Systems & Services Business Strategy

Hitachi IR Day 2016

June 1, 2016

Keiichi Shiotsuka
Senior Vice President and Executive Officer,
Head of Systems & Services Business
Hitachi, Ltd.
Systems & Services Business Strategy

[Contents]

1. Review of 2015 Mid-term Management Plan
2. Function of the Systems & Services Business
3. Growth Strategy
4. Business Performance Trends
5. Conclusion
1. Review of 2015 Mid-term Management Plan
[Information & Telecommunication Systems Segment]

- Expanded revenues and achieved optimization of consolidated management
- Challenges lie in taking prompt action on changes to the market environment and achieving global levels of profitability

<table>
<thead>
<tr>
<th></th>
<th>FY2015 Results</th>
<th>Previous Forecast *1</th>
<th>Difference</th>
<th>[Reference] Initial Target *2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenues</td>
<td>2,109.3 billion yen</td>
<td>2,100.0 billion yen</td>
<td>+9.3 billion yen</td>
<td>2,100.0 billion yen</td>
</tr>
<tr>
<td>Adjusted Operating Income Ratio</td>
<td>6.7%</td>
<td>7.5%</td>
<td>(0.8)%</td>
<td>10%</td>
</tr>
<tr>
<td>EBIT Ratio</td>
<td>5.2%</td>
<td>6.9%</td>
<td>(1.7)%</td>
<td>9.8%</td>
</tr>
</tbody>
</table>

### Accomplishments
- Improved profitability by optimizing front-line functions (Absorbed Hitachi Solutions’ businesses in the social, financial and government & public sectors)
- Successful project management in large-scale mission critical projects (Controlled SE resources equivalent of 30,000 person-months)
- Expanded service business and global business
- Implemented structural reforms of telecommunications & network systems and consolidation of storage manufacturing bases

### Challenges
- Service deployment in anticipation of needs associated with the digitalization of customer businesses
- Delays in business structure reforms in rapid response to changes to the market environment and product portfolio changeover (Telecommunications & network, storage, servers)

Systems & Services Business Strategy

[Contents]

1. Review of 2015 Mid-term Management Plan
2. Function of the Systems & Services Business
3. Growth Strategy
4. Business Performance Trends
5. Conclusion
## 2-1. Hitachi Group’s Position in FY2018

Front develops and provides services to drive expansion of revenues and profits

### Front

<table>
<thead>
<tr>
<th>Power / Energy</th>
<th>Industry / Distribution / Water</th>
<th>Urban</th>
<th>Finance / Public / Healthcare</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Transition to distributed power supply utilizing IT</td>
<td>- Use “Lumada” IoT platform to optimize value-chain for industry and distribution</td>
<td>- Improvement of Quality of Life in communities</td>
<td>- FinTech / My-number</td>
</tr>
<tr>
<td>• Microgrid, Regional energy management</td>
<td></td>
<td>- From Rail as a Service to Outcome Delivery</td>
<td>- Healthcare Service (Platform)</td>
</tr>
<tr>
<td>• Renewable energy</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Platform

<table>
<thead>
<tr>
<th>Products</th>
<th>IT Platform</th>
<th>Control System Platform</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Industrial Products</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Group Companies</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>IT Products</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
2-2. Function of the Systems & Services Business

Connect the services, platforms and products of each front BU modeling after the front BUs that are leading in digitalization

Accelerate Digitalized Social Innovation Business

Front

<table>
<thead>
<tr>
<th>Power / Energy</th>
<th>Industry / Distribution / Water</th>
<th>Urban</th>
<th>Finance / Public / Healthcare</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nuclear Energy BU</td>
<td>Industrial &amp; Distribution BU</td>
<td>Building Systems BU</td>
<td>Financial Institutions BU</td>
</tr>
<tr>
<td>Power BU</td>
<td>Water BU</td>
<td>Railway Systems BU</td>
<td>Government &amp; Public Corporation BU</td>
</tr>
<tr>
<td>Energy Solutions BU</td>
<td>Water BU</td>
<td>Urban Solutions BU</td>
<td>Healthcare BU</td>
</tr>
</tbody>
</table>

Common IT Functions: Application development, engineering, maintenance & operation, project management and quality assurance

Platform

Products
Front Business

- Consulting

- Financial Information Systems
  IT for banks, insurance and capital markets

- Government & Public Corporation Information Systems
  IT for government offices, local governments and education

- Company-wide Common IT Functions
  Application development, engineering, maintenance & operation, project management and quality assurance

