



Becoming a Global Leader in the Social Innovation Business

Hitachi will transform rapidly to achieve the innovations required by the times.

Reaching a record high for the second consecutive year, fiscal 2018 adjusted operating income* at Hitachi came in at ¥754.9 billion, with the adjusted operating income ratio for the year meeting the Mid-term Management Plan target of 8%. Total Hitachi, Ltd. stockholders' equity on the balance sheet during the period covered by the plan was up approximately ¥500 billion, backed by the Company improving its ability to generate cash. Having achieved a V-shaped recovery after recording losses of ¥787.3 billion in fiscal 2008, Hitachi is now moving into a new stage of development.

* Adjusted operating income is defined as total revenues less cost of sales and selling, general, and administrative (SG&A) expenses.

Toshiaki Higashihara
President & CEO

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Returning to Our Roots

Reaffirming Our Strengths Based on the Lessons of the Past

In 2020, Hitachi will celebrate the 110th anniversary of its founding as a manufacturer of electrical machinery.

In all that time, one of the biggest turning points was the management crisis. The Company at the time posted the largest

loss ever for a Japanese manufacturer, with stockholders' equity of about ¥2-¥3 trillion being adversely impacted to fall at about ¥1 trillion. Hitachi had been called an "unsinkable giant" in the past, so how did things become so bad that it found itself being ridiculed as

“a sinking giant”? I believe this situation came about due to there being no real sense of crisis at the Company. That said, after posting this huge loss, management did move to rebuild itself and spur an earnings recovery through a major reshuffling of the Company’s businesses and reforms to Hitachi’s corporate governance structure.

Having witnessed the Company’s struggles, I learned the importance of simultaneously implementing “peacetime structural reforms” and a “sustainable growth strategy.” Crafting bold and decisive strategies when an emergency arises is one thing, but if, in periods of relative calm, a company is not looking likely to become a world-class competitor, its leadership needs to take steps, including shrinking or withdrawing from struggling businesses. I have taken to heart the lesson that if a business fails to act boldly and with speed, there is a very real risk of it not being able to survive, especially in these uncertain times.

Completing the V-Shaped Recovery

Initiatives to Improve Profitability and Achieve Our Mid-term Management Plan Targets

I became Hitachi’s president and COO in 2014 and president and CEO in fiscal 2016, when we launched the 2018 Mid-term Management Plan. Hitachi was unable to achieve the income ratio targets in its 2015 Mid-term Management Plan, and we were determined not to let that happen again during the period covered by the new plan. So what was the best way to achieve our minimum adjusted operating income ratio target of 8% and the creation of a structure supporting margins in the double digits?

Our first move, launched in April 2016, was to overhaul our organizational structure. This involved dividing up our large in-house company system into small business units, allowing us to clearly identify the challenges and issues in each business. While enacting measures aimed at spurring improvements in low-profit businesses, we also shrunk or withdrew from businesses where these measures appeared unlikely to work. Our efforts to tighten project management and review fixed costs on a companywide basis contributed to a reduction in unnecessary costs, and we lifted on-site awareness of cash flow by making the cash conversion cycle (CCC) a key management indicator. I believe the organizational overhaul allowed us

So the question is how best to create a growth strategy. Faced with truly dire conditions, we decided to “return to our roots.” Since its founding, Hitachi has focused on contributing to the improvement of people’s lives by following a corporate philosophy based on the desire to “contribute to society through the development of superior, original technology and products.” Established as a manufacturer of five-horsepower induction motors, Hitachi has not only developed its ability to create products, but has honed its abilities in control and operational technologies (OT) in the more than 100 years it has operated as a manufacturer, as well as its knowledge in information technologies (IT) over the past 50 years. Hitachi’s strengths lie in its ability to combine OT, IT, and its products to create new value and provide solutions that meet the needs of its customers and society. I believe the creation of an organization that makes full use of this strength allows us to contribute to the resolution of various social issues, which in turn contributes to sustainable growth at Hitachi.

to see issues that were previously difficult to see, and with the ability to make quick management decisions, I soon began to see results.

