

CFO Message

Supporting Hitachi Group's Social Innovation Business through the appropriate capital allocation

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Mr. Kawamura joined Hitachi in 2015 after serving as an executive officer at Mitsubishi Corporation. Leveraging the experience he gained at Harvard Business School and the World Bank, he has played a key role as Chief Strategy Officer (CSO) since 2018 and has driven structural reforms and the design of the 2021 Mid-term Management Plan. He was appointed Chief Financial Officer (CFO) in April 2020.



Q: Having been promoted from CSO to CFO, how are you approaching your role as CFO?

The primary duty of the CFO is to make management decisions, mainly about investments, in addition to budgeting and compiling results, the actual work of legal financial accounting, and ensuring accounting compliance. In my previous role as the CSO, I oversaw growth and investment strategies, as well as the Mid-term Management Plan. As the CFO starting in April this year, I support top management in making business decisions by allocating capital and funds across the entire company and comprehensively monitoring returns as a result of it. Japanese companies divide up the roles and responsibilities of the CSO (a majority of which belong to the corporate planning department) and the CFO, but around the world, many companies combine the functions of the CSO and CFO. I believe the experiences I gained as the CSO will be useful in fulfilling my responsibilities as the CFO.

In its 2021 Mid-term Management Plan, ending March 31, 2022, Hitachi plans to execute ¥2.0 trillion–¥2.5 trillion in growth investments. The funds needed for these investments are, of course, based on our operating cash flows, but being procured from diverse sources, including debt financing (e.g., loans from financial institutions, issuance of corporate bonds). Looking ahead, we are keen to maximize returns on investments by appropriately allocating capital while aligning investments with our strategies, procuring capital through an optimal combination of means with an eye on a rise of debt costs. If necessary, Hitachi will reshuffle its business portfolio. It is important to steer the portfolio toward assets that generate higher returns, while optimizing operations on the capital procurement side. Business restructuring is done while comprehensively considering strategic value and synergies with core businesses. On occasion, decisions are made to scale down or withdraw from businesses even if they are profitable.

Q: Last year, Hitachi added return on invested capital (ROIC) as a key performance indicator. What are your thoughts on ROIC management over the past year?

In the past, operating income and operating income ratio were our key performance indicators. In addition to these KPIs, we introduced ROIC as a new indicator last fiscal year, for the purpose of clarifying our intention of pursuing profits commensurate with the cost of capital, while remaining aware of the balance sheet. Hitachi is in position to accelerate company-wide growth by improving capital efficiency and concentrating management resources in highly profitable businesses. Foreign investors make up approximately 50% of Hitachi's shareholders. Part of the reason why we introduced ROIC as a KPI is because these foreign investors pay close attention to the cost of capital. Over the past year, we have striven to instill ROIC management from business units (individual profit centers) to the front lines by using an ROIC tree, which breaks down the individual elements of ROIC and suggests ways to improve each one. To increase earnings, ROIC must exceed the weighted average cost of capital (WACC), a measure of procuring cost of capital (i.e., ROIC spread is a positive value). Since last year, we have periodically conducted reviews of ROIC in each business unit. I believe the rollout of ROIC has had an impact, as discussions have come to center more on ROIC and consensus has formed around ROIC, based on whether the cost of capital aligns with the business being advanced. In addition, ROIC management is increasingly understood in light of the reorganization and use of idle assets such as land, and the concentration of capital that leads to greater investment efficiency.

Despite the impact from COVID-19, which was not envisioned when the 2021 Mid-term Management Plan was drafted in early fiscal 2019, our key management targets have not been changed as of today for capital allocations, including ¥2.5 trillion for growth

investments, a 10% adjusted operating income ratio and 10% ROIC. Debt has increased considerably in accordance with the massive investment Hitachi made to acquire ABB's power grids business, resulting in a temporary elevation in the Debt/Equity (D/E) ratio above our target of 0.5 times, which was set relatively conservatively. Hitachi plans to continue investing in growth while leveraging under the adequate financial discipline and controlling debt so the D/E ratio falls back below 0.5 times going forward. When executing investment, it is necessary to create earnings opportunities while managing risks. By understanding and analyzing the constant changes in the business environment and considering societal issues, our competitive advantages and constraints on management resources, we seek to properly identify and manage a variety of risks as a company. I believe one of my most important duties is to judge and monitor these risks.

