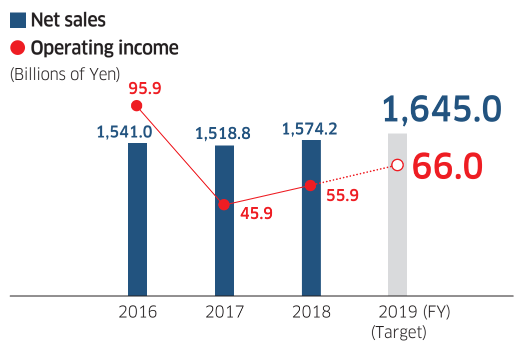
Yoshinori Kanehana
Representative Director,
President and Chief Executive Officer

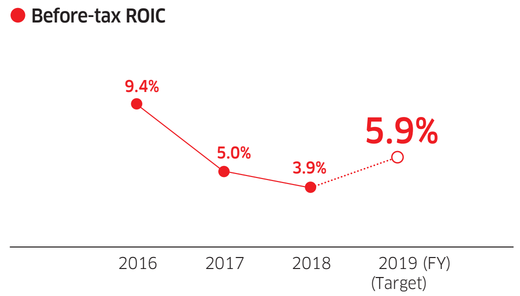
Let me take this opportunity to extend our deepest apologies to stakeholders for the considerable inconvenience and worry that arose due to manufacturing defects in Kawasaki-built *Shinkansen* (bullet train) bogie frames.

Manufacturing Defects in *Shinkansen* Bogie Frames

First of all, in regard to the manufacturing defects in the series N700 *Shinkansen* bogie frames, I would like to take this opportunity to reiterate our deepest apologies for the considerable inconvenience and worry that this incident caused. So that such defects do not occur again, we spent the past six months, since April 2018, in a concerted effort, hinging on the Companywide Quality Control Committee, which benefits from the exchange of opinions with outside experts, to uncover the root cause of the defects and explore corrective measures that will prevent recurrence. The results of the committee's investigation and subsequent discussions were announced on September 28, 2018*, and going forward, we will carefully apply corrective measures at all stages of production to recover stakeholder confidence and fulfill at a higher level our social responsibility as a manufacturing company. In these efforts, we ask for the support and understanding of our stakeholders. (Details on our initiatives are provided on pages 23-24 of this report.)

URL: https://global.kawasaki.com/news_C3180928-1.pdf





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

Looking Back on Fiscal 2018

In fiscal 2018, we posted net sales of ¥1,574.2 billion, operating income of ¥55.9 billion and before-tax ROIC of 3.9%. Of note, operating income was up ¥9.9 billion year on year, despite a drop in profitability on commercial aircraft components in the Aerospace segment and the booking of provision for losses on construction contracts—specifically, a rolling stock project for a North American customer—in the Rolling Stock segment. It was good results from the Motorcycle & Engine and Precision Machinery segments that pushed sales and income higher. Even with the solid improvement in operating income, profit attributable to owners of the parent rose only ¥2.7 billion year on year, to ¥28.9 billion, held back from a larger increase due to the booking of an extraordinary loss in the Ship & Offshore Structure segment, incurred from the termination of a contract agreement to build an offshore service vessel for a customer in Norway.

Forecast for Fiscal 2019

We announced a performance forecast in April 2018, highlighting net sales of ¥1,650.0 billion, operating income of ¥75.0 billion and before-tax ROIC of 8.0%. But a review at the halfway point, based on potentially huge losses in the Rolling Stock segment and the unavoidable booking of losses on the engine business in the Aerospace Systems segment, led management to downgrade performance expectations. We now expect net sales of ¥1,645.0 billion, operating income of ¥66.0 billion and before-tax ROIC of 5.9%.

Loss on Major Project and Thorough Efforts to Prevent Recurrence

Key reasons for not reaching our initial targets in fiscal 2018 were the booking of an extraordinary loss of ¥12.8 billion in the Ship & Offshore Structure segment, as a sluggish natural resource development market led to the termination of a contract agreement to build an offshore service vessel for a customer in Norway, and the booking of provision for losses of ¥21.8 billion in the Rolling Stock segment over two years, because of worsening profitability on a local train contract for the Long Island Rail Road in North America. And in fiscal 2019, the Aerospace Systems segment will be impacted by a provision of ¥9.7 billion to cover Kawasaki's portion of costs in the event of engine failure.

