Hitachi Transport System, Ltd.

Summary of Small-Scale Meeting (Online)

1. Outline of the meeting

(1) Date: February 4, 2022 (Fri) 1) 10:00 AM to 11:00 AM 2) 1:00 PM to 2:00 PM (Total 2 times)
(2) Attendees:
Seiki Sato (Senior Vice President and Executive Officer, General Manager, Corporate Strategy Office)
Nobukazu Hayashi (Senior Vice President and Executive Officer, General Manager, Financial Strategy Office)
Kiyoshi Nagao (Vice President and Executive Officer, General Manager, Business Management Headquarters)
Isao Takaoka (Deputy General Manager, Corporate Strategy Office)
(3) Subject: Q&A

2. Main Q&A (summary)

(1) About the financial results for the 3rd quarter ended December 31, 2021 and the full-year forecasts

Q1. 3Q (three months) results for the automobile business show decreases in revenues of ¥1.4 billion and in operating income of ¥2 billion. Why is the decrease in operating income bigger than the decrease in revenues?

A1. The automobile business consists mainly of VANTEC and JPH in North America. VANTEC reported decreases both in revenues and operating income due to semiconductor shortage and shipment delay of other parts mainly in Japan. JPH reported an increase in revenues due to increased orders but increased transport outsourcing costs due to driver shortage reduced operating income.

Additional Q. Considering the cost increase due to driver shortage is a structural issue, will it be a risk in the future?

Additional A. The cost increase due to driver shortage will be a risk, but we will try to charge and receive appropriate fees by getting customers' understanding of transport cost.

Q2. The detail of variations for revenues shows an increase in new orders. Why?

A2. There is a large project underway in the U.S., which is contributing to revenues. We, including our officers, are now approaching customers as part of our efforts to grow our topline, which will go into full swing from next fiscal year.

Q3. Why did strategic investments increase in 3Q? What do you think the future investment effect will be?

A3. We classified and recorded consulting fees of various projects and IT-related costs as strategic investments from 3Q. We expect the investment effect for FY2021 will be approximately ¥1 billion.

Q4. It appears VANTEC expects a slow recovery in automobile-related demand in 4Q. Please tell us why.

A4. In addition to semiconductor shortage, shipping of other automobile parts is also falling behind due to the Omicron variant of COVID-19, which may cause the recovery in 4Q to be slower than initially planned. So we need to carefully monitor future production trends.

Q5. What do you think the results of global logistics for FY2022 will be in light of the FY2021 results exceeding the plan?

A5. Global logistics' results are exceeding the plan thanks to high freight costs and year-on-year volume increase but have not returned to the pre-COVID-19 level yet. We are currently developing the FY2022 plan with the assumption that high freight costs will continue until 1H of FY2022, start declining gradually from 2H, and become stable in FY2023.

Q6. Operating margin appears to be slightly declining, but is it recovering in 2H after bottoming out in 2Q?

A6. Operating margin was 5.7% in 1Q, 4.8% in 2Q, and 5.4% in 3Q, so 2Q was the lowest. The freight forwarding business was doing well, but automobile-related business was stagnant due to COVID-19 and stay-at-home demand for outdoor, home appliances, and daily commodities, etc. slightly decreased year-on-year. Although it's not showing a deteriorating trend, we need to keep monitoring closely in 4Q.

Q7. Please tell us about the impact of the fire on BS and CF so far and in the future.

A7. The balance sheet has shrunk by approximately ¥10 billion because of derecognition of right-of-use assets and lease liabilities in 3Q. For CF, we plan to receive insurance proceeds for our own assets. We will try to complete the recognition of both loss and insurance proceeds by the end of this fiscal year.

Q8. It appears that additional risks of ¥1.2 billion incorporated in 4Q (three months) include approximately ¥0.6 billion of additional costs related to the fire. What is the likelihood of such costs being incurred?

A8. Because of the fire, we are shipping mainly from alternative locations in Kanto to many customers, so we incurred approximately ¥0.2 billion of costs for transport/delivery, etc. to Western Japan in December and expect to incur additional ¥0.6 billion in 4Q. In addition, we expect a slow recovery in automobile and apparel-related demands in 4Q, so we incorporated the total of ¥1.2 billion of additional risks.

