Message from the CFO

Having established an earnings foundation for business transformation, we will execute growth investments on an unprecedented scale in order to make a leap forward toward becoming a sustainable high-growth company

Director
Executive Officer
In Charge of Group Finance and Accounting
General Manager of Finance & Accounting Division

Yasuaki Fukumoto

Evaluation of Project Change

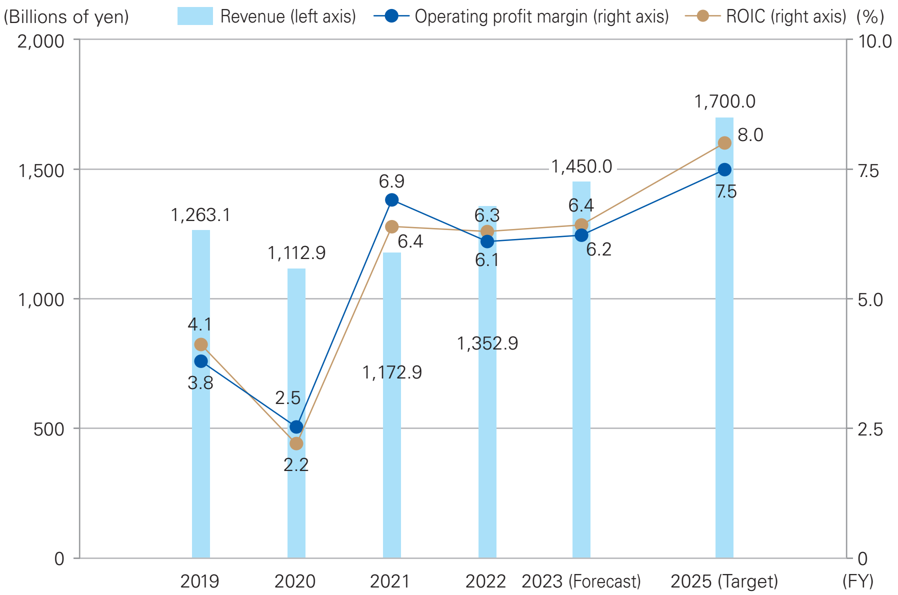
As a period of preparation and transition toward business portfolio optimization, we undertook the following two initiatives under Project Change, which completed its term in the fiscal year ended March 31, 2023. (i) Transformation of business model from a business centered on products and services to a business that provides value to all stages of the life cycle (lifecycle businesses; LCB), (return to a growth trajectory); (ii) Creation of new businesses such as ammonia value chain, air transportation systems, and maintenance and disaster prevention and mitigation (creation of Growth Business).

During the period of Project Change, the business environment was difficult due to factors such as the spread of COVID-19, conflict between Russia and Ukraine, insufficient supply of semiconductors, and soaring prices of materials and equipment. In particular, we saw a decline in the performance of the civil aero engine business. However, this was offset by increased profits in the three onshore heavy machinery domains, where profitability was enhanced by the improvement of management methods for long-term and large-scale construction that we had been already working on. As a result, the operating cash flow (hereinafter, "operating CF") for fiscal 2021 was 114.1 billion yen, exceeding 100 billion yen for the first time. The operating profit for fiscal 2022 was 81.9 billion yen, a record-high level, and the revenue of the lifecycle business (LCB) increased by 35% compared to fiscal 2019. We evaluate that the company has made steady progress in strengthening its earnings foundations and accelerated its preparations for business transformation.