In terms of our growth strategy, we launched Lumada, which incorporates the sum of our technological knowhow, in May 2016, and established a system providing digital solutions throughout the group. Lumada is Hitachi’s advanced digital solutions, services, and technologies for turning customers’ data into insights to drive digital innovation. Lumada-based revenues have already expanded to exceed ¥1 trillion.

While promoting the reshuffling of our businesses, including the sale of listed subsidiaries, we are also actively working to incorporate businesses within the group that could be expected to generate synergies with Lumada. As examples of this, in 2017 we acquired air-compressor firm Sullair, which has a global footprint especially in North America, and we aim to complete the acquisition of ABB’s power grid business in the first half of 2020. The intent of the ABB power grid business acquisition is the greater provision of innovative energy solutions through an expansion in global sales channels. And to take it one step further, we also aim to incorporate the philosophy

and know-how of this globally successful company into Hitachi in order to spur further positive changes. I believe acquisitions of this type can provide Hitachi with a stepping-stone toward its goal of

creating greater value on a global scale as it moves into its next growth stage.

The View after Rebirth

Exploring the Purpose of Our Business

If I were to summarize the 2018 Mid-term Management Plan, I would say its biggest achievements included instilling a shared sense of crisis in employees throughout the Company and fostering a growing focus on income and cash. These changes resulted in Hitachi achieving its Mid-term Management Plan target for an adjusted operating income ratio of 8%, as well as a growing perception that Hitachi as a global company should naturally produce income margins in the double digits, and that the Company should be a global leader in the Social Innovation Business.

After having achieved a V-shaped recovery, is it really necessary for the Company to push income ratios to 10% or higher? I have for some time been saying, “Show me the cash!” to our employees, in part as I feel it is necessary to focus on what comes before profit.

In this sense, I will never forget the first factory manager at Omika Works with whom I worked after joining the Company quoting from Yuzo Yamamoto’s novel, *A Stone by the Roadside*. A line in the novel essentially says, “There is only one you and you have only one life, so if you don’t really use it, are you really human? Have you really lived?” To apply that to today, if you spend more than half your life at work, then it is through that work that you have the opportunity to feel the happiness of people and society. It is through the job in front of you that you can help people and society. In other words, I think contributing to building social and environmental value is a major driver behind our personal growth and our job satisfaction.

A look around the world shows an unending series of changes impacting people’s lives. These include resource shortages and climate change, demographic changes brought on by the aging of society, and the issues accompanying urbanization. Amid such an environment, there are growing efforts around the world, including the Society 5.0^{*1} initiative in Japan, to resolve through innovation the social issues outlined in the United Nations Sustainable Development Goals (SDGs). Hitachi’s corporate philosophy for the past 109 years has been to “contribute to society through the development of superior, original technology and products” and if each of its 300,000 employees around the world can find satisfaction in resolving social and environmental issues through advancing the Social Innovation Business and broadening the field of related activities, I believe it would surely contribute to continued growth for Hitachi. Of course, it is important to improve economic value, but I also believe it is important at the same time to improve social and environmental value. We aim to pursue this goal based not only on leadership from the top, but also through bottom-up participation from employees who find real purpose in their work. If we can accomplish this, I believe Hitachi will be all the stronger for it.

*1 Society 5.0 expresses a new idea of society and related efforts to achieve this, as advocated by the Japanese government. The aim is to develop the economy while addressing societal issues by deploying AI, IoT, robots and other forms of advanced science and technology to make use of various data creating an affluent, human-centered society. The name refers to the evolution of a fifth form of society, continuing from the hunter-gatherer, agrarian, industrial, and information societies.

