Overview

In the fiscal year ended March 31, 2018, the global economy was relatively lacking in vigor overall due to the economic slowdown in emerging countries and resource-rich countries, along with other factors, despite the ongoing modest growth centered in the U.S., where the real economy remains strong, and in China, where foreign and domestic demand was robust. In addition, uncertainty about future prospects for the real economy persists, including influence on corporate activities due to Brexit, concerns about trade friction due to an expansion of protectionist policies in the U.S., and other factors. Going forward, these risks with the potential to drag down the global economy must continue to be watched.

The Japanese economy has been recovering modestly, due to the modest increase in capital investment, the improvement in corporate earnings, and other factors. Going forward, the economy is expected to grow modestly overall, but there is a possibility that economic policies enacted by countries around the world, especially the U.S., and geopolitical risks on the Korean Peninsula and in other regions, could result in rapid and significant fluctuations in foreign exchange rates. As a result, foreign exchange rates must continue to be watched carefully.

Amid such an operating environment, the Group's orders received in the fiscal year ended March 31, 2018, increased versus the previous fiscal year, mainly in the Aerospace, Rolling Stock and Precision Machinery segment. Net sales increased overall, due to increases in the Precision Machinery, Gas Turbine & Machinery, and Motorcycle & Engine segments, despite a decline in the Plant & Infrastructure segment. Operating income and recurring profit both increased, due to higher profit in the Precision Machinery segment, improvement in the Ship & Offshore Structure segment, and other factors, despite the deterioration in the Rolling Stock segment in conjunction with worsening profitability on passenger railcars for the U.S. and other factors, including decreased profit in the Aerospace segment. Net income attributable to owners of parent increased as a result of extraordinary income (gain on sale of fixed assets), reduced tax expenses due to the recognition of deferred tax assets related to losses in a shipbuilding joint venture project in Brazil, and other factors, despite the posting of extraordinary loss in conjunction with the termination of a shipbuilding contract for an offshore service vessel.

As a result, the Group's consolidated orders received increased ¥259.3 billion from the previous fiscal year to ¥1,608.0 billion, consolidated net sales increased ¥55.4 billion year on year to ¥1,574.2 billion, consolidated operating income increased ¥9.9 billion year on year to ¥55.9 billion, consolidated recurring profit rose by ¥6.5 billion year on year to ¥43.2 billion, and net income attributable to owners of parent increased ¥2.7 billion year on year to ¥28.9 billion. ROIC* was 3.9%, while ROE was 6.4%.

* Before-tax ROIC = EBIT (income before income taxes + interest expense) / invested capital (interest-bearing debt + shareholders' equity)

Results of Operations

Net Sales

As noted, consolidated net sales increased by ¥55.4 billion from the previous fiscal year to ¥1,574.2 billion. Overseas sales totaled ¥905.8 billion. By region, sales in the United States were ¥381.1 billion, sales in Europe accounted for ¥172.2 billion, sales in Asia outside Japan contributed ¥237.2 billion, and sales in other areas added ¥115.2 billion. The ratio of overseas sales to consolidated net sales increased by 0.2 percentage points to 57.5%, compared to 57.3% in the previous fiscal year.

The following sections supply additional details on the consolidated performance of each business segment. Please note that operating income or loss includes intersegment transactions.

Ship & Offshore Structure

With respect to the business environment surrounding the Ship & Offshore Structure segment, while new-build vessel prices are recovering after bottoming out and demand for gas-fueled vessels has been increasing in conjunction with the tightening of environmental regulations, competition remains intense due to factors including the pushing back of demand for LNG carriers due to a delay in LNG development projects and the continuation of policies by the Chinese and South Korean governments to support their domestic shipbuilding industries.

Amid such an operating environment, consolidated orders received were ¥4.7 billion, a ¥32.2 billion year on year decline from the previous fiscal year when orders for submarines were received, due to the termination of a shipbuilding contract for an offshore service vessel, despite receiving orders for LPG carriers and Kawasaki JETFOIL during the period.