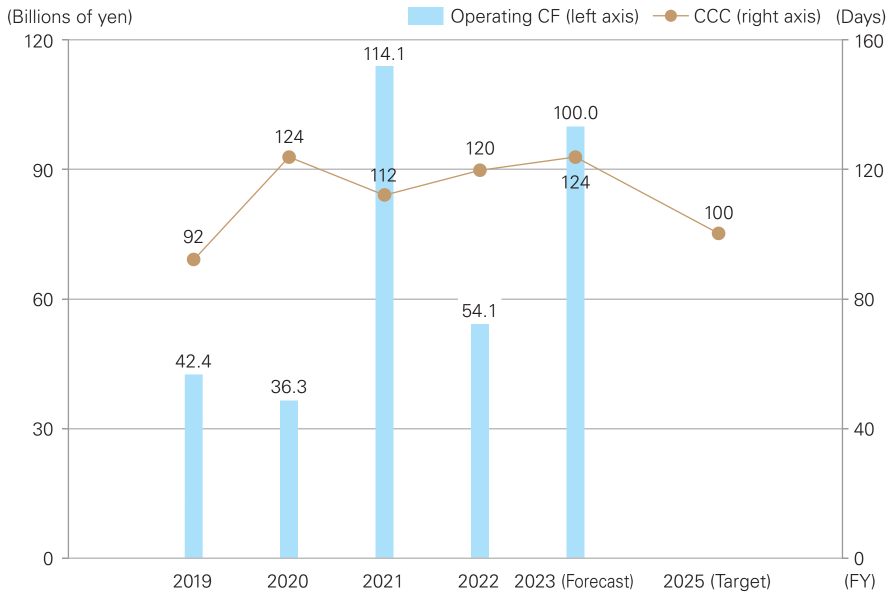
Financial and Capital Strategy and Future Initiatives under the "Group Management Policies 2023"

Under the "Group Management Policies 2023" announced in May 2023, we will continue to reform our business model in order to make a breakthrough into a company that can achieve sustainable high growth. The cash generation capabilities strengthened during the period of "Project Change" will support this reform. In the "Group Management Policies 2023," we have set an investment budget of 500 billion yen for three years. The source of funds of this investment is the cash generated through business activities. More than half of the investment budget will be allocated to the Growth and Development-focus Business, and the remaining half will be allocated to maintaining the competitiveness of the Core Businesses.
In addition to the above, we plan to invest on an unprecedented scale, including approximately 30.0 billion yen for each fiscal year (equal to a total of 90.0 billion yen over three years) as expenses to realize transformation (increased investment in R&D and human resources, and investment in structural reforms). As a result, the management targets (operating profit margin: 7.5%; ROIC: 8% or higher; CCC: 100 days) are slightly below the targets of "Project Change." However, we have determined that during the period of the "Group Management Policies 2023," we should prioritize investment in growth from a medium- to long-term perspective, rather than pursuing profits from a short-term perspective.
The background to this decision is that the criteria for performance evaluation and investment decisions have come to emphasize not only short-term "economic value" but also "social value." "Social value" is created by resolving social issues through business, however after a certain period of time (20 to 30 years), it must be replaced by economic value which contributes to the enhancement of our corporate value. We believe that the clean energy domain is not only a vital part of the company's business strategy, but it is also an area where IHI Group's dreams are made of. For investments in such businesses, we discuss the possibility of investment return from a long-term perspective, placing emphasis on the business plan and story. This is because we may miss new business opportunities and growth opportunities if we make decisions based only on conventional quantitative indicators. In investment decisions, financial managers including myself often put on the brakes (i.e., be defensive) in consideration of various risks. However, during the period of the new medium-term management plan, I believe that we must also play an accelerating role (i.e., be on the offensive) in encouraging the top management and business areas.
Basically, the investments will be funded by cash generated from business operations, but we are not always cash rich. We will also utilize sustainable finance in order to make flexible investments. As a company that places ESG at the core of its management, we see business operations and sustainable finance as integral parts of one another, and the clarity of the use of funds will enhance the quality of our financing.