IT Platform & Products

IT Platform
- IoT Platform
- Data Analytics
- Artificial Intelligence
- Cloud Services
- Cyber Security
- Software

IT Products
- Storage
- Servers
- Telecommunications & Network Equipment
Systems & Services Business Strategy

[Contents]
1. Review of 2015 Mid-term Management Plan
2. Function of the Systems & Services Business
3. Growth Strategy
4. Business Performance Trends
5. Conclusion
3-1. Business Policy

Expand social innovation business with a focus on global and digital solutions as growth targets

**Product Maintenance / System Operation**
- Maintain profitability with improved efficiency
  - Hardware maintenance
  - Mainframe operation
  - Software support services
- Long-term contraction

**Japan Systems Integration (SI)**
- Stable profits on strength of management capabilities
  - From-scratch development
  - System replacements including hardware and middleware
  - Data recording and storage

**Global and Digital Solutions**
- Develop market with business services and the IoT platform supporting them
  - Customer collaborative creation-type services
  - Services for social infrastructure (Transportation, disaster prevention, etc.)
  - Artificial intelligence, big data analytics, etc.
- Driver of overall growth

**IT Products**
- Concentrate on products that support services
  - Servers and storage
  - Automatic teller machines (ATMs)

**Market**
- Rapid expansion
- Commoditization and intensifying competition

**Base Business**
- Independent (Closed)
- General (scalable)

**Driver of overall growth**
- Collaborative Creation (Open)
3-2. FY2018 Business Performance Target and Key Measures [by Sub-segment]

Accelerate the shift to services and solutions and switch to a high-profitability structure with adjusted operating income ratio of 10%.

### Business performance target

<table>
<thead>
<tr>
<th></th>
<th>FY2015 Results</th>
<th>FY2016 Forecast</th>
<th>FY2018 Target</th>
<th>Vs. FY2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenues</td>
<td>2,109.3 billion yen</td>
<td>2,040.0 billion yen</td>
<td>2,200.0 billion yen</td>
<td>104%</td>
</tr>
<tr>
<td>Adjusted Operating Income Ratio</td>
<td>6.7%</td>
<td>7.0%</td>
<td>10.0%</td>
<td>+3.3 points</td>
</tr>
<tr>
<td>EBIT Ratio</td>
<td>5.2%</td>
<td>4.1%</td>
<td>10.0%</td>
<td>+4.8 points</td>
</tr>
</tbody>
</table>

### Key measures [by sub-segment]

**Front Business**
Launch digital solutions positioning systems integration business as a base

**IT Platform & Products**
- **IT Platform**
  Build the platform for digital solutions
- **IT Products**
  Focus on products that support digital solutions
3-3. Front Business

Launch digital solutions positioning systems integration business as a base

Establish a digital solution business model and expand global business

- Strengthen upstream consulting that creates new business models
- Develop and provide new services utilizing IoT platform
  (Smart factories, smart railways, financial innovation, the Social Security and Tax Number utilization, etc.)
- Expand collaborative creation-type businesses
  (Established joint venture with Sompo Japan Nipponkoa Insurance (October 2015), etc.)
- Expand locally driven global business
  (Global procurement logistics services for manufacturers, payment services)

Expand profits from systems integration business

- Firm orders for large-scale system projects and successful project completion
  (financial mission critical systems, cloud migration, etc.)
- Prompt response to market needs (migration to open systems for legacy systems, etc.)

Company-wide utilization of common IT functions

- Dynamically allocate the SEs and software development resources to each front BU
- Utilize the project management systems and operations built up in the IT field
3-4. IT Platform

Build the platform for digital solutions

- Develop the IoT platform that combine IT (Information Technology) and OT (Operational Technology) by operating integrally with Services & Platforms BU
- Deploy the IoT platform globally as a growth engine for expanding digital solutions market

OT [Physical]

- IoT Devices / Sensors
  - Smart Factories
  - Fintech
  - MYNumber Utilization
  - Medical Device Maintenance
  - Equipment Maintenance
  - Energy Management

IoT Platform “Lumada”

- Analytics
  - Pentaho
- Artificial Intelligence
  - Hitachi AI Technology/H
- Security

Templates, analytics tools for existing systems, standard OSS, APIs, etc.

