatriate workers.

In addition, we are working to reinforce our business continuity plan (BCP) and business continuity management (BCM), so that when faced with a risk, such as natural disaster or accident, we are able to minimize the impacts on our business activities and restore operations as soon as practical. In FY2018, regular training was conducted on the use of the safety confirmation system, which was adopted in preparation for disasters such as major earthquakes. Going forward, we will continue to heighten awareness of crisis management across the entire Group and take steps to strengthen our risk management system.

Basic policy on respect for human rights

In order for a company to continually expand globally, it is imperative to establish a corporate culture that enables each and every employee to respect the rights and personality of one another and exert their greatest creative potential in all regions both inside and outside of Japan. The HCM Group carries out human rights initiatives following its policies on human rights explicitly stated in the HCM Group Codes of Conduct and the HCM Group Human Rights Policy.

We continually provide education on human rights included in rank-specific training for new employees and new section managers, among others, for the purpose of improving each individual employee's awareness of human rights. We conduct training concerning harassment during our compliance training in order to create workplaces that are sound and comfortable. For reports concerning human rights, employees can use the internal whistle-blower system and external stakeholders can use the inquiries feature on our website.

Going forward human rights initiatives will be applied at an individual level while we aim to create a work environment that empowers diverse human resources to take an active role.

Results of human rights training in fiscal 2018

	Participants in training during fiscal 2018	Number of participants that are section manager or above	Number of participants that are general employees
Hitachi Construction Machinery ^{*1}	500 persons	88 persons	412 persons
HCM Group companies ^{*2}	1,412 persons	231 persons	1,181 persons
Total	1,912 persons	319 persons	1,593 persons

^{*1} The number of HCM participants are participants of rank-specific training
^{*2} Group companies are the total for the 8 domestic companies

Business Performance

The HCM Group launched a new mid-term management plan, "CONNECT TOGETHER 2019," in April 2017. We are promoting the development of "Solution Linkage" utilizing ICT and IoT to offer solutions to customers' challenges on safety, productivity, and decrease in lifecycle costs. And, to expand the source of revenue besides new machine sales in addition to the existing parts & service business, we are expanding the value chain (Parts & Services, Solution business, Rental etc. other than new machine sales) by enhancing the parts & service business for mining machines and facilities provided by H-E Parts and Bradken, HCM's consolidated subsidiary that we acquired in FY2016, and by entry into the rental business in North America through ACME, and in the U.K. through Synergy Hire, which was established in February 2019. We promoted enhancement of the parts & service business through a globally launched service called "ConSite," and added to the menus of "ConSite" the newly launched "ConSite OIL," the first service in the industry to predict problems of engines and hydraulic equipment by remotely inspecting the condition of its oil by oil sensors installed in each machine, in order to contribute to reducing customers' lifecycle costs.

In the Amsterdam factory of Hitachi Construction Machinery Europe, we opened ICT demonstration sites where customers can experience ICT construction. We also decided to introduce ICT hydraulic excavators to the European market, which will be the first time in the overseas market, to strive to spread ICT construction beyond the Japanese market. In Oceania, we decided to establish a new regional headquarters in April 2019 in order to strengthen its business in the region and further expand its construction machinery and mining machinery sales as well as its parts and service business. In Europe, which has some of the strictest regulations in the world, with the prospect of a rise in demand for EV construction machinery, a new company, EAC, which was established with a German distributor for developing electric construction machinery and special application products, developed electric excavators in the 2t and 8t classes as concept models. We are focusing on expanding sales of the well-accepted AC-3 series of rigid dump trucks equipped with an advanced vehicle body stability-assist function, in addition to offering a fleet management system and aggressively developing an autonomous haulage system (AHS) to optimize the mining operations that we promote jointly with Whitehaven Coal in Australia, by taking advantage of Hitachi Group's strengths.

Additionally, we are working to restructure the main domestic bases to further strengthen our technical capabilities and product development to create a more efficient production system. At the same time, we are working to optimize capital investments and reduce fixed costs, establishing a high profit structure. As part of restructuring, on April 1, 2019 we implemented an absorption-type merger of KCM Corporation, which is a full sub-

sidary and takes part in the development and production of wheel loaders. Also, at five factories in Ibaraki Prefecture, our energy consumption activities have been well appraised and we won the ECCJ Chairman Prize of the Energy Conservation Grand Prize for excellent energy conservation equipment for Fiscal 2018 (hosted by The Energy Conservation Center, Japan).

Consolidated revenue for this term (April 1, 2018 to March 31, 2019) increased by 7.8% year on year to ¥1,033,703 million due to increased sales of new machines mainly in Asia and Oceania, North America, and Europe, as well as increased sales of the value chain business mainly from parts & services.

Adjusted operating income increased by 24.9% year on year to ¥116,841 million, operating income increased by 6.9% to ¥102,296 million, and net income attributable to the owners of the parent increased by 14.2% to ¥68,542 million due to a decrease in the cost of sales, in addition to the contribution of the parts & service business and mining business.

