Capital Allocation Strategy

2018 Mid-term Management Plan Achievements and Issues 2018

Profitability Improves, Leading Toward Further Growth in Corporate Value

Under the 2018 Mid-term Management Plan, Hitachi promoted structural reforms in unprofitable businesses, enhanced project management and engaged in other efforts aimed at improving profitability. The Company also disposed of assets with earnings not expected to generate a return on equity or invested capital and implemented measures aimed at improving the Cash Conversion Cycle (CCC). These efforts resulted in ROA, a financial indicator, reaching 6.2% (excluding the temporary impact of a nuclear power station project in UK), which exceeded the 5.0% target set for fiscal 2018. In addition, the D/E ratio, a measure of financial discipline, was maintained at a level well below 0.5 times. However, we recognize that there are further challenges to maximize corporate value.

Retained earnings increased, while the dividend payout ratio and labor's share of income remained at the same level. To achieve further growth going forward, we must strategically allocate capital in investment areas.

To increase capital efficiency, we will further reduce assets not expected to meet investment capital, promote utilization of external capital markets using financial leverage, make an effort to understand risks according to changes in the business environment and attempt to strike a balance between efficiency and risk management.

Furthermore, we will promote management that is more aware than ever of capital costs, engage in a financial strategy aimed at further reductions in capital costs and monitor stock risk and return indicators represented by the β-value and manage them with the goal of optimizing them.

Corporate Governance Code revisions have been in effect since June 2018 and the way of dialogues with capital markets has changed, thus we recognize the necessity of innovation in conventional management methods. In addition to our basic approach to earnings plans and capital policies, we will indicate targets related to profitability and capital efficiency and explain how much shareholder returns in excess of capital costs we will generate over the medium to long term in light of business portfolio reorganization and the strategic allocation of management resources based on precise ascertainment of capital cost.

Measures Under the 2021 Mid-term Management Plan

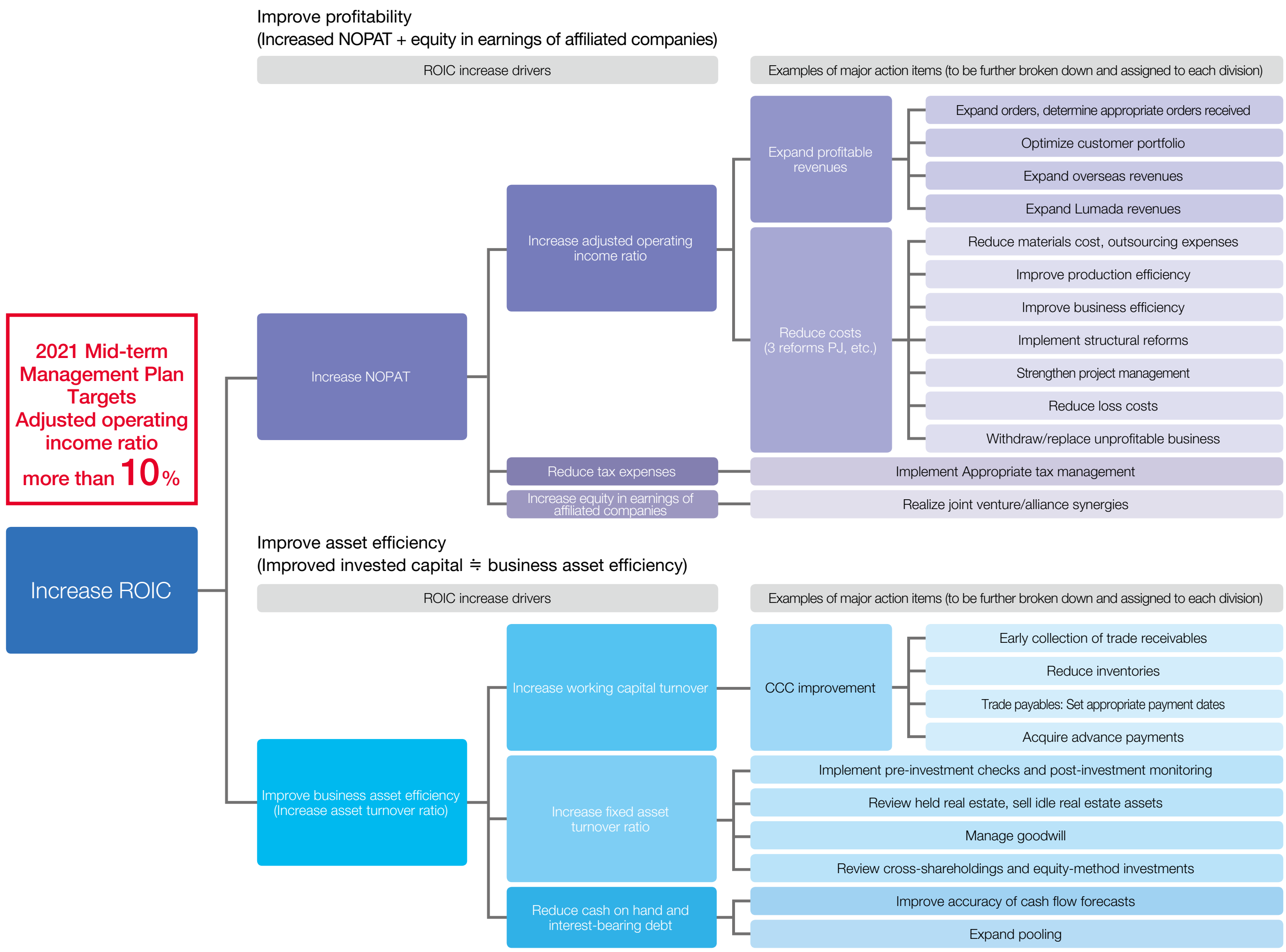
Promoting ROIC Management with a Higher Awareness of Capital Costs

