Message from the CFO

Aiming at sustainable increase of corporate value with ROIC management, I will serve as a "bridge" between the management and sites.

Nobukazu Hayashi
Senior Vice President and Executive officer
General Manager, Financial Strategy Office

Support the Management and Fill the Gap with Sites

When I was a new employee, my supervisor used to say repeatedly, "The mission of accounting department is to play a role like nerves and blood vessels in a company. Visit various sites and find and remedy what is wrong quickly to support the management. That is what accounting department is supposed to do." So, I perform my duty as CFO with this motto in mind to this day.

I understand that the role of CFO is to use the "ability to understand the movements beyond the figures" cultivated in a long experience of working in the sections close to "sites" such as regional headquarters operating logistics centers, and serve as a "bridge" between the management and sites and promote in sites the operation focusing on capital efficiency.

An example of "bridge" is operation of the budget system. Although we transitioned from a consolidated subsidiary of Hitachi, Ltd. to its equity-method affiliate in 2016, Hitachi Group's DNA has taken root in our corporate culture, which carefully operates the budget system and continually encourages growth with "stretch targets." Toward the end of each fiscal year, the Financial Strategy Office provides business divisions with guidelines for the budgeting of the next fiscal year with an aim to enhance effectiveness of the budget system. In case there is a gap between the budget prepared by a business division and the target figures set by the management, we try to reduce or eliminate the gap by setting the difference as a stretch target. As for global logistics business, whose revenues have almost tripled in the last 10 years and account for approximately 40% of the total revenues in recent years, its business environment and stance on budgeting are largely different from those of domestic business, and therefore, we focus on achieving the results close to management targets as a group by adjusting the individual stretch of the domestic and global business based on their respective situation.

Improve Asset Efficiency and Profitability Based on a Business Assessment Reflecting the Actual Situation

When we started the previous Mid-term Management Plan "Value Creation 2018" in 2016, we also launched full-scale initiatives focusing on asset efficiency and capital efficiency. Our first initiative, "change of business assessment approach," levelled the cost structure (depreciation or rent expenses) of logistics centers which used to vary largely depending on whether the center was an "own asset" or "leased asset" in order to understand the "real profitability" of each logistics center including that of warehouse management, in-plant operation, and delivery. As a result, it became possible to assess business or assets based on the actual situation, which led to liquidation of idle assets by sales, improvement of asset efficiency through sale/relocation of the head office building, and proactive sales and lease back of unprofitable assets.

Pursue the Optimum Balance of Funding

In 2016, we stopped using the Hitachi Group's cash pooling system*[1] for funding purpose and started to issue corporate bonds and borrow from banks at our own discretion. Especially when we acquired shares of SAGAWA EXPRESS in association with the capital and business alliance with SG Holdings, we carefully adjusted the ratio of "syndicated loans" and "issuance of corporate bonds" to secure debt capacity for future borrowing. Since then, our basic funding policy is to consider the optimal ratio of direct and indirect financing based on the financial situation and interest rate trends at that time. We also strive to maintain a credit rating of A or higher*[2] to secure a sufficient level of liquidity.

In place of the Hitachi Group's cash pooling system, we have our own cash management system to loan the Group's funds to our domestic group companies, and for overseas group companies, we extend parent-subsidiary loans and the Group's intra-regional pooling system in China.

*1 A system with the purpose of improving capital efficiency and reducing interest-bearing debt of Hitachi, Ltd. on a consolidated basis whereby group companies pool their surplus funds in a centralized account and borrow from it in case of shortage of funds.
*2 Issuer rating: A (Stable) (Rating and Investment Information, Inc.) (released on December 25, 2019)

Introduce KPI Focusing on Capital Efficiency (Comparison of ROIC and WACC)

In FY2018, as an initiative to further improve capital efficiency, we incorporated a business assessment scheme using ROIC based on WACC as KPI into the budget process and investment assessment criteria. The reason is that, in order to achieve sustainable increase of corporate value, we need to break away from a short-term thinking focusing on profit and loss (statement of profit or loss) and spread the approach to consider the balance sheets and capital efficiency throughout the Group.

To spread the "ROIC management" concept in sites, domestic companies will put emphasis on providing explanations at managers meetings and through the company magazines, and also plan to make available e-learning for all employees in FY2020. Such approach has spread steadily among overseas companies through various notices, budget reports, and annual EGBM*[3], etc.

Although we just started the "ROIC management" initiatives focusing on the balance sheets and capital efficiency from the perspective of shareholders and investors, we will continue our efforts to spread it in domestic and overseas offices and further enhance it to achieve sustainable increase of corporate value.

*3 EGBM (Expanded Global Business Meeting): A meeting attended by officers of the Company and managers of overseas subsidiaries, etc.