A Vision for a New Leap Forward

Aiming to be a Global Leader in the Social Innovation Business

The modern age has been called the era of VUCA (Volatility, Uncertainty, Complexity, Ambiguity), where it is increasingly difficult to predict the future. This is why it is important to maintain focus on what

we value, and on the standards we use when making decisions. With Hitachi, these are grounded in our corporate mission and our values, which are based on the concepts of “harmony, sincerity, and a

pioneering spirit.” For historical perspective, Namihei Odaira, who founded Hitachi at age 36, noted that the motors and generators he repaired at the copper mines in what is now Hitachi City, Ibaraki Prefecture were all imported from abroad, and that Japanese industry could never develop if people in the country didn’t learn to make these devices on their own. With that idea, he founded Hitachi alongside a number of fellow engineers. I believe the founding of the Company was largely the result of Mr. Odaira’s desire to change Japan and contribute to the development of society and the country as a whole.

That kind of drive still exists in Hitachi today. Our focus is not only on economic value, revenues and income, but also on using innovation to resolve the many challenges facing society. We believe that Hitachi should be synonymous with Social Innovation Business, and with that kind of presence, we hope to widely contribute to society as a global leader. Even though times have changed, I believe the founder’s spirit continues to guide our management as part of Hitachi’s unchanging values.

I believe global leaders must have a clear vision of what they should be and that they should take the lead in creating history.

I also believe employees should do more than just fulfill the goals of leadership and that they should also focus on how their work can contribute to improving social and environmental value. Whenever I engage in direct communication, I am continually pushing for this kind of shift in the mind-set of our employees. The approach is not based on instilling a sense of crisis, but rather on raising awareness of the importance of social and environmental contribution.

Expressing sentiments such as “today we were able to supply safe water to people in the area” and “we contributed to the treatment of cancer patients,” our 300,000 employees worldwide are well aware of their contributions to the environment and society, as well as their connection to society in their daily work. I believe that this builds motivation in our employees, and through the combined efforts of all, it contributes to the creation of higher social and environmental value, and ultimately economic value for the Company.

Charting a Path to Growth: Launching the 2021 Mid-term Management Plan

Realizing Our Three Values and Establishing Goals for the Future

Our 2021 Mid-term Management Plan, launched in April 2019, focuses on simultaneously improving social value, environmental value, and economic value, and establishes five business sectors (IT, energy, industry, mobility and smart life) for the creation of social innovation. To put it differently, these are areas in which Hitachi can make use of the technological know-how it has built up through its many years of developing social infrastructure. Moreover, in each of these business sectors, Lumada can be used as a common platform to achieve the goals of improving people’s quality of life (QoL) as well as corporate value at our client companies.

Strengthening Lumada, which can accelerate innovation, is key to growth moving forward. Indeed, the creation of multiple reusable solutions in each of the key business fields can lead to the resolution of issues that cross industry and geographic boundaries.

The image of toy blocks provides a good analogy for better understanding. As with the variety of colors and shapes of a child’s

blocks coming together to form a unique structure, we can provide a variety of solutions, such as energy management, human flow simulations, and autonomous driving solutions, in a unique customized package to meet the specific needs each customer.

An example of this is the Copenhagen Metro project, for which Hitachi is supplying 24-hour driverless trains and related systems.

The Dynamic Headway solution used in testing these systems focuses on train station congestion, using data from mounted sensors to measure fluctuations in the number of passengers arriving. Based on this information, the system then optimizes the number of trains in operation. Hitachi’s efforts are focused on solving customer issues by combining solutions such as human flow simulations, automated timetable generation, and operational management optimization as customizable blocks. Amid the trend toward growing urbanization, better public transportation is increasingly required to prevent traffic congestion and create

comfortable public spaces, and given that the Copenhagen Metro project also optimizes operational efficiency and conserves energy,

it is contributing to improvements in social, environmental and economic value.

Accelerating Innovation to Spur Growth

Building an Innovation Ecosystem with Lumada at Its Core

So the question now is how to strengthen and evolve Lumada. I believe this requires the building of an “innovation ecosystem” that accelerates collaboration with business partners, universities, research institutes, and customers around the world.