Consolidated net sales fell ¥7.5 billion year on year to ¥95.6 billion, due to a decline in the volume of construction work related to submarines and other factors.

Consolidated operating loss was ¥3.8 billion, a ¥17.6 billion improvement from the previous fiscal year, when additional allowance for doubtful receivables was posted and there was an increase in provision for losses on construction contracts.

Rolling Stock

With respect to the business environment surrounding the Rolling Stock segment, there continues to be stable demand in Japan for the replacement of aging railcars. In North America, while there have been some changes to railcar order plans in the New York area, which is the core market, demand for new and replacement railcars have been increasing. Meanwhile, in Asia, demand in emerging markets is increasing in tandem with the Japanese government's efforts to promote infrastructure-related exports.

Amid such an operating environment, consolidated orders received rose by ¥98.5 billion from the previous fiscal year, when rolling stock for a domestic subway and other orders were received, to ¥257.1 billion, due to receiving large-scale orders, such as for new generation subway cars for New York City Transit and for rolling stock for a high-speed railway (MRT) in Bangladesh.

Consolidated net sales increased ¥4.6 billion year on year to ¥141.7 billion due to the increase of sales in the domestic market, despite a decline of overseas sales such as in North America, Asia and other countries.

Operating income declined ¥15.9 billion year on year to an operating loss of ¥12.4 billion due to a provision for losses on construction contracts for passenger railcars for the Long Island Railroad in the U.S., expenses for replacing the N700 series Shinkansen bogie frame and other factors.

Aerospace

Concerning the business environment surrounding the Aerospace segment, there is a certain level of demand from the Ministry of Defense in Japan despite the tight defense budget, while demand for new and replacement commercial aircraft is increasing in conjunction with a rise in the number of air passengers.

Amid such an operating environment, consolidated orders received increased ¥137.3 billion year on year to ¥374.4 billion due to the remaining high level of demand for component parts for commercial aircraft and an increase in demand from the Ministry of Defense.

Consolidated net sales increased ¥0.2 billion year on year to ¥330.2 billion, due to the increase in sales to the Ministry of Defense and other factors, despite a decline in sales of component parts for commercial aircraft.

Consolidated operating income fell ¥4.1 billion year on year to ¥20.9 billion due to the decline in profitability of component parts for commercial aircraft and other factors.

Gas Turbine & Machinery

Concerning the business environment surrounding the Gas Turbine & Machinery segment, in the aircraft field, demand for aircraft engines is increasing due to growth in demand for commercial aircraft based on the increase in the number of air passengers. In the energy and environmental field, although there is large potential demand for distributed power sources in Japan, investment plans are slightly delayed in connection with the liberalization of electricity. Meanwhile, overseas, demand for distributed power sources is increasing due to stronger interest in investment in the environment and energy conservation among other factors.

Amid such an operating environment, consolidated orders received declined ¥12.2 billion year on year to ¥248.1 billion due to a decline in gas engine power plants for the domestic market and other factors.

Consolidated net sales increased ¥24.5 billion year on year to ¥266.4 billion due to the increase in component parts of aircraft engines and other factors.

Operating income was ¥14.7 billion, a ¥0.5 billion decrease from the previous fiscal year due to a decrease in highly profitable orders in the energy segment, despite an increase in sales.

Plant & Infrastructure

In the business environment surrounding the Plant & Infrastructure segment, in addition to the recovery in resource development and oil and natural gas related investment overseas arising from the rise in crude oil prices, there is still a demand for energy infrastructure maintenance in Asia. In Japan, there is ongoing demand for the replacement of aging facilities of refuse incineration plants and industrial machinery.

Amid such an operating environment, consolidated orders received increased ¥5.0 billion year on year to ¥100.1 billion due to the increase in refuse incineration plants and operations, despite overseas orders decreasing.

Consolidated net sales fell ¥36.4 billion year on year to ¥124.4 billion due to the decline in the volume of construction work on a chemical plant for an overseas market and other factors.