Principles Regarding Appropriation of Earnings and Dividends for the Year under Review and the Fiscal Year Ending March 31, 2020

The HCM Group will maintain and strengthen its financial structure and work to bolster its internal reserves while considering implementation plans for upfront investments, including investments for technology development and facilities based on medium- and long- term business strategies. At the same time, HCM will pay dividends of surplus linked to its consolidated business results twice annually, comprising interim and year-end dividends, with a target payout ratio of around 30% or higher.

With the aim of enabling the execution of a flexible capital policy, Hitachi Construction Machinery will acquire treasury shares in consideration of necessity, financial conditions, and stock price movement.

With regard to the FY2018 year-end dividend, at the Meeting of the Board of Directors held on May 21, 2019, a resolution was approved for cash dividends per share of ¥57 with the record date of March 31, 2019. As a result, cash dividends for the entire FY2018 amounted to ¥100 per share. Dividends for FY2019 are to be determined.

Consolidated Balance Sheets

(unit: millions of yen)

Item	Previous fiscal year (reference) As of March 31, 2018	Current fiscal year As of March 31, 2019
Assets		
Current assets	597,829	673,888
Cash and cash equivalents	81,929	67,347
Trade receivables	219,599	238,234
Inventories	255,623	324,844
Income taxes receivable	1,894	1,167
Other financial assets	28,029	25,904
Other current assets	10,342	14,110
Subtotal	597,416	671,606
Assets held for sale	413	2,282
Non-current assets	491,967	511,368
Property, plant and equipment	299,987	311,245
Intangible assets	37,748	42,092
Goodwill	35,016	34,564
Investments accounted for using the equity method	29,549	32,628
Trade receivables	41,392	44,357
Deferred tax assets	17,463	19,145
Other financial assets	20,148	17,279
Other non-current assets	10,664	10,058
Total assets	1,089,796	1,185,256
Liabilities		
Current liabilities	366,422	470,623
Trade and other payables	268,230	259,570
Bonds and borrowings	69,892	185,641
Income tax payables	11,000	12,012
Other financial liabilities	11,584	10,165
Other current liabilities	5,716	3,235
Non-current liabilities	218,344	171,972
Trade and other payables	18,839	16,203
Bonds and borrowings	160,773	119,167
Retirement and severance benefits	17,341	17,958
Deferred tax liabilities	11,314	8,726
Other financial liabilities	2,354	1,158
Other non-current liabilities	7,723	8,760
Total liabilities	584,766	642,595
Equity		
Equity attributable to owners of the parent	448,502	486,407
Common stock	81,577	81,577
Capital surplus	81,991	81,991
Retained earnings	279,201	328,344
Accumulated other comprehensive income	8,802	△ 2,428
Treasury stock, at cost	△ 3,069	△ 3,077
Non-controlling interests	56,528	56,254
Total equity	505,030	542,661
Total liabilities and equity	1,089,796	1,185,256

Consolidated Statements of Income

(unit: millions of yen)

Item	Previous fiscal year (reference) From April 1, 2017 to March 31, 2018	Current fiscal year From April 1, 2018 to March 31, 2019
Revenue	959,153	1,033,703
Cost of sales	△ 695,316	△ 735,507
Gross profit	263,837	298,196
Selling, general and administrative expenses	△ 170,255	△ 181,355
Adjusted operating income	93,582	116,841
Other income	6,658	5,369
Other expenses	△ 4,503	△ 19,914
Operating income	95,737	102,296
Financial income	2,910	3,781
Financial expenses	△ 7,390	△ 8,091
Share of profits (losses) of investments accounted for using the equity method	4,355	4,716
Income before income taxes	95,612	102,702
Income taxes	△ 26,390	△ 28,516
Net income	69,222	74,186
Net income attributable to		
Owners of the parent	60,004	68,542
Non-controlling interests	9,218	5,644
Total net income	69,222	74,186
Net income attributable to owners of the Parent per share (basic) (yen)	282.16	322.31
Net income attributable to owners of the Parent per share (diluted) (yen)	282.16	322.31

Consolidated Statements of Comprehensive Income

(unit: millions of yen)

Item	Previous fiscal year (reference) From April 1, 2017 to March 31, 2018	Current fiscal year From April 1, 2018 to March 31, 2019
Net income	69,222	74,186
Other comprehensive income		
Items that cannot be reclassified into net income		
Net gains and losses from financial assets measured at fairvalue through OCI	1,444	△ 1,743
Remeasurements of defined benefit obligations	△ 378	△ 1,077
Other comprehensive income of equity method associates	7	7
Items that can be reclassified into net income		
Foreign currency translation adjustments	△ 2,425	△ 8,988
Cash flow hedges	160	64
Other comprehensive income of equity method associates	△ 313	△ 502
Other comprehensive income, net of taxes	△ 1,505	△ 12,239
Comprehensive income	67,717	61,947
Comprehensive income attributable to owners of the parent	58,437	57,445
Non-controlling interests	9,280	4,502

Consolidated Statements of Changes in Equity Current Fiscal Year (From April 1, 2018 to March 31, 2019)