To prevent huge project losses and to ensure seamless risk management through all stages of a project, from before order acceptance through contract execution to delivery, we established the Project Risk Management Committee last year. I chair this committee, which meets monthly to bring together corporate knowledge on projects with the potential to significantly impact operations and provide a venue for identifying risk, exploring responses and rolling out initiatives throughout the Group. In the Ship & Offshore Structure segment, we focused our attention on business restructuring, and our efforts showed positive results, including a return to profitability in this segment in the second half of fiscal 2018. Currently, we have before-tax ROIC of 8% in sight for fiscal 2021. The Rolling Stock segment has also struggled, with results continuing to deteriorate for a consecutive fiscal year. We take this situation very seriously, substantiated by the establishment of the Rolling Stock Business Restructuring Committee with myself as chairman to achieve drastic reinforcement in project management. This committee is also looking into policies that will enhance segment responsiveness to changes in market structure as well as improvements in the organizational structure. The goal is to announce final decisions by the end of the current fiscal year and then shift into implementation.

Desired Corporate Status Through MTBP 2016

Our targets for fiscal 2019, as described in MTBP 2016, are net sales of ¥1,740.0 billion, operating income of ¥100.0 billion and before-tax ROIC of 11.0%. But we are two years behind schedule, an unavoidable consequence of a delay in projects that were expected to contribute to business results sooner and the appearance of losses I mentioned earlier. Nevertheless, we believe qualitative business strategies are on track and no changes to the strategic blueprint are necessary. In addition, we anticipate higher net sales on a Group-wide basis from fiscal 2022 onward as well as a drastic improvement in profitability, paralleling increases in commercial aircraft components and after-sale services on jet engines in the Aerospace Systems segment.

By deepening Kawasaki-ROIC Management, we will achieve at minimum our hurdle rate of 8% before-tax ROIC from fiscal 2020 and ensure thorough hurdle rate management for all business units, which will lead to higher enterprise value.

Given this forecast, we find no reason to revise the picture we see for the Kawasaki Group in 2025, as described in MTBP 2016, which targets net sales of ¥2,400.0 billion, an operating income margin exceeding 9% and before-tax ROIC of at least 14%. We will forge ahead with the strategies laid out in MTBP 2016 toward realization of the corporation we seek to be by 2025.

Deepening 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, before-tax ROIC is expected to fall below the hurdle rate for three consecutive years, since fiscal 2017. On an accounting basis, we are in the black, but from a Kawasaki-ROIC Management perspective, failure to achieve the hurdle rate is like being in the red. In fiscal 2020, all employees will work as a single team, focusing on the approaches outlined over the next few pages to achieve at the very minimum a before-tax ROIC of 8%, which is our hurdle rate.

All Employees Involved in Efforts to Boost Enterprise Value

Employees throughout the Kawasaki Group are totally behind the effort to boost enterprise value and are fully engaged in the process in their own workplaces. We have set KPI having 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 to higher enterprise value and thereby effectively and efficiently boost ROIC in the course of daily operations. Follow-up work is undertaken as necessary.

Management with Cash Flow Emphasis

Paralleling the approaches described above, we have made operating cash flow an issue of particular importance and maintain specific measures to enhance the efficiency of working capital, including better payment terms and asset reduction through shorter duration/stages up to delivery of products.

Thorough Hurdle Rate Management and Strategy for Possible Scale-Down/Withdrawal

Within the Group, there are 28 business units, and before-tax ROIC is calculated for each one to track business status. For any business unit that fails to achieve its hurdle rate, intermediate goals will be set at regular intervals with follow-up efforts designed to reach the stated hurdle rate. If the business unit finds it too difficult to meet its goals, we will consider scaling down the size of operations or withdraw completely. We will not be soft on a troubled business unit but rather encourage management with a sense of urgency.

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 such as these are becoming more serious and more prevalent worldwide. Against this backdrop, we have tapped four product and service categories from among all Kawasaki Group operations as drivers of growth: commercial aircraft and jet engines, energy, rolling stock for overseas markets, and robots. We will prioritize the allocation of resources into business activities related to these four categories, 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, demand for commercial aircraft could be as high as 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 from this demand situation. In the commercial aircraft business, we are involved in the development and production of the Boeing 777X, the U.S. company's most advanced aircraft, and as planned, we shipped out components for the first 777X in February 2018. In the jet engine business, we supply core components for 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.

Also, with the integration of the aircraft and jet engine businesses, we will strive to identify new business opportunities through tie-ups and reinforce the business structure.

Energy In the energy business, we integrated our energy-related businesses into the newly created Energy System & Plant Engineering Company to accelerate our response to expanding energy demand overseas, especially in Asia. We will maximize the advantages afforded by restructuring to

CCPP: Combined Cycle Power Plant (original power plant featuring all Kawasaki-built components with a basic configuration of two L30A gas turbines, two waste heat recovery boilers and one steam turbine)

***EPC: Engineering, procurement and construction*

hone our ability to sell solutions that incorporate facilities and systems, such as an emphasis on 100MW-class CCPP* in Southeast Asia, and also to improve EPC** capabilities and expand our overseas presence. The scale of our energy business currently hovers around ¥100.0 billion, but we expect it to triple more or less, to ¥300.0 billion, by 2025.