Despite the drop in sales, operating income was ¥2.9 billion, a ¥0.3 billion increase from the previous year when there was an increase in provision for loss on construction contracts.

Motorcycle & Engine

Regarding the business environment surrounding the Motorcycle & Engine segment, the modest growth in motorcycle markets in developed countries continues, and the decline in demand for motorcycles in emerging countries is signaling a bottoming out. With respect to utility vehicles, the market continues to grow stably mainly in North America, and the general-purpose engine market is also growing steadily.

Amid such an operating environment, consolidated net sales increased ¥18.6 billion year on year to ¥331.6 billion due to the increase in motorcycles and vehicles for developed countries and general-purpose engines, despite the decline in motorcycles for emerging markets.

Consolidated operating income increased ¥3.5 billion year on year to ¥15.2 billion due to the increase in sales.

Precision Machinery

With respect to the business environment surrounding the Precision Machinery segment, the construction machinery market is brisk, centered on robust demand for heavy-duty excavators in China, and our construction machinery manufacturers, which are our customers, are competing to increase production. As for robots, in addition to increased demand in the automotive and semiconductor fields, demand is growing due to the expanded use of industrial robots caused by a shortage of workers.

Amid such an operating environment, consolidated orders received increased ¥40.2 billion year on year to ¥207.1 billion due to the increase in hydraulic components for construction machinery and various industrial robots.

Consolidated net sales increased ¥43.7 billion year on year to ¥198.9 billion due to an increase in sales of hydraulic components for construction machinery and various industrial robots.

Consolidated operating income increased ¥8.5 billion year on year to ¥21.6 billion due to the increase in sales.

Other

Consolidated net sales increased ¥7.6 billion year on year to ¥85.0 billion.

Consolidated net operating income decreased ¥0.2 billion year on year to ¥2.9 billion.

Cost, Expenses, and Earnings

Cost of sales increased by ¥40.8 billion from the previous fiscal year to ¥1,319.7 billion. As a result, gross profit increased by ¥14.6 billion to ¥254.5 billion and the gross profit margin increased by 0.3 percentage points to 16.1% from 15.8% in the previous fiscal year.

Selling, general and administrative expenses grew ¥4.6 billion to ¥198.6 billion, primarily because of higher salaries and benefits and R&D expenses.

Operating income, as noted, increased by ¥9.9 billion to ¥55.9 billion. The ratio of operating income to net sales increased by 0.5 percentage points to 3.5%, from 3.0% in the previous fiscal year.

Other expenses, net deteriorated to ¥22.9 billion from ¥7.0 billion in the previous fiscal year due to factors that included the posting of extraordinary loss with the termination of a shipbuilding contract for an offshore service vessel.

As a result, after deduction of profit attributable to non-controlling interests, profit attributable to owners of parent increased by ¥2.7 billion from the previous fiscal year to ¥28.9 billion. The ratio of profit attributable to owners of parent to net sales increased by 0.1 percentage points to 1.8% from 1.7% in the previous fiscal year. ROE (calculated using average total shareholders' equity) increased by 0.4 percentage points to 6.4% from 6.0% in the previous year.

Capital expenditures came to ¥82.1 billion, down from ¥82.7 billion in the previous fiscal year. R&D expenses were ¥45.4 billion, up from ¥43.6 billion in the previous fiscal year.

Financial Conditions

Total assets at March 31, 2018 were ¥1,785.0 billion, a ¥97.6 billion increase from March 31, 2017. Current assets increased ¥70.4 billion year on year to ¥1,148.3 billion, due to an increase in trade receivables. Fixed assets increased ¥27.1 billion year on year to ¥636.7 billion, primarily due to an increase in holdings of property, plant and equipment because of capital investment.

Consolidated liabilities increased ¥67.6 billion year on year to ¥1,303.6 billion at March 31, 2018, due to an increase in interest-bearing liabilities such as long-term debt and other factors. Interest-bearing liabilities increased ¥45.9 billion year on year to ¥446.6 billion.