● **Revenue and Operating Profit Margin, ROIC**



● **Operating CF and CCC**

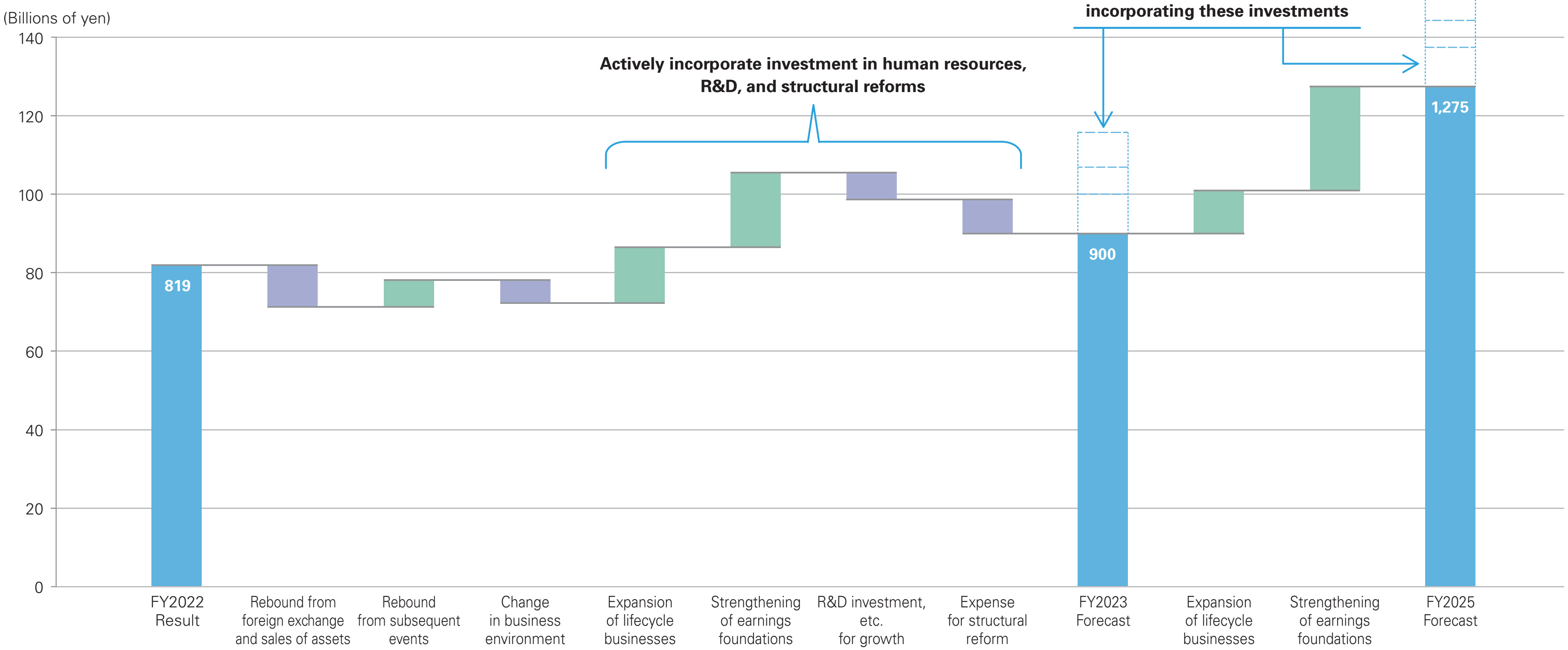


Message from the CFO

Transformation of our Core Businesses and improvement of capital efficiency in Growth Business are keys to achieving ROIC 8%
The key to success in achieving the ROIC target of 8% or higher in fiscal 2025 will be the degree to which we can exploit and evolve LCB in our Core Businesses and improve profitability and capital efficiency in our Growth Business.
Since LCB requires little capital investment and is expected to have stable and high profitability, we will promote the expansion of LCB in our Core Businesses. Our Growth Business, such as aero engines and space, are expected to play the role of driving the company's growth. However, it is important to control working capital and increase efficiency since the financial burden of working capital tends to be heavy in this area. By promoting DX for inventory and production management and visualizing the movement of goods, we will build a system to maintain working capital at an appropriate level even during periods of business expansion.
Raising the awareness of each and every employee is necessary to achieve management targets. While it is important to present and implement specific measures, this is not sufficient. Employees' mindsets will not change unless the management continues to emphasize that they are committed to achieving the targets. True reform will not be realized unless we can identify and break through the challenges that stand in the way. Improvements can be made, but reforms are necessary to establish them.

