

# Pursuing prosperity with Society

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President  
(Representative Director)

## Message from the Top Management

We will always strive for innovation to create new value and enhance enterprise value, now and 100 years from now.

### Looking Back on Fiscal 2017

In fiscal 2017, we posted net sales of ¥1,518.8 billion, operating income of ¥45.9 billion and before-tax ROIC of 5.0%. Operating income was down ¥50.0 billion from a year ago. This is largely because the yen trended higher in forex markets, decreasing profitability on component parts for commercial aircraft in Aerospace, and because of sizable losses booked by Ship & Offshore Structure on offshore service vessels business for customers in Brazil and Norway and by Plant & Infrastructure on overseas LNG tank projects.

### Restructuring for Ship & Offshore Structure

Given the tough business environment and the past two years of sizable losses for Ship & Offshore Structure, a restructuring committee was set up to undertake a fundamental revision of the segment's structure. This committee put together a segment restructuring policy hinging on efforts to shrink the scale of domestic operations, deepen integrated operations with our Chinese shipbuilding joint ventures and withdraw from the offshore service vessels business. Going forward, under my leadership, we will steadily implement segment restructuring measures and achieve before-tax ROIC of at least 8%—assuming ¥100 to the U.S. dollar—by fiscal 2021.

### Reinforcement of Risk Management

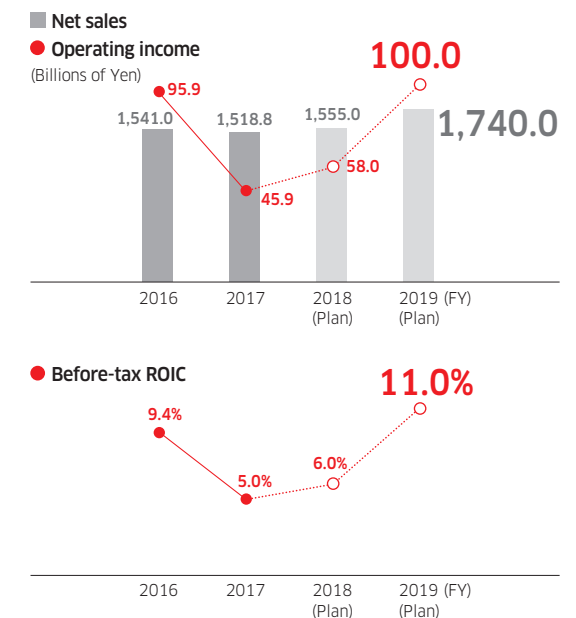
To prevent a repeat of the huge project losses that occurred, we will strengthen risk management, through all stages, from before order acceptance to after completion. Specifically, we will emphasize efforts to visualize the risk amount, quickly identify changes in status through KPI\* and other measurements, and share insights and examples of approaches that lie buried within each business segment. We will avert risk but also respond immediately if risk appears. I will be personally involved, too, monitoring the progress of key projects on a monthly basis as chairman of the newly established Project Risk Management Committee.

\*KPI (Key Performance Indicators): Quantitative business metrics used to evaluate the degree of success in reaching business goals.

### Fiscal 2018 Forecast and MTBP 2016

The performance forecast for fiscal 2018 calls for net sales of ¥1,555.0 billion. Operating income is expected to reach ¥58.0 billion, up ¥12.1 billion from fiscal 2017, mainly due to a recovery in Ship & Offshore Structure that offsets a possible decrease in Aerospace caused by a drop in production on component parts for commercial aircraft.

Under the medium-term business plan—MTBP 2016—drafted in 2016, we position the three years of MTBP 2016 as a period for strengthening our business foundation to increase enterprise value over the medium to long term, so that we can realize our image of the corporation we want to be in 10 years. In MTBP 2016, we identified three fundamental strategies: promote further progress on Kawasaki-ROIC Management, implement investments targeting medium- to long-term growth, and realign our businesses. The Kawasaki Group is moving steadily forward on the various measures set out in MTBP 2016, and making persistent efforts to improve business management, with an emphasis on cutting costs and shrinking invested capital to reach our targets.



Before-tax ROIC = EBIT (Income before income taxes and non-controlling interests + Interest expense) / Invested capital at year-end (Interest-bearing debt + Shareholders' equity)



### Ensuring Thorough Kawasaki-ROIC Management

Across the Kawasaki Group, efforts to improve enterprise value are a top priority, and Kawasaki-ROIC Management is an integral part of this process. To raise enterprise value, we must ensure profitability exceeds capital costs. For the Group, the hurdle rate is before-tax ROIC of 8%.