Consolidated net assets increased ¥30.0 billion year on year to ¥481.3 billion, as the increase due to the posting of net income attributable to owners of parent was partly offset by dividend payments and other factors.

The ratio of shareholders' equity to total assets increased by 0.2 percentage points to 26.1% from 25.9% at the end of the previous fiscal year. In addition, the net debt-to-equity ratio deteriorated 1.7 percentage points from 78.9% to 80.6% as of March 31, 2018.

Cash Flows

Operating activities provided net cash of ¥56.0 billion, a ¥37.4 billion decrease from the previous fiscal year. Major sources of operating cash flow included income before income taxes of ¥32.9 billion and depreciation and amortization of ¥56.1 billion. Major uses of operating cash flow included expenditure of ¥35.5 billion due to an increase in trade receivables and expenditures of ¥26.4 billion due to an increase in inventories.

Investing activities used net cash of ¥80.5 billion, which is ¥15.7 billion more than in the previous fiscal year, due mainly to requisition of property, plant and equipment, as well as intangible assets.

Free cash flow, which is the net amount of cash from operating and investing activities, showed a net outflow of ¥24.5 billion, against a net inflow of ¥28.6 billion in the previous fiscal year.

Financing activities provided net cash of ¥37.7 billion, which is ¥53.6 billion more than in the previous fiscal year when ¥15.8 billion was used. This was due mainly to an increase in proceeds due to a net increase in short-term debt and the increase in proceeds from long-term debt.

Given these changes in cash flows, cash and cash equivalents at end of year settled at ¥64.3 billion, up ¥13.6 billion from the beginning of the year.

Management of Liquidity Risk

To manage liquidity risk comprehensively, the Finance Department formulates and renews financial plans in a timely fashion based on reports from each business segment. In addition, measures are taken to diversify sources of financing, adjust the balance of long- and short-term financing with consideration for financial conditions and secure commitment lines (credit limit of ¥54.0 billion, immediate activation possible) and commercial paper (issuance limit of ¥150.0 billion).

Management Indicators

As target management indicators, the Company has adopted Earnings (Operating income, Recurring profit, Profit attributable to owners of parent) and Return on Invested Capital [ROIC = EBIT (Income before income taxes + Interest expense) / Invested Capital (Interest-bearing debt + Shareholders' equity)] as indicators for measuring capital efficiency.

The Company's group-wide businesses are segmented and subdivided into Business Units (hereinafter referred to as "BUs"), and ROIC management is applied to each and every BU. Those BUs not clearing the ROIC hurdle rate (minimum required level) are required to take practical actions for clearing the hurdle rate early. On the other hand, those BUs already clearing the ROIC hurdle rate are encouraged to achieve the ROIC level for the top market leader and, while taking initiatives to enhance Economic Value Added (EVA), improve the enterprise value of the entire group.

With the improvement of these management indicators, the Company also seeks to improve its Return on Equity (ROE = Profit attributable to owners of parent / Shareholders' equity).

Dividends

As a basic management policy, the Company aims to increase corporate value by consistently generating profit exceeding the cost of invested capital. In line with this policy, the Company believes that one priority for management is to engage in cutting-edge research and development as well as innovative capital investment required to achieve future growth and thereby return profits to shareholders by enhancing shareholder value over the long term.

In order to maintain a good balance between enhancing shareholder value and returning profits to shareholders through dividends, the Company has set a medium- to long-term consolidated payout ratio standard of 30% corresponding to the consolidated profit attributable to owners of parent and in light of both the outlook for future earnings and a comprehensive examination of its financial condition, including its free cash flow, D/E ratio (debt-to-equity ratio) and other factors.

The Company has a basic policy of distributing surplus retained earnings as dividends twice a year, once after the fiscal second quarter and once after the fiscal year-end. Interim dividends are authorized by the Board of Directors, while year-end dividends are authorized at the general meetings of shareholders.