The Company is already working with research institutions and domestic universities such as the University of Tokyo to create solutions to social issues. As example is the “Hitachi The University of Tokyo Laboratory.” We are also focused on expanding these kinds of collaborative relationships to include overseas universities, research institutions, and customers. In April 2019, Hitachi launched the collaborative creation project Kyoso-no-Mori at its Central Research Laboratory, inviting customers and partners from

all over the world to create new ideas alongside Hitachi researchers and designers.

We are also actively working on initiatives designed to contribute to the acceleration of innovation around the world. These efforts include acting as a supporting partner to start-ups as they create new innovations, and establishing a corporate venture capital fund.

We will continue to work toward improving the social, environmental, and economic value of our customers by creating an ecosystem for co-creation and establishing Lumada as the driving force behind the accelerated development of the Social Innovation Business.

Building a Global “Delivery” System

Front-Line Personnel with the Hitachi DNA Hold the Key to Success

After focusing on solutions to customer issues and assessing feasibility and profitability, the framework for building on Lumada’s foundation is now complete. There are already about 650 Lumada customer cases, and we believe this shared base will assist us in providing solutions that truly satisfy our customers. However, for the sake of our customers, I believe it is vital to develop front-line personnel who can provide even higher-added-value solutions. Hitachi’s collaborative efforts with its customers are not based on a vertical relationship, with one party acting above the other, but instead are based on side-by-side cooperation with the aim of improving social value. It’s important for those involved to always think with a sense of ownership and be at the forefront of discussions. If the direction of the organization or team is different, our employees will work together in line with the final decision in the spirit of “harmony”, leaving aside their previous opinions. Moreover, they will put forth their most

“sincere” efforts for our customers and partners, and even should they fail, they will never give up on their “pioneering spirit.” I believe securing and fostering frontline personnel exhibiting these qualities is a key to our success.

By combining the common solutions accumulated through Lumada, we can customize solutions for customers in different parts of the world. Moreover, to strengthen our front-line human resources so that we can realize this kind of “innovation ecosystem,” we are not only training in-house employees, but also actively recruiting personnel from outside the Company. Given that cultures and business practices vary according to region and country, we are working to cultivate human resources in each of those areas. As an example, we have been able to secure human resources in areas such as California’s Silicon Valley who are not only talented and experienced, but share a deep commitment to harmony,

sincerity, and the pioneering spirit that make up the Hitachi founding spirit.

I worked at the Omika Works in Ibaraki Prefecture for about 29 years after joining the Company in 1977. The plant was created in 1969 to house the combined control departments that were split off from the Hitachi and Kokubu plants, and for some time after I was assigned to the facility, there was still a lot of talk about from which of the original plants you came. That said, my time there allowed me to experience the creation of a shared culture, as gradual integration brought with it the spirit of building a “Greater Omika” plant. In my opinion, the

more background diversity there is, the better. I believe human resources recruited from around the world will be instrumental in sharing Hitachi’s values and resolving the social issues impacting our customers. I have high expectations as well as great confidence in this effort.

Total Growth Investment of ¥2.5 Trillion

Aggressively Pursuing Growth Opportunities While Maintaining an Eye on Capital Costs

Hitachi will invest more aggressively in growth, including M&A, over the next three years from fiscal 2019 to fiscal 2021 as part of its effort to become a true global leader. More specifically, we target a total investment of ¥2.5 trillion during the period, including about ¥1 trillion for the already announced acquisition of ABB’s power grid business. Growth investment will be focused on the IT and industry sectors, where we will enact unprecedented investment in both human resources and R&D. To carry out large-scale investment, we will use financial leverage to reduce capital costs (WACC) and improve ROE, while at the same time fostering management awareness of capital efficiency by establishing return on invested capital (ROIC) as a new KPI.

