

## Message from the CTO

We will strategically promote technological innovations needed to reach our goals and provide construction machinery solutions in tune with the times.

### Hideshi Fukumoto

Vice President and Executive Officer, CTO  
President, Research & Development Group and  
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### The role HCM should play in future society and markets

HCM has grown over the past seven decades by continually manufacturing construction machinery, but the social environment surrounding the company has undergone major changes. From an era characterized predominantly by domestic demand generated by rapid economic growth driven by social infrastructure improvements to an era of global competition where HCM gambled its future with an overseas expansion, today we find ourselves in an era where we must combat serious social issues, including a declining labor population caused by a declining birthrate and aging society, frequent occurrences of serious disasters caused by climate change, and a move to review energy sources. Also, as symbolized by the SDGs, we must not only pursue our own growth, but also equally contribute to a sustainable society. Meanwhile, digital technologies that will provide solutions to these issues continue to advance at a rapid pace, resulting in the keywords such as 5G, AI, IoT and big data now a part of our daily vocabulary. In such a transformative time, our customers demand not only machinery with good performance, but also solutions that solve their issues and the speed in execution to provide these solutions.

Given these changes, HCM believes it is important to create three types of value (benefit). The value of things provided by good products, customer value that resolves the challenges customers face, and social value, where we tackle the challenges of resolving social issues. Specifically, we launched the ZAXIS brand of machines offering reliability, operability, and economic advantage (things) and the Solution Linkage<sup>®</sup>, brand of solutions where HCM works with customers to resolve their challenges. We are now working to strengthen both.

With Solution Linkage<sup>®</sup>, we aim to provide three types of customer value (benefit): improving safety, enhanced increasing productivity, and lower reducing life cycle costs. Therefore, we are working to build systems<sup>\*1</sup> that utilize data to visualize the frontlines and work and increase efficiency of management, build solutions<sup>\*2</sup> for automation and manpower reduction that pursues safety and efficiency simultaneously, and build systems<sup>\*3</sup> that predict and diagnose breakdowns to prevent them from happening. We are also actively promoting the electrification of hydraulic excavators and dump trucks, aimed at reducing CO<sub>2</sub> emissions, a particularly important aspect of social value.

\*1 Solution Linkage<sup>®</sup> Mobile, WENCOmine, etc.

\*2 Use of i-Construction an autonomous haulage system for mining dump trucks, etc.

\*3 ConSite<sup>®</sup>, etc.

### Points to consider in the technological innovation process

Construction machinery have dramatically evolved over the years. HCM aims for work sites that are safe and highly efficient for people and machines with a predominant focus on people. As a goal for this, we have established targets that can be achieved together with customers, such as contribute to zero fatalities related to machinery and cut in half CO<sub>2</sub> emissions from our products. Toward this end, we are working on the development of products, technologies and solutions. To achieve this goal, open innovation that seeks out technology broadly around the world is vital to complement our organic development efforts.

HCM has used synergies with the Hitachi Group as a foundation for open innovation. To further accelerate these efforts, we have established a dedicated organization. This organization is partnering with 66 companies for ICT solutions in response to i-Construction to develop solutions and provide support to customers. In addition, it is building close relationships with venture firms in Europe and the United States to effectively accelerate the development of collision mitigation systems, breakdown prediction and diagnosis systems, automation, and electrification systems.

Looking ahead, we will use the technologies needed for achieving our goals as a strategic roadmap for products and technologies and secure the human resources and other resources necessary. In addition, we will shift our conventional development process from processes focused on taking ample time to new processes that are shorter in duration while using customer frontlines to improve customer satisfaction. In this manner, we will boldly tackle a number of challenges.

### To our stakeholders

HCM marked the milestone of its 70th anniversary since its full-fledge production of construction machinery began. However, the path we have taken was not always smooth sailing; it represents an accumulation of efforts supported by our relationships with many business partners and customers. Therefore, we want to occupy a presence that support our customers.

We are in a time of great uncertainty about the future, and the trials awaiting companies are expected to become even more severe going forward. Given this, HCM aspires for growth together with customers by providing customers with construction machinery products and solutions in sync with the times as a close and reliable partner anywhere in the world.

## Message from the CFO

We will promote sounder cash flows and establish a resilient financial footing that is resilient even in a severe business climate.