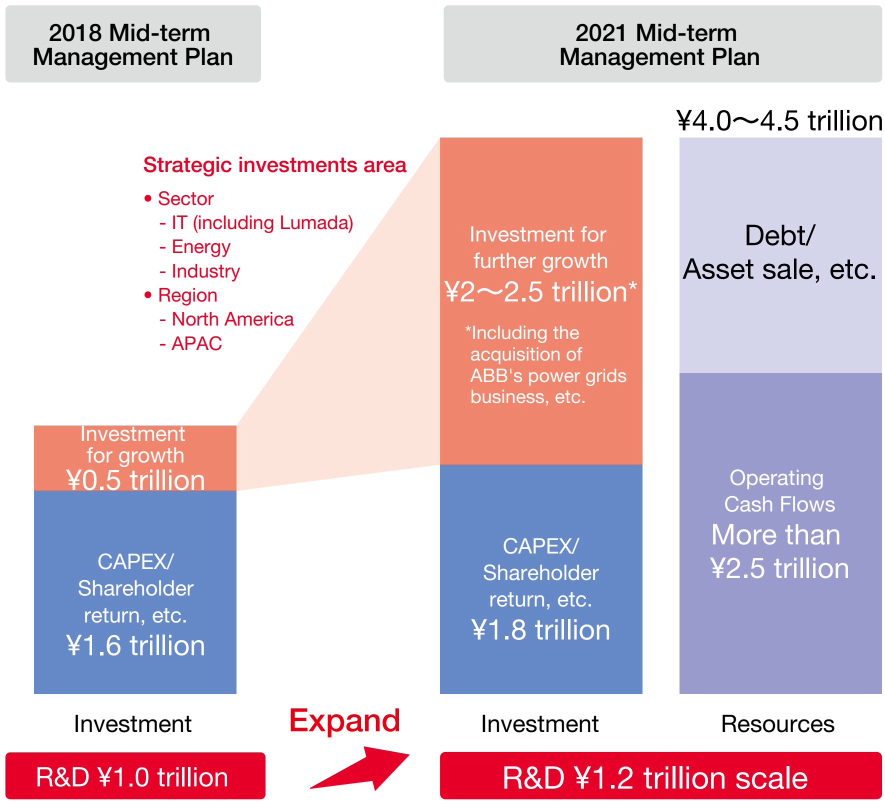
Under the 2021 Mid-term Management Plan, Hitachi Group will introduce Return on Invested Capital (ROIC) as a management indicator and promote the improvement of capital efficiency and the growth of highly profitable businesses through our management. ROIC is an indicator that evaluates returns generated by invested capital calculated by dividing business profit after taxes by invested capital. To increase returns, ROIC needs to exceed the weighted average cost of capital (WACC), which is the cost of raising invested capital.

Going forward, aiming for ROIC above 10%, we will strive to increase the difference between ROIC and WACC (ROIC spread) and increase shareholder value by strengthening profitability and reducing WACC through the use of financial leverage. To achieve this, we will improve adjusted operating income, while at the same time continuing to promote the disposition and sales of owning shares as well as real estate and other idle assets aimed at improving business asset efficiency with the aim of appropriately structural reforms of unprofitable businesses and countermeasures to businesses with challenges.

Proactive Investment in Growth Areas

While promoting management with an awareness of capital costs, we will make large-scale growth investments of approximately ¥2.0 to ¥2.5 trillion over the next three years using financial leverage that targets an optimal capital structure. Of this amount, we have already announced the investment of ¥1 trillion in the ABB power grid business, and positioning IT and industry as priority investment areas, we will attempt to expand our digital solutions business focused on Lumada, while at the same time targeting growth by strengthening services and products required for the provision of solutions. In terms of regional strategies, we will make the necessary investments focusing on the North American and Asia-Pacific regions, making bigger investments than ever before in an attempt to strengthen R&D and human resource development.





Basic investment policy

M&A

- Expand the digital solutions business while strengthening products and services and securing human resource development, which are efforts essential to providing solutions

R&D

- Strengthen development focused on AI (image analysis, voice recognition, machine learning, etc.), robotics, electrification and security to establish a Cyber Physical System (CPS)

Human resources

- Produce and strengthen human resources who can create new innovation using digital technology and provide optimal digital solutions to customers through external recruitment and internal human resource development