IT [SoR]

- Existing Applications / Systems
  - Business Management
  - Customer Management
  - Production Control
  - Inventory Control
  - Procurement Control
  - Distribution Control

SoE: System of Engagement   SoR: System of Record   OSS: Open Source Software   API: Application Programming Interface
### Focus on products supporting digital solutions
Transform business portfolio focusing on products related to the IoT platform

#### 1. Priority development products

<table>
<thead>
<tr>
<th>Storage</th>
<th>Functions for IoT Platform</th>
</tr>
</thead>
</table>
| - Flash storage  
- Big data / IoT data management | - Data Management  
  - Data lifecycle management,  
  data lake management  
  - Data analytics and visualization |
| Software | |
| - Data integration, analytics and visualization  
(Pentaho Software)  
- Artificial Intelligence (Hitachi AI Technology/H) | |
| - Operations management software  
(Job Management Partner 1, Software Defined Infrastructure) | |
| Servers, etc. | |
| - Cloud infrastructure (converged infrastructure)  
- Network security | - Application management  
  - Efficient data center operation  
  - High-reliability and automated control of IT infrastructure |

#### 2. Business structure reforms (FY2013 – 2015 results) — Continue cost improvements from FY2016 onward

<table>
<thead>
<tr>
<th>Personnel Relocations</th>
<th>Business Structure Reform Costs (FY2015)</th>
</tr>
</thead>
</table>
| - Utilize software development engineers in service departments  
- Utilize telecommunications & network engineers in IoT-related departments | 10.0 billion yen* |
| Cost Structure Reforms | Cost Reduction Benefits (Total of FY 2015 and FY2016) |
| - Focus on priority development products  
- Reduce total costs through consolidation of manufacturing bases, etc. | 12.0 billion yen |

* Including amounts recorded as “Corporate items & Eliminations”
3-6. Strengthen Cost Strategy and Cash Generation

Switch to a cost and profit structure that responds to the shift to service businesses

<table>
<thead>
<tr>
<th>FY2015 (Results)</th>
<th>FY2016 (Forecast)</th>
<th>FY2018 (Target)</th>
</tr>
</thead>
<tbody>
<tr>
<td>6.7</td>
<td>7.0</td>
<td>10.0</td>
</tr>
<tr>
<td>27.2</td>
<td>28.3 [(1.1)]</td>
<td>27.2 [+0.0]</td>
</tr>
<tr>
<td>66.1</td>
<td>64.7 [+1.4]</td>
<td>62.8 [+3.3]</td>
</tr>
</tbody>
</table>

- Adjusted operating income ratio
- SG&A margin improvement points (Vs. FY2015)
- Cost of sales ratio [Gross profit improvement points (Vs. FY2015)]
- Gross profit

SG&A
- Optimize back-office departments within the Group
- Reduce expenditure outside the Group
- Reduce IT costs
  - Build a work-operations cloud infrastructure shared throughout the Group

Gross profit
- Improve productivity in system development
  - Utilize common application development infrastructure
  - Strengthen collaboration with partner companies and expand utilization of Asian development bases
- Reduce the cost of sales ratio with the introduction of high-added value software-based solutions

CCC Improvement

<table>
<thead>
<tr>
<th>FY2015 (Result)</th>
<th>FY2016 (Forecast)</th>
<th>FY2018 (Target)</th>
</tr>
</thead>
<tbody>
<tr>
<td>62.3 days</td>
<td>59.1 days</td>
<td>59.1 days</td>
</tr>
</tbody>
</table>

Cash generation
- Level sales through expanding fee-based businesses
- Promote fluidization of trade receivables
- Reduce inventory assets
  - Minimize maintenance component inventory

SG&A: Selling, general and administrative expenses  CCC: Cash Conversion Cycle
Systems & Services Business Strategy

[Contents]

1. Review of 2015 Mid-term Management Plan
2. Function of the Systems & Services Business
3. Growth Strategy
4. Business Performance Trends
5. Conclusion
4-1. Business Performance Trends (1)

**Revenues (Billions of yen)**

<table>
<thead>
<tr>
<th>FY2015 (Results)</th>
<th>FY2016 (Forecast)</th>
<th>FY2018 (Target)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2,109.3</td>
<td>2,040.0</td>
<td>2,200.0</td>
</tr>
</tbody>
</table>

- FX effects (65.2)
- Reduction in large projects, etc. (40.5)
- Expanded sales +36.4
- Increased sales from Front Business +135.0
- Increased sales from IT Platform & Products +5.0
- Eliminations and Others +20.0

**Adjusted operating income (Billions of yen)**

<table>
<thead>
<tr>
<th>FY2015 (Results)</th>
<th>FY2016 (Forecast)</th>
<th>FY2018 (Target)</th>
</tr>
</thead>
<tbody>
<tr>
<td>141.3</td>
<td>143.0</td>
<td>220.0</td>
</tr>
</tbody>
</table>