Major initiatives focusing on asset efficiency and capital efficiency (recent five years)

Mid-term Management Plan/FY		Measures
Previous Mid-term Management Plan Value Creation 2018	FY2016	■ Partially changed the business assessment approach (assess centers owned by the Group by adding market rent) ■ Issued corporate bonds of ¥30 billion ■ Set ROE as an important management indicator
	FY2017	■ Asset liquidation (e.g. sale of distribution centers with low asset efficiency, leaseback)
	FY2018	■ Introduced "comparison of ROIC and WACC" as one of the investment decision criteria ■ Newly established the Financial Strategy Office ■ Created rules for strategic investments ■ Issued corporate bonds of ¥30 billion
Current Mid-term Management Plan LOGISTEED 2021	**FY2019**	■ **Reset ROIC to reflect the adoption of IFRS 16 *Leases* (adopted in FY2019)**
	FY2020	■ **Introduced ROIC and WACC in the budget control**

Reset ROIC after the adoption of IFRS 16 *Leases*

The adoption of IFRS 16 *Leases* had some impact on the Company's financial condition and various financial indicators such as WACC as it requires to recognize leased real estate on the balance sheets and related interest expenses.
In particular, the calculation method of ROIC, which is compared with WACC, was redefined as the results using the previous method would deviate from actual situation.

Impact of IFRS 16 *Leases*

- Recognize a right-of-use asset representing the right to use the underlying leased asset over the lease term and a lease liability representing the obligation to make lease payments for nearly all lease transactions
- Subsequent to recognition of right-of-use-assets and lease liabilities, recognize depreciation of right-of-use assets and interest on lease liabilities (interest expenses) separately

B/S impact

Items	Impact of adoption	
Total assets	Recognition of right-of-use assets	Increase
Total liabilities	Recognition of lease liabilities	
Total equity		
Total liabilities and equity		

P/L impact

Items	Impact of adoption	
Revenues		
Adjusted operating income	・Decrease in rent expenses ・Increase in depreciation	Positive impact
EBIT		
Income before income taxes	・Increase in interest expenses	Negative impact
Net income attributable to stockholders of the parent company		

Impact on financial indicators, etc. (FY2019)

Items	Before adoption		After adoption
Total assets	¥621.2 billion	↗	¥879.1 billion
Debt to equity ratio	0.83 times	↗	1.92 times
Total equity attributable to stockholders of the parent company ratio	37.6%	↘	26.5%
ROE	9.9%	↘	9.5%
ROA	3.7%	↘	2.4%
ROIC (previous standard) (new standard)	5.3%	↘	3.1% 5.4%

Resetting of ROIC

We redefined the calculation method of ROIC as the calculation of ROIC of the financial statements including the impact of IFRS 16 using the previous method would result in financial indicators deviated from the Company's economic substance.
(Redefined as below because the Group's interest expenses, which were previously a small amount, increased due to the adoption of IFRS 16.)

Calculation method of ROIC

- Changed the numerator used in the calculation of ROIC from net income to NOPAT (Net Operating Profit After Taxes) + equity method profit or loss.
- Formula: (NOPAT + equity method profit or loss) / Invested capital (2 year-average of interest-bearing debt + 2 year-average of equity attributable to stockholders of the parent company)
  [Reference] Previous formula: Net income / Invested capital (2 year-average of interest-bearing debt + 2 year-average of equity attributable to stockholders of the parent company)

Improve Business Efficiency with the Sites as the Starting Point

We are continuing improvement activities aimed at improving profitability as an essential requirement to practice ROIC management more effectively. The main objective of the improvement activities, referred to as "Rise-up200 Project ('R200PJ')" in the previous Mid-term Management Plan and "VC21*4 activity" in the current Mid-term Management Plan, is to improve efficiency and productivity of logistics centers. The Company's logistics centers used to differ from one another in factors including "customers," "delivery destination," "specifications/equipment," and "human resources," and each center worked on improvement and evolved independently. While it was one of our strengths, it also posed an issue that profitability and systems differed in each center. To address such issue, we launched R200PJ in FY2016 which carried out the bottom-up activities by engaging outside consultants and implemented improvement measures to align all centers' profitability with that of profitable centers and standardize IT systems. As our successful efforts to promote it as a company-wide project, such as reporting at the Executive Committee and inclusion in the budget report, we generated the improvement effect worth roughly ¥3 billion in three years, and were able to use it to make new strategic investments. Under VC21 which started in FY2019 at full scale, we have expanded the scope of target sites while maintaining the basic stance of R200PJ, and aim to realize the organization where each employee continues their improvement efforts with a stronger sense of "personal ownership" (Refer to page 29). Under the Mid-term Management Plan "LOGISTEED 2021", we also promote implementation of WFM*5 for standardization of working hours management and SPV*6 for standardization and labor saving of accounting operations. We intend to promote the visualization of management by integrating these two systems, and also improve operational efficiency through coordination with other systems.