Approach to shareholder returns
As we move forward with proactive investments for transformation, we must also be aware of the need to enhance shareholders' equity as a risk buffer, i.e., secure financial soundness. We will also enhance shareholder returns to this end. The basic policy in shareholder returns is stable dividends, and we are aiming for a consolidated dividend payout ratio of around 30%. While share buybacks is an option, during the period of "Group Management Policies 2023," we will prioritize the

● **Factors in Operating Profit Changes** (FY2022-FY2025)



allocation of cash generated to growth investments. We believe that if our efforts are appreciated by the capital market, our share price will rise over the medium to long term, leading to returns to our shareholders.

Securing and maintaining stakeholder trust

Until now, we have disclosed information of the company mainly focused on past performance, and have not been able to adequately present a medium to long-term growth story. We would like to use the mandatory disclosure of sustainability information beginning with the annual securities report for fiscal 2022 as an opportunity to strengthen our communication of a value creation story that integrates financial and non-financial value. In order to create "a world where nature and technology work in unity," which is our sustainability goal, we must aim to become a corporate entity that achieves sustainable high growth. We will engage in constructive dialogue with the capital market and our stakeholders to gain their understanding that the major growth investments we will make over the next three years are necessary to achieve this goal.

Such enhanced dialogue not only leads to the realization of the "G" (Governance) in ESG management, and "securing and maintaining stakeholder trust," but is also expected to reduce the capital cost and increase the ROIC spread (ROIC-WACC: Capital cost). We will enhance our corporate value by promoting IR activities that gain a high degree of trust from the stakeholders.

● Main Management Indicators

IFRS Standard					
	FY2019	FY2020	FY2021	FY2022	FY2023 (Forecast)
Orders received	1,280.0 billion yen	1,097.0 billion yen	1,261.2 billion yen	1,366.1 billion yen	1,500.0 billion yen
Revenue	1,263.1 billion yen	1,112.9 billion yen	1,172.9 billion yen	1,352.9 billion yen	1,450.0 billion yen
Operating profit	47.8 billion yen	27.9 billion yen	81.4 billion yen	81.9 billion yen	90.0 billion yen
Profit attributable to owners of parent	8.2 billion yen	13.0 billion yen	66.0 billion yen	44.5 billion yen	50.0 billion yen
Operating cash flow	42.4 billion yen	36.3 billion yen	114.1 billion yen	54.1 billion yen	100.0 billion yen
Investment cash flow	-85.5 billion yen	-40.4 billion yen	27.9 billion yen	-52.3 billion yen	-100.0 billion yen
Free cash flow	-43.0 billion yen	-4.1 billion yen	142.0 billion yen	1.7 billion yen	0 billion yen
Dividends per share	50 yen (¥30 interim; ¥20 year-end)	0 yen	70 yen (¥30 interim; ¥40 year-end)	90 yen (¥40 interim; ¥50 year-end)	100 yen (¥50 interim; ¥50 year-end)
ROIC	4.1%	2.2%	6.4%	6.3%	6.4%
Operating profit margin	3.8%	2.5%	6.9%	6.1%	6.2%
CCC	92 days	124 days	112 days	120 days	124 days
D/E ratio	2.00 times	1.85 times	1.24 times	1.14 times	1.13 times
ROE	2.8%	4.5%	19.3%	11.0%	11.0%
Ratio of equity attributable to owners of parent	15.0%	16.4%	20.3%	22.2%	23.2%

ROIC: (Operating profit + Interest and dividend income) after tax / (Equity attributable to owners of parent + Interest-bearing liabilities)
CCC: Working capital / Revenue × 365 days
D/E ratio: Interest-bearing liabilities / Total equity
ROE: Profit attributable to owners of parent / Equity attributable to owners of parent
Ratio of equity attributable to owners of parent: Equity attributable to owners of parent / Total liabilities and equity