- FX effects (2.2)
- Reduction in large projects, etc. (9.8)
- Investment in business expansion (7.8)
- Expanded sales +8.7
- Cost reductions +12.8*
- Increased income from Front Business +51.0
- Increased income from IT Platform & Products +41.0
- Eliminations and Others (15.0)

* Including effect of business structure reforms: +11.3
## 4-2. Business Performance Trends (2)

<table>
<thead>
<tr>
<th></th>
<th>FY2015 (Results)</th>
<th>FY2016 (Forecast)</th>
<th>FY2018 (Target)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Orders Received (billions of yen)</td>
<td>2,257.1</td>
<td>2,040.0*</td>
<td>2,200.0*</td>
</tr>
<tr>
<td>Overseas Revenue Ratio</td>
<td>33%</td>
<td>34%</td>
<td>37%</td>
</tr>
</tbody>
</table>

* From FY2016, the figures for orders received are the same as those for revenues to manage orders received as revenues.
4-3. Business Performance Trends (3) [By Sub-segment]

Revenues

<table>
<thead>
<tr>
<th></th>
<th>FY2015 (Results)</th>
<th>FY2016 (Forecast)</th>
<th>FY2018 (Target)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Billions of yen</td>
<td>(107.1)</td>
<td>(130.0)</td>
<td>(110.0)</td>
</tr>
<tr>
<td>Front Business</td>
<td>1,429.8</td>
<td>1,420.0</td>
<td>1,555.0</td>
</tr>
<tr>
<td>IT Platform &amp; Products</td>
<td>786.6</td>
<td>750.0</td>
<td>755.0</td>
</tr>
<tr>
<td>Eliminations &amp; Others</td>
<td>(107.1)</td>
<td>(130.0)</td>
<td>(110.0)</td>
</tr>
</tbody>
</table>

Adjusted operating income

<table>
<thead>
<tr>
<th></th>
<th>FY2015 (Results)</th>
<th>FY2016 (Forecast)</th>
<th>FY2018 (Target)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Billions of yen</td>
<td>0.8</td>
<td>(4.0)</td>
<td>(19.0)</td>
</tr>
<tr>
<td>Front Business</td>
<td>120.6</td>
<td>120.0</td>
<td>171.0</td>
</tr>
<tr>
<td>IT Platform &amp; Products</td>
<td>19.9</td>
<td>27.0</td>
<td>68.0</td>
</tr>
<tr>
<td>Eliminations &amp; Others</td>
<td>19.9</td>
<td>27.0</td>
<td>68.0</td>
</tr>
</tbody>
</table>

EBIT

<table>
<thead>
<tr>
<th></th>
<th>FY2015 (Results)</th>
<th>FY2016 (Forecast)</th>
<th>FY2018 (Target)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Billions of yen</td>
<td>(15.8)</td>
<td>(17.0)</td>
<td>(2.0)</td>
</tr>
<tr>
<td>Front Business</td>
<td>114.2</td>
<td>117.0</td>
<td>170.0</td>
</tr>
<tr>
<td>IT Platform &amp; Products</td>
<td>10.7</td>
<td>16.0</td>
<td>52.0</td>
</tr>
<tr>
<td>Eliminations &amp; Others</td>
<td>10.7</td>
<td>16.0</td>
<td>52.0</td>
</tr>
</tbody>
</table>
Systems & Services Business Strategy

[Contents]

1. Review of 2015 Mid-term Management Plan
2. Function of the Systems & Services Business
3. Growth Strategy
4. Business Performance Trends
5. Conclusion
5. Conclusion

**FY2018 Target**

<table>
<thead>
<tr>
<th></th>
<th>FY2018</th>
<th>Vs. FY2015</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Revenues</strong></td>
<td>2,200.0 billion yen</td>
<td>+90.7 billion yen [+4.3%]</td>
</tr>
<tr>
<td><strong>Adjusted Operating Income [EBIT] Ratio</strong></td>
<td>10.0% [10.0%]</td>
<td>+3.3% [+4.8%]</td>
</tr>
<tr>
<td><strong>Gross Profit Margin</strong></td>
<td>+3.3 points (Vs. FY2015)</td>
<td></td>
</tr>
<tr>
<td><strong>SG&amp;A Margin</strong></td>
<td>±0.0 points (Vs. FY2015)</td>
<td></td>
</tr>
</tbody>
</table>