*4 Value Change & Creation 2021 *5 WFM (Workforce Management): Human resource management
*6 SPV (Smart Performance Visualization Platform): A system to manage domestic performance

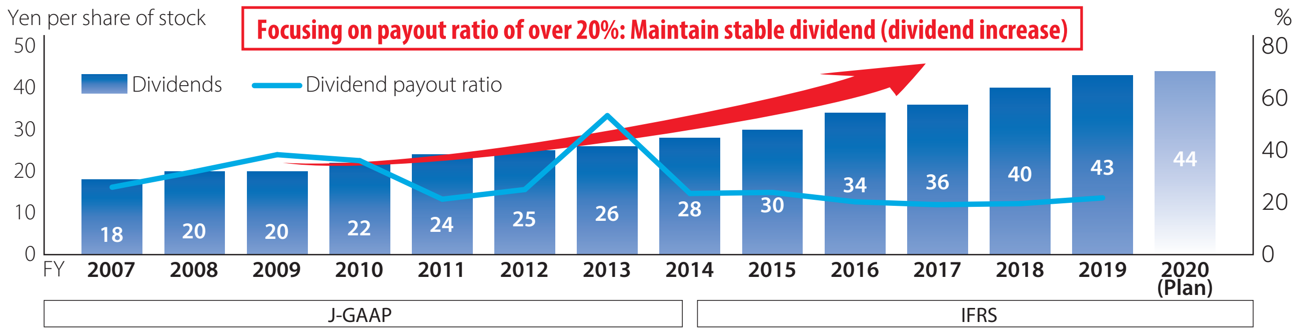
Strategic Investments to Establish Competitive Advantage

Under the recognition that the Group is still at a growing stage, we will make proactive strategic investments toward changes and evolution under the Mid-term Management Plan "LOGISTEED 2021." With the basic policy of "investment to establish sustainable competitive advantage by building a structure no one can imitate," we plan to invest ¥86 billion (Mid-term Management Plan, accumulated) in promotion of DX*7, establishment of IT platform, introduction of new technology and development of new business as well as human resource/safety measures and M&As (refer to page 31). In FY2020, the second year of the Mid-term Management Plan, we will select items to accelerate LOGISTEED and focus on investments in items to form the core of digital platform, including supply chain solutions, smart warehouse, and digitalization of transport, with an aim to further accelerate enhancement of the core functions and expansion of our customer service lineup. Especially in the area of digital related technology, while we are making progress in improving individual equipment and software, we still need to create a system to control them in an optimal way from a comprehensive viewpoint to establish competitive advantage; and therefore we will focus on strategic investments to make it happen.

*7 Digital Transformation

Aim for Stable Increase in Dividends While Securing Funds for the Growth

Going forward, our basic policy of dividends is to seek to maintain stable distribution linked to business performance, while considering medium-to-long-term business expansion and securing internal reserves to strengthen corporate structure. Under the policy, the Mid-term Management Plan "LOGISTEED 2021" aims at a stable and continuous increase in dividends with the target of the dividend payout ratio of 20% or higher while securing funds for the growth investment.



TSR (Total Shareholder Return) outperformed TOPIX
*Index being the stock price as of March 31, 2015 as 100

FY	2015	2016	2017	2018	2019	
TSR of HTS	**105**	**131**	**170**	**189**	**139**	%
TOPIX incl. dividend	89	102	119	113	102	

Policy on the Development of Next-Generation Finance Human Resources

As mentioned above, as our global logistics business accounts for about 40% of total revenues in recent years, we consider that abundant overseas experience is essential for human resources who will be in charge of the Group's financial strategy, including future CFO. Therefore, we aim to foster a number of candidates for CFO through a rotation system whereby all managers and chiefs of the Financial Strategy Office must experience overseas assignments, and also by having them experience all of "overseas subsidiary," "Accounting and Finance Department of the Head Office," and "regional headquarters/regional companies" to become all-round players.

Dialogue with Our Shareholders and Investors

In dialogue with our shareholders and investors, I always strive not only to provide detailed explanations about ROIC, ROE, and our dividend policy but also to reassure them by explaining the uniqueness of our business including the price revision cycle of 3PL business in an easy-to-understand manner. I also endeavor to openly talk about the risks such as impacts of the COVID-19 pandemic on our performance in addition to our strengths of high level of safety and quality of our services which has led to support from customers, in an effort to maintain relationship of trust with our shareholders and investors.