Unfortunately, the Group's before-tax ROIC stalled at 5.0% in fiscal 2017, below the hurdle rate, and the target for fiscal 2018 is 6.0%, also short of the stated 8%. This means enterprise value is falling even though we are in the black, and that translates into a loss from a Kawasaki-ROIC Management perspective. I have a feeling this situation is critical, and call for employees to share such feeling. However, by ensuring thorough Kawasaki-ROIC Management, I am sure we will be able to realize higher enterprise value.

The key to ensuring thorough Kawasaki-ROIC Management is, to me, the principle that a business unable to achieve a before-tax ROIC hurdle rate of 8%, even in the medium to long term, cannot be permitted to continue as a business that is unlikely to ever contribute to higher enterprise value. Within the Group, there are about 30 business units, and before-tax ROIC is calculated for each one. For any business unit showing before-tax ROIC under 8%, strategies to improve that status to the targeted 8% and a timeframe

for reaching that level will be clearly laid out, and intermediate goals will be set out periodically. We may also consider drastic options that might include shrinking the scale of business or complete withdrawal in cases where these business units face difficulties achieving these goals.

### All Employees Involved in Kawasaki-ROIC Management

Another vital aspect of Kawasaki-ROIC Management is full employee participation throughout the Group to realize higher enterprise value. Employees in all divisions are diligently working to boost ROIC in the course of daily operations. At production sites, the goal is to cut costs, of course, but efforts go further to decreasing mistakes and reparation work and speeding up production periods. In design divisions, the objective is shorter design periods, more efficient development and designs with production efficiency in mind. In sales divisions, the emphasis is on profitable pricing and early receipt of payment. In procurement divisions, the spotlight is on lower material costs and streamlined inventories. In other areas, we seek efficient capital investment and R&D investment. We have set KPI that have a favorable impact on enterprise value, based on the characteristics that define each business, so that employees throughout the Group are better able to grasp the "what" and "how" to contribute

We will ensure thorough Kawasaki-ROIC Management, setting the hurdle rate of before-tax ROIC at 8%, and achieve higher enterprise value.

to higher enterprise value and effectively engage in Kawasaki-ROIC Management. Follow-up work is undertaken as necessary.

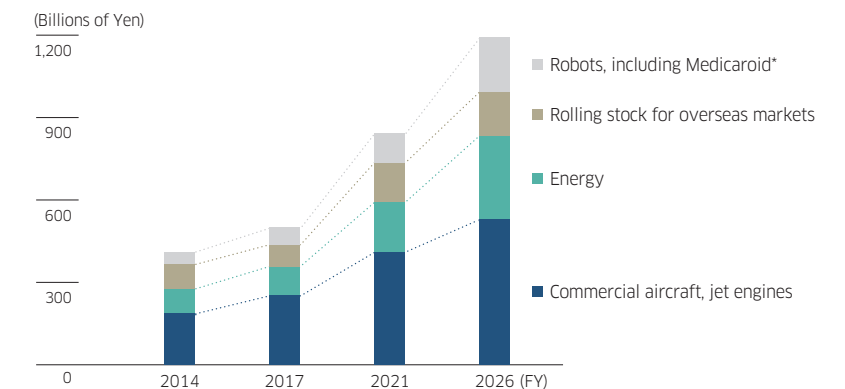
### Businesses that Drive Growth

Insufficient social infrastructure and rising environmental risks in emerging countries, the graying of society and an ensuing labor shortage in developed countries, increasingly active movement of people paralleling globalization—social issues are becoming more serious and spreading more around the world. Against this backdrop, Kawasaki Group products and services are in greater demand, and we believe our businesses will grow steadily. Particularly, we have high expectations for commercial aircraft and jet engines, energy, rolling stock for overseas markets, and robots. These four businesses will be growth-drivers, with the scale of business likely expanding from the current level of around ¥500.0 billion to somewhere near ¥1.2 trillion by 2025.