Q9. I think there were both positive (rise in freight costs in the freight forwarding business) and negative (semiconductor shortage, etc.) impacts of COVID-19 on business results. Which one was bigger? And what about FY2022?

A9. In FY2021, the positive impact of improved profitability in the freight forwarding business was bigger and offset the negative impact in 3PL/automobile-related businesses. In FY2022, if high freight costs continue and 3PL/automobile-related businesses recover, we may expect profit increase, but we also expect to incur some costs until a location replacing Maishima Sales Office starts operation.

(2) About the progress of the Mid-term Management Plan, and the next Mid-term Management Plan

Q10. Please review the progress toward targets and goals in the current Mid-term Management plan qualitatively and quantitatively.

A10. We expect to achieve revenues of ¥720 billion with support from the special demand in the freight forwarding business. The target of operating income reflecting the effect of IFRS 16 (approximately ¥2.5 billion) is ¥38.5 billion, and we slightly fell short of it. We will aim to grow topline mainly by enhancing overseas businesses and focusing on DX strategies developed under the current Mid-term Management Plan.

Additional Q. Will the next Mid-term Management Plan mainly focus on overseas businesses?

Additional A. Our focus will be on shared milkrun in the U.S., intermodal business in Europe, consolidation of sites and enhancement of wide-area logistics services in India, carbon neutrality initiatives, and measures to support upstream processes in the manufacturing industry.

Q11. What is the current level of external sales of SSCV and the estimated earnings in the next Mid-term Management Plan?

A11. SSCV-Safety is used by Ministry of Land, Infrastructure, Transport and Tourism and Ministry of Economy, Trade and Industry in their research projects and also introduced by several customers. The number of orders received through Hitachi's sales channel is also increasing. We are now determining the sales target and intend to set it at a challenging level. SSCV-Smart is now being introduced in the Group and partner companies. DX initiatives are creating new added value by combining each other, which will be the key elements of the next Mid-term Management Plan.

Q12. I presume the next Mid-term Management Plan will include various investments, but is there any investment to be reduced from the current level?

A12. We expect an increase in overseas and DX investments. In Japan, we are considering using cash generated from the use of lease, sale of assets, and leaseback for investments. Purchased assets, which were previously about ¥20 billion, will be increased to about ¥25 billion. We intend to execute M&As if the opportunities arise.

Q13. About the targets in the next Mid-term Management Plan, please tell us how you plan to improve capital efficiency.

A13. In addition to ROE, we also use ROIC as an indicator, and we aim to achieve ROIC of the 5% level, ROE of over 10%, and total asset turnover ratio of over 1 by the final fiscal year of the next Mid-term Management Plan. To improve asset efficiency, we are considering various measures including the use of logistics centers during the night and enhancement of hazardous substances warehouses.

Q14. Are you considering capital alliance, etc. with peer companies?

A14. In terms of collaboration with peer companies, we are constantly monitoring local midsize transport companies as potential M&A candidates to enhance transportation capacity. In overseas, we are considering transport companies and freight matching companies, etc. as our potential M&A candidates or alliance partners.

Q15. Please tell us about the shareholder return policy toward the next Mid-term Management Plan.

A15. We are not satisfied with our current payout ratio and considering increases in both payout ratio and the amount of dividends.

(3) Other

Q16. How are you responding to "maximum limit of overtime hours for drivers," so-called Year 2024 Problem?

A16. To reduce drivers' total working hours, we are working to promote modal shift, operate double-trailer trucks in the Higashi-Meihan Expressway, and reduce loading and unloading time by developing and introducing a loading dock reservation management system. We are also increasing the number of our own vehicles to enhance the transport capacity while improving transport efficiency by establishing centralized vehicle assignment centers nationwide and expanding the vehicle assignment management network of our partner companies using SSCV-Smart.

Q17. Please tell us about SCDOS (Supply Chain Design & Optimization Services) in detail.

A17. SCDOS is a solution to visualize logistics operations in the entire supply chain, enabling projection of future shipping volume and inventory level by tracing cargoes in transit and checking inventory level. We have offered our services to design the entire supply chain to about 40 companies and the services to trace cargoes to about 100 companies. In addition, our services include simulations to improve logistics, warehouse monitoring, and decarbonization monitoring, etc. aimed at carbon neutrality, and customers may also choose to install the system only.

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