Hitachi will also strengthen its business foundation to accelerate development of the Social Innovation Business. In addition to operational reforms based on data accumulated thanks to advancements in production systems and business processes, as well as the promotion of digital transformation by expanding the scope of Lumada’s in-house use, we are working to reduce fixed costs and improve efficiency in sales and indirect operations. Maintaining an awareness of what is appropriate for a global company, we will continue to work toward improving profitability, with a gross profit margin^{*2} target of 30% or higher and an SG&A ratio^{*3} target of under 20%.

I believe an acceleration in the Social Innovation Business requires Hitachi to further improve the level of trust it enjoys from society. With this in mind, we will promote compliance, quality assurance, and safety by utilizing digitalization and Lumada to reduce manual tasks.

Based on these efforts, our fiscal 2021 earnings targets include average annual revenues rising organically by more than 3%, an adjusted operating income ratio above 10%, and cumulative operating cash flow for the three years greater than ¥2.5 trillion. Moreover, we target ROIC of above 10%, with the overseas revenue ratio climbing from 51% at present to better than 60%.

^{*2} Gross profit margin: The percentage of gross profit to revenues.

$$\frac{[\text{revenue} - \text{cost of sales}]}{\text{revenues}} \times 100$$

^{*3} The SG&A ratio: The ratio of the sum of all direct and indirect selling expenses and all general and administrative expenses to revenues. $\text{SG\&A expenses/revenues}$

Keywords for Survival in the Age of Data Capitalism:

Speed, Trust, Transparency and Customer Perspective

There is a paradigm shift taking place as we move from the age of products to the age of digitalization and the importance of speedy management continues to grow. Conversation at both the World Economic Forum in Davos at the beginning of the year and the G20 Summit in June centered on Data Free Flow with Trust (DFFT), with the expectation of improvements in private information banks and national databases. While the free trade of cross-border data requires trust, I believe there can be no trust without transparency. In this age of data, Hitachi, with its sensors and analysis technologies essential for data collection, will likely find more opportunities to promptly provide customers with solutions, and should encounter more opportunities to both improve economic

value and resolve social issues.

Of course, an opportunity is only an opportunity if we are properly prepared to take advantage of it. With a venturing spirit backed by the Company's "contribute to society" mission and its corporate philosophy grounded in "Harmony, Sincerity, and a Pioneering Spirit," each of our employees is committed to building a relationship of trust with our customers and the wider society. Moreover, with the higher goal of contributing to a better world, Hitachi and its employees will continue to work tirelessly to quickly provide solutions tailored to the customer's needs. I believe these efforts will lead to more opportunities for Hitachi to become a global leader in the Social Innovation Business.

Pursuing Dialogue with Stakeholders to Further Their Understanding of Hitachi's True Value

Communication is essential in building relationships of trust with external parties. It has been said by some that Hitachi's share price and market capitalization are rather low, and when looking back, it certainly appears that shareholder returns have for a long time not been at a level of which we could be proud. Given these circumstances, I strongly believe it necessary to bolster communication with those in the capital markets to deepen trust. There are likely a substantial number of stakeholders who still have the impression of Hitachi as a manufacturer of heavy electrical machinery, something carried over from many years ago. However, the Company is undergoing rapid change, and that change is likely to accelerate moving forward. With the goal of improving stakeholder understanding of Hitachi as it stands now, as well as its future course, we will continue to work to increase opportunities for communication while simultaneously improving transparency, including in the disclosure of ROIC, adjusted operating income, and revenues by sector.

In regard to shareholder returns, Hitachi targeted a low consolidated payout ratio of 20%–30% during the period covered by the 2018 Mid-term Management Plan, and it paid dividends at this level except in fiscal 2018, when after-tax net income was particularly low due to transitory factors. Our goal moving forward is to increase dividends paid to our shareholders to a higher level.

Based on the "Hitachi Social Innovation is Powering Good" campaign tagline that launched this year, we will strive to provide social, environmental, and economic value in line with our efforts to contribute to enhanced value for our corporate customers and an improved quality of life for people in general. We thank you and look forward to your continued support as we move forward.

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