**Commercial aircraft and jet engines** By 2036, commercial jet airplanes could be upwards of 47,000 units on a global basis, which is double what it is today. Our commercial aircraft business as well as our jet engine business should benefit significantly. In the commercial aircraft business, we are involved in development and production of the Boeing 777X, the U.S. company's most advanced aircraft. A new factory for the 777X was completed in February 2017. In the jet engine business, we supply intermediate pressure compressors, Fan Drive Gear Systems (main gears) and combustors—core components in the latest jet engines made by Rolls-Royce in the United Kingdom and Pratt & Whitney in the United States. Although these jet engine components require up-front investment, future parts and maintenance demand should generate sizable profits.

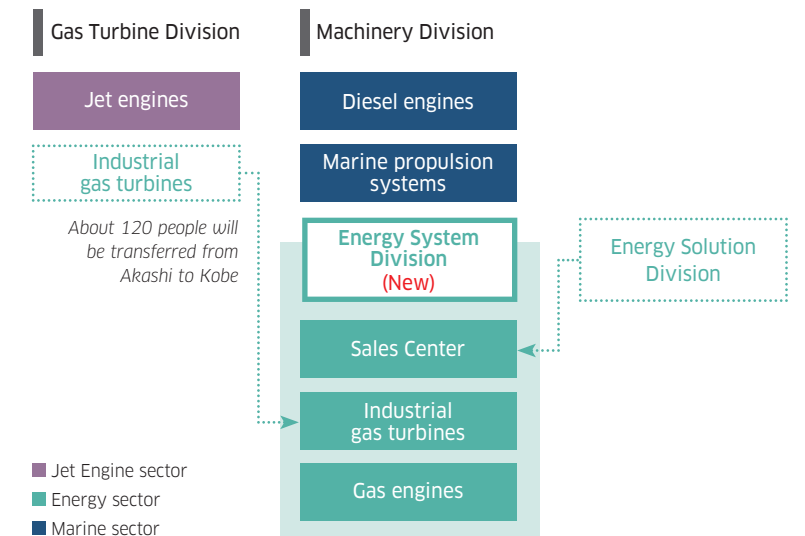
**Energy** In the energy business, we restructured our organization in April 2017 to enhance our response to expanding energy demand overseas, especially in Asia. The energy business in the Gas Turbine Division and the Machinery Division were integrated under the newly established Energy System Division. Through the new division,

### Predicted Sales from Key Products and Services that Drive Growth



\*Medcaroid Corporation: A joint venture established with Sysmex Corporation to develop and manufacture medical robots; accounted for by the equity method.

### Organization Restructuring of Energy-related Businesses



we aim to strengthen our ability to sell solutions, boost EPC\* capabilities, and accelerate overseas business development. The scale of our energy business currently stands at about ¥100.0 billion, but we expect it to triple more or less, to ¥300.0 billion, by 2025.

\*EPC: Engineering, procurement and construction

**Rolling stock for overseas markets** In the rolling stock business for overseas markets, we anticipate more projects financed by ODA loans to take place in the emerging countries of Asia. We are able to manufacture all types of rolling stock and will draw on this strength to steadily capture new orders.



**Robots** The robot business has grown considerably in the last few years. “duAro,” our dual-armed SCARA robot\*, is easy to install and can operate alongside people. Given the labor shortage in developed countries, we expect huge demand for duAro. In other areas of robotics, the market for medical robots is rapidly expanding and could reach ¥2 trillion by 2019 on a global basis. The Kawasaki Group is involved in the medical robot business through Mediaroid, a joint venture established with Sysmex Corporation, and in March 2017, welcomed the launch of “Vercia,” an operating table applying robot technology for hybrid operating rooms. Mediaroid is also developing a robot that assists in surgery, with a debut date sometime in fiscal 2020.

\*SCARA robot: Selective Compliance Articulated Robot Arm robot

#### Strengthening Technology and Synergies

The foundation of medium- to long-term growth is technological capabilities. Under MTBP 2016, we will invest about ¥150.0 billion in R&D pursuits over three years from fiscal 2017. This is about ¥25.0 billion more than the level earmarked during the previous business plan. We will polish our technological capabilities, which are a source of competitiveness, and utilize this expertise to develop products and services not easily copied by any other corporate group and thereby build a high barrier to entry by rival companies. In addition, the Kawasaki Group counts many world-class technologies in its corporate toolbox, and by combining these technologies and demonstrating synergies derived from these combinations, the Kawasaki Group will be able to offer even more innovative products and services. Toward this end, we established the Technology Synergy Section within the Corporate Technology Division and will earnestly pursue synergies across all business segments to achieve greater success.