Robots The robot business has grown considerably in the last few years, reflecting progress in technology that promotes collaboration with humans in working operations as well as simplified instruction during installation. Also, looking to address a shortage of expert engineers, we developed *Successor*, a robot system with the potential to convey skills to as-yet-untrained technicians. In other robotic pursuits, we have ventured into the market for medical robots. The market scale for medical robots could reach ¥1.5 trillion by 2020. Our involvement in this corner of the robotics world is through Medicaroid Corporation, a joint venture with Sysmex Corporation, which launched *Vercia*, a robot operating table for hybrid operating rooms. Medicaroid Corporation is also working toward the fiscal 2020 debut of Robotically Assisted Surgical Device, and development of this robot is moving steadily along.

Strengthening Technology and Promoting Synergies

The foundation of medium- to long-term growth is, without a doubt, technological capabilities. So what we want to do is develop products and services not easily copied by any other corporate group and build a high barrier to entry by rival companies. In addition, by combining the many world-class technologies in our corporate toolbox, particularly those under the oversight of the Corporate Technology Division, and demonstrating synergies derived from combinations of these technologies, we will create even more innovative products and services.

ESG Initiatives

Given the changing business environment and diversifying expectations and requests from stakeholders, in fiscal 2018, we identified material issues—materiality—based on fulfillment of CSR by the Kawasaki Group. We also undertook a review of the CSR activity matrix and decided to reinforce initiatives to address social issues and realize a low-carbon society through our businesses and to deal with CSR issues, such as governance, human resources development, human rights, compliance and supply chain management. We narrowed these issues down even further, pinpointing four—1) providing safe and secure, clean, comfortable movement of people and transportation of goods by land, sea and air, 2) creating clean energy, 3) improving social infrastructure, especially in emerging countries, and 4) responding to needs of an aging society and shortage of labor through automation— that derive value to society from our business activities. We defined these four issues as top priorities to be achieved over the long term. We also set new non-financial targets and will track progress. In addition, we see a connection between business and SDGs, and we have clarified goals and targets that we should contribute to as the Kawasaki Group. By increasing our value to society through business activities underpinned by the pursuit of Group synergies and innovation, we will contribute to the achievement of SDGs.

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 a rich sense of awareness cultivated through a life that promotes fulfillment on a daily basis, and contribute to higher productivity in their respective workplace and, by extension, the Group. Toward this end, we have introduced K-Win (Kawasaki Workstyle Innovation) Activities throughout the Group to encourage new approaches to work.

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 2019, we will set the stage for promoting activities and introduce a remote work (work from home) program. We will also run workstyle seminars and programs to enhance operating efficiency 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 welcomed two new outside directors—Yoshiaki Tamura and Jenifer Rogers—to the team. Already, the majority of our audit & supervisory board members are from outside the Company, and outside directors comprise 25% of the director total. This reinforces governance at Kawasaki. We also keep an open channel to capital markets and actively encourage constructive dialogues with a purpose—engagement—that involve shareholders and companies to build higher enterprise value together.

Thoughts on Return to Shareholders

The Kawasaki Group adheres to a basic management policy that emphasizes efforts to improve enterprise value, that is, consistently generating income exceeding capital costs from a future-oriented perspective. Return to shareholders is a key management priority that we realize by constantly investing in the leading-edge 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 enterprise value and delivering returns to shareholders through the distribution of dividends. To do so, we take a comprehensive view of financial status, including performance forecasts as well as free cash flow and the debt-equity ratio, and we have set a benchmark of 30% for the consolidated payout ratio.

"Changing forward"

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. In addition, a wave of innovation is building with full-scale use of information and communication technology (ICT) and the Internet of Things (IoT) as well as artificial intelligence (AI), which has the potential to significantly alter the way we do business and the content thereof. The atmosphere is charged with a critical feeling in this regard, and I believe we ourselves must evolve if we are to respond quickly to the new environment. Toward this end, in October 2017, we embraced a forward-looking perspective on change within the Group under the banner, "Changing forward." I will personally lead the way in this challenge and apply this banner as a motto in management of the Company and the Group.

As always, we will strive to realize our Group Mission "Kawasaki, working as one for the good of the planet" and continue to create value for all stakeholders.

The Kawasaki Group will tackle challenges without being afraid of changes under the banner, "Changing forward" to help solve social issues on a global scale and create new value for society.