Q: Can you explain Hitachi's approach to capital allocation?

Hitachi is keenly aware of the importance of growing in tandem with capital markets. We believe in the importance of having constructive conversations with participants on capital markets that watch companies in various industries along different time lines. For this reason, we make a concerted effort to prepare informational environment for it. Accordingly, this fiscal year, we took a leap of raising our disclosure level of managerial information. I hope that these enhanced disclosures will shed more light on Hitachi's management conditions among capital market participants.

Hitachi mainly considers growth investments in the area where significant synergies with Lumada, our strategic core, can be anticipated, namely digital and IT businesses. In an environment of rapid advances in technology (big tech era), being too much cautious on investment strategies could translate into various opportunity losses in the future. Hitachi aims to maximize corporate value through the pursuit of relatively short-term profits and medium- to long-term growth investments, while considering the balance of overall resource allocations, including R&D spending.

As for shareholder returns, I believe improving corporate value is fundamentally important, more than anything else. We aim to increase earnings per share as a result of improved profitability of overall businesses, which is achieved through investments based on appropriate strategies and the creation of an optimal business portfolio by shuffling assets from weak-performing businesses into relatively profitable businesses. And we believe it is also important to steadily and continually increase dividends. When the timing and various conditions are right, Hitachi considers share buybacks. Hitachi intends to comprehensively improve shareholder returns while striking a balance among increasing corporate value, dividends and share buybacks (maximize total shareholders return).

Q: What is Hitachi's policy on allocating financial and nonfinancial resources in line with its aim of becoming a global leader in the Social Innovation Business?

Hitachi follows strategies that move it closer to its vision of becoming a global leader in the Social Innovation Business. It is important for us to support business units, the front lines for advancing its strategies, on the financial side. I believe the core mission of the finance department is to maximize efficiency in the procurement of financial resources and effectively deploy them to facilitate their sales activities without restriction.

Hitachi promotes the Social Innovation Business by amplifying its presence in social infrastructure and digital transformation. As exemplified in the acquisition of ABB's power grids business, It is necessary to mobilize a large sum of funds for the Social Innovation Business, and we need to come up with an optimal solution to these funding needs. In addition, it is important to prepare a financial foundation on a regular basis so that these essential investments can be made in a timely manner. Hitachi has an adequate level of liquidity, as the pace of capital accumulation has accelerated alongside constant increase in profits. Readying a foundation for procuring funds is a crucial element of financial strategy, and this foundation entails building cordial and all-around relationships with external financiers and investors, including financial institutions and capital markets around the world, international institutions and government entities.

Furthermore, social expectations for corporations have changed dramatically. For a sustainable company, the nonfinancial side has become increasingly important, in terms of contribution to solutions for social and environmental problems, in addition to management indicators that focus on profitability. Hitachi is proactively tackling social and environmental issues, such as by reducing its carbon footprint, a cause of global warming, and augmenting its corporate behavior as a good corporate citizen. Strategically investing in fields that facilitate solutions for these social and environmental problems should translate into medium- to long-term growth for Hitachi, in my opinion. If we lose sight of the nonfinancial aspects of social and environmental values and mechanically make investment decisions based on the adequacy of short-term profitability, our future corporate values could be eroded. To pursue economic, social and environmental value in parallel (not sequentially), Hitachi will manage operations with an eye on medium- to long-term returns, while paying due consideration to nonfinancial value and relationships, which do not always factor into short-term profitability. The finance department lends its support to the parallel pursuits of economic, social and environmental value.