### Keiichiro Shiojima

Executive Officer, CFO  
President, Financial Strategy Group



### Review of the financial standing in the previous mid-term management plan

Under the mid-term management plan CONNECT TOGETHER that ended in FY2019, we established management indicators for financial soundness that included ROE of 9% or higher and net D/E ratio of 0.4 times or lower, in addition to performance targets of sales revenue of 850 billion yen or higher, adjusted operating profit margin of 9% or higher. Under the plan, the entire company implemented this growth strategy. We were able to attain these targets ahead of time in FY2017 and FY2018, but in FY2019, the final fiscal year of the plan, we unfortunately fell short of all of these targets, excluding sales revenue, due to the impacts of weaker demand from U.S.-China trade frictions that began in the second half of FY2018, a stronger yen, and frequent occurrence of natural disasters.

In particular, during the fourth quarter of FY2019 the impacts of the COVID-19 pandemic emerged, causing a slowdown of demand in every market, resulting in increasing inventories, and the drop in operating capital was greater than expected, resulting in negative free cash flow. However, despite these severe headwinds, we were able to secure an adjusted operating income ratio of 8.2%. This shows that our efforts to expand and strengthen the value chain business paid off, which helped to support our earnings power. Strategically speaking, we review this as steady success.

### Outlook for FY2020 and financial strategy looking ahead

The impacts of COVID-19 are expected to be protracted and in the second half demand for construction machinery is not expected to recover to the level of previous years. Amidst this severe market environment, customers, too, are facing a number of business challenges. The HCM Group believes that speeding up and reinforcing the value chain business in the previous mid-term management plan and fully contribute to solutions to customer challenges will lead to stable profits. Of course, the entire company will work on reducing indirect expenses at the same time. Now is the time that new working styles considerate of restrictions on travel and meetings due to COVID-19 are needed. To increase productivity more efficiently, we will consider as needed reviews or postponement of new investment together with the review of work flows for the entire company. Meanwhile, we will continue without interruption investment in the reorganization of our plants in Japan, which we have worked on from the previous mid-term management plan. The goal is to quickly harvest the positive outcomes of investment by improving profitability by means of enhanced production efficiency and lowering of the sales cost ratio.

As our financial strategy, first we will quickly shrink inventory assets

and increase the accuracy of inventory management for sounder cash flows. In addition, we are addressing delays in receivables recovery expected at Group companies using a commitment line established at the start of the fiscal year. By continuing to improve capital efficiency and maintain the optimum balance of short- and long-term borrowings, we will aim to establish a resilient financial footing strongly resilient against contingencies should they occur. We will examine the diversification of financing methods for future investments, including issuing environmentally-considerate bonds, such as green bonds.

#### 1. Investment strategy for sustainable growth

Since the previous mid-term management plan, we have steered in the direction of reinforcing the value chain domain, while holding off on expanding product lines. This direction will be carried over in the new mid-term management plan, under which we will actively consider expanding the value chain business, executing complimentary M&A deals, and investing in network expansion. Regarding the consolidation of overseas plants, a rough schedule has been put into place, and we will focus on plant reorganization in Japan under the new mid-term management plan. We will carefully monitor and control the current investment plan for FY2020 based on market conditions.

#### 2. Improving capital efficiency and financial soundness

Our main policy is to generate ample cash flow by reducing operating capital and securing stable profits through the expansion of value chain earnings, while achieving a good balance between dividends as a shareholder return, improvement in financial footing, and growth investment.

#### 3. Policy on returning profits to shareholders

We have had a policy for some time to achieve a payout ratio of 30% or higher, and we will carry over this policy to FY2020 as well.

### To our stakeholders

On April 1, 2020, I became the HCM Group's Chief Financial Officer (CFO). My term soon began with the strong headwinds of COVID-19. Nevertheless, to fulfill the expectations of customers in terms of the Group's products and services, and to fulfill our social responsibilities, including addressing environmental issues, I plan to make steady efforts toward building a resilient economic base and financial footing that is not susceptible to changes in the economy and one that can agilely respond to changing situations.

In addition, I will increase opportunities for engagement with stakeholders to fulfill my accountability and ensure that feedback from stakeholder is utilized to improve management as needed.