(unit: millions of yen)

	Equity attributable to owners of the Company					
	Common stock	Capital surplus	Retained earnings	Accumulated other comprehensive income		
				Remeasurements of defined benefit obligations	Net gains and losses from financial assets measured at fair-value through OCI	Cash flow hedges
Balance at beginning of year	81,577	81,991	279,201	△ 1,232	8,992	149
Cumulative effects of changes in accounting policies			32			
Restated balance	81,577	81,991	279,233	△ 1,232	8,992	149
Net income			68,542			
Other comprehensive income				△ 1,098	△ 1,741	64
Comprehensive income for the year	—	—	68,542	△ 1,098	△ 1,741	64
Acquisition of treasury stock						
Sale of treasury stock						
Dividends to stockholders of the Company			△ 19,564			
Changes in ownership inter-ests in subsidiaries without a loss of control						
Change in the scope of consolidation						
Transfer to retained earnings			133		△ 133	
Expiration of subscription rights						
Transactions with owners	—	—	△ 19,431	—	△ 133	—
Balance at end of year	81,577	81,991	328,344	△ 2,330	7,118	213

(unit: millions of yen)

	Equity attributable to owners of the Company					
	Accumulated other comprehensive income		Treasury stock, at cost	Total	Non-controlling interests	Total equity
	Foreign currency translation adjustments	Total				
Balance at beginning of year	893	8,802	△ 3,069	448,502	56,528	505,030
Cumulative effects of changes in accounting policies		—		32		32
Restated balance	893	8,802	△ 3,069	448,534	56,528	505,062
Net income		—		68,542	5,644	74,186
Other comprehensive income	△ 8,322	△ 11,097		△ 11,097	△ 1,142	△ 12,239
Comprehensive income for the year	△ 8,322	△ 11,097	—	57,445	4,502	61,947
Acquisition of treasury stock		—	△ 8	△ 8		△ 8
Sale of treasury stock		—		—		—
Dividends to stockholders of the Company		—		△ 19,564	△ 4,795	△ 24,359
Changes in ownership inter-ests in subsidiaries without a loss of control		—		—		—
Change in the scope of consolidation		—		—	19	19
Transfer to retained earnings		△ 133		—		—
Expiration of subscription rights		—		—		—
Transactions with owners	—	△ 133	△ 8	△ 19,572	△ 4,776	△ 24,348
Balance at end of year	△ 7,429	△ 2,428	△ 3,077	486,407	56,254	542,661

Consolidated Statements of Cash Flow

(unit: millions of yen)

Item	Previous fiscal year (reference) From April 1, 2017 to March 31, 2018	Current fiscal year From April 1, 2018 to March 31, 2019
Net income	69,222	74,186
Depreciation	32,306	32,343
Amortization of Intangible assets	5,526	4,611
Impairment losses	549	2,143
Income tax expense	26,390	28,516
Share of profits of investments accounted for using the equity method	△ 4,355	△ 4,716
Gain (loss) on sales of property, plant and equipment	△ 574	△ 458
Financial income	△ 2,910	△ 3,781
Financial expenses	7,390	8,091
(Increase) decrease in accounts and trade receivables	△ 27,497	△ 19,101
(Increase) decrease in lease receivables	△ 14,257	△ 7,115
(Increase) decrease in inventories	△ 24,664	△ 76,497
Increase (decrease) in accounts and notes payables	53,337	△ 18,583
Increase (decrease) in provisions and retirement benefit obligations	△ 248	△ 587
Other	△ 17,667	△ 11,995
Subtotal	102,548	7,057
Interest received	2,548	2,525
Dividends received	1,179	1,800
Interest paid	△ 5,089	△ 5,357
Income tax paid	△ 16,658	△ 31,718
Net cash provided by operating activities	84,528	△ 25,693
Capital expenditures	△ 16,887	△ 26,231
Proceeds from sale of property, plant and equipment	4,603	5,251
Acquisition of intangible assets	△ 4,464	△ 8,536
Acquisition of investments in securities and other financial assets(including investments in associates)	△ 21,416	△ 1,315
Sales of investments in securities and other financial assets(including investments in associates)	469	318
Collection of long-term loan receivables	88	47
Other	45	127
Net cash provided by (used in) investing activities	△ 37,562	△ 30,339
Increase (decrease) in short-term borrowings, net	△ 33,864	67,386
Proceeds from long-term borrowings and bonds	90,386	36,197
Payments on long-term borrowings and bonds	△ 70,844	△ 28,766
Payments on lease payables	△ 4,700	△ 6,388
Dividends paid to owners of the parent	△ 9,361	△ 19,562
Dividends paid to non-controlling interests	△ 2,103	△ 4,933
Other	3	△ 6
Net cash provided by (used in) financing activities	△ 30,483	43,928
Effect of exchange rate changes on cash and cash equivalents	△ 9	△ 2,478
Net increase (decrease) in cash and cash equivalents	16,474	△ 14,582
Cash and cash equivalents at beginning of year	65,455	81,929
Cash and cash equivalents at end of year	81,929	67,347