Expand the social innovation business with a focus on global and digital solutions as growth targets
Cautionary Statement

Certain statements found in this document may constitute “forward-looking statements” as defined in the U.S. Private Securities Litigation Reform Act of 1995. Such “forward-looking statements” reflect management’s current views with respect to certain future events and financial performance and include any statement that does not directly relate to any historical or current fact. Words such as “anticipate,” “believe,” “expect,” “estimate,” “forecast,” “intend,” “plan,” “project” and similar expressions which indicate future events and trends may identify “forward-looking statements.” Such statements are based on currently available information and are subject to various risks and uncertainties that could cause actual results to differ materially from those projected or implied in the “forward-looking statements” and from historical trends. Certain “forward-looking statements” are based upon current assumptions of future events which may not prove to be accurate. Undue reliance should not be placed on “forward-looking statements,” as such statements speak only as of the date of this document.

Factors that could cause actual results to differ materially from those projected or implied in any “forward-looking statement” and from historical trends include, but are not limited to:

- economic conditions, including consumer spending and plant and equipment investment in Hitachi’s major markets, particularly Japan, Asia, the United States and Europe, as well as levels of demand in the major industrial sectors Hitachi serves, including, without limitation, the information, electronics, automotive, construction and financial sectors;
- exchange rate fluctuations of the yen against other currencies in which Hitachi makes significant sales or in which Hitachi’s assets and liabilities are denominated, particularly against the U.S. dollar and the euro;
- uncertainty as to Hitachi’s ability to access, or access on favorable terms, liquidity or long-term financing;
- uncertainty as to general market price levels for equity securities, declines in which may require Hitachi to write down equity securities that it holds;
- uncertainty as to Hitachi’s ability to continue to develop and market products that incorporate new technologies on a timely and cost-effective basis and to achieve market acceptance for such products;
- the possibility of cost fluctuations during the lifetime of, or cancellation of, long-term contracts for which Hitachi uses the percentage-of-completion method to recognize revenue from sales;
- credit conditions of Hitachi’s customers and suppliers;
- fluctuations in the price of raw materials including, without limitation, petroleum and other materials, such as copper, steel, aluminum, synthetic resins, rare metals and rare-earth minerals, or shortages of materials, parts and components;
- fluctuations in product demand and industry capacity;
- uncertainty as to Hitachi’s ability to implement measures to reduce the potential negative impact of fluctuations in product demand, exchange rates and/or price of raw materials or shortages of materials, parts and components;
- increased commoditization of and intensifying price competition for products;
- uncertainty as to Hitachi’s ability to achieve the anticipated benefits of its strategy to strengthen its Social Innovation Business;
- uncertainty as to the success of acquisitions of other companies, joint ventures and strategic alliances and the possibility of incurring related expenses;
- uncertainty as to the success of restructuring efforts to improve management efficiency by divesting or otherwise exiting underperforming businesses and to strengthen competitiveness;
- uncertainty as to the success of cost reduction measures;
- general socioeconomic and political conditions and the regulatory and trade environment of countries where Hitachi conducts business, particularly Japan, Asia, the United States and Europe, including, without limitation, direct or indirect restrictions by other nations on imports and differences in commercial and business customs including, without limitation, contract terms and conditions and labor relations;
- uncertainty as to the success of alliances upon which Hitachi depends, some of which Hitachi may not control, with other corporations in the design and development of certain key products;
- uncertainty as to Hitachi’s access to, or ability to protect, certain intellectual property rights, particularly those related to electronics and data processing technologies;
- uncertainty as to the outcome of litigation, regulatory investigations and other legal proceedings of which the Company, its subsidiaries or its equity-method associates and joint ventures have become or may become parties;
- the possibility of incurring expenses resulting from any defects in products or services of Hitachi;
- the potential for significant losses on Hitachi’s investments in equity-method associates and joint ventures;
- the possibility of disruption of Hitachi’s operations by natural disasters such as earthquakes and tsunamis, the spread of infectious diseases, and geopolitical and social instability such as terrorism and conflict;
- uncertainty as to Hitachi’s ability to maintain the integrity of its information systems, as well as Hitachi’s ability to protect its confidential information or that of its customers;
- uncertainty as to the accuracy of key assumptions Hitachi uses to evaluate its significant employee benefit-related costs; and
- uncertainty as to Hitachi’s ability to attract and retain skilled personnel.

The factors listed above are not all-inclusive and are in addition to other factors contained in other materials published by Hitachi.