#### Opportunities in ICT/IoT

In recent years, rapid progress in information and communication technology (ICT) has created a situation some call Industry 4.0. The Kawasaki Group will be able to provide highly competitive products and services by combining the latest ICT and the Internet of Things (IoT) technology with years of accumulated product development expertise. Currently, we are collecting information coming out of Silicon Valley, in the United States, and pursuing research into the application of ICT/IoT

technology to products and services in each business segment. These activities hinge on the ICT System Department in the Corporate Technology Division and the Innovation Department in the Marketing Division at the head office.

#### Efforts in Environmental Management

Momentum to deal with global warming has been growing worldwide since the Paris Agreement went into effect in 2016, and people are paying greater attention to long-term corporate activities to realize a sustainable society such as through CO<sub>2</sub> reduction. In our activities, we—the Kawasaki Group—are guided by Environmental Vision 2020, initiated in 2010, which targets dramatic energy savings and reduced industrial waste at production sites, product-based contributions to reduce CO<sub>2</sub> and heightened awareness as an environmentally friendly brand through Kawasaki Green Products. These efforts are yielding steady results. In addition, we recently drafted Kawasaki Global Environmental Vision 2050, a new, long-term vision emphasizing three basic concepts: CO<sub>2</sub>-free, waste-free and harm-free. Guided by this vision, we will contribute to various objectives with a particular focus on controlling global warming, promoting a recycling-oriented society and protecting biodiversity.

#### Promoting Workstyle Reform

For the Kawasaki Group to post stable profits over the long term, grow as a corporate group, and enhance enterprise value, it is vital that employees are able to demonstrate their capabilities, underpinned by rich sensitivity cultivated in their fulfilling daily lives, and contribute to higher productivity in their respective workplace and, by extension, the Group. Toward this end, we have embraced K-Win (Kawasaki Workstyle Innovation) Activities throughout the Group to encourage new approaches to work, mainly for employees in administrative and technical positions.

These activities tie into evolving corporate culture, business restructuring and support by corporate systems and are intended to limit long working hours while raising productivity and fostering a good work-life balance. In fiscal 2018, we will set the stage for sharing the content of activities, with workstyle seminars and programs to enhance operating efficiency organized for employees.

#### Corporate Governance and Engagement

We constantly review the corporate governance system, as it applies to the Kawasaki Group, based on the gist of the Corporate Governance Code and the Stewardship Code. Recently, with approval at the General Meeting of Shareholders, we appointed two new outside corporate auditors—Satoru Kohdera and Atsuko Ishii—so that the majority of corporate auditors are now from outside the Company. This has reinforced the oversight function. We also keep an open channel to capital markets and actively promote constructive dialogues with a purpose—engagement—that involve shareholders and companies. This way, we raise enterprise value together.

#### Thoughts on Return to Shareholders

The Kawasaki Group adheres to a basic management policy of improving enterprise value, that is, consistently generating income exceeding capital costs, over the long term. Return to shareholders is a key management priority that is realized by continuously investing in the state-of-the-art R&D and innovative facilities needed to drive growth and by raising shareholder value over the long term. In addition, we seek to strike a good balance between raising shareholder value and delivering returns to shareholders through the distribution of dividends. To do so, we take a comprehensive view of financial status, including

future performance as well as free cash flow and the debt-equity ratio, and have set a benchmark of 30% for the consolidated payout ratio over the medium to long term.

#### Shining Brightly for Another 100 Years

The Kawasaki Group traces its roots back to 1878, when Shozo Kawasaki established Kawasaki Tsukiji Shipyard. The Group has grown, of course, since then and has utilized diverse, high-level technological capabilities to create uniquely innovative products and services that address all sorts of social issues.

In recent years, the world has undergone incredible changes, and the speed of change is accelerating. I believe in the excellent technologies and human resources of the Kawasaki Group, but I also think employees must share my critical feeling about changes in the environment and must always strive for innovation so that the Group can create new value, now and 100 years from now, and continuously enhance enterprise value. It is my duty to lead the way, and I will manage the Company and the Group focusing on speed.

We seek to realize our mission statement “Kawasaki, working as one for the good of the planet” and will continue to create value for all stakeholders.

We will reinforce  
our technological capabilities to realize  
medium- to long-term growth  
and generate synergies across  
the Kawasaki Group.

