

## Strategy and Vision – Message from the CEO



# Becoming a high-performance materials company unparalleled in the world

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### Introduction

Under the Fiscal Year 2018 Medium-Term Management Plan, the Hitachi Metals Group aims to expand its businesses globally and improve its profitability. Along with organic growth, we will seize opportunities for further growth through mergers and acquisitions, and work continuously to renovate our portfolio. With our diverse business portfolio that has evolved over the more than 100 years since the Company was established, we aim to become even stronger by bringing together diverse high-performance materials, and demonstrate a conglomerate premium unique to Hitachi Metals.

In the automobile industry, the shift toward EVs\* is rapidly accelerating as the overall manufacturing industry is experiencing a major wave of technological innovation led by the Internet of Things (IoT) and artificial intelligence (AI). These developments are providing a strong boost to the Hitachi Metals Group. Hitachi Metals' strength as a high-performance materials company unparalleled in the world lies in being able to address the shift to EVs by proposing integrated solutions that involve magnets, soft magnetic materials, and power cables for high-efficiency motors, as well as integrated

solutions for the IoT and AI with semiconductor-related products such as lead frame materials, LTCC substrates, and mass flow controllers.

### Looking back at fiscal 2017

Fiscal 2017 was my first year as President and CEO. During that year, we faced three difficult operating issues, but I believe we have made steady improvements in each area. Through *monozukuri* innovation, we overcame production technology issues for the automotive heat-resistant cast component HERCUNITE™ for significantly increased yields, while also reviewing our pricing with the understanding of customers, and in March 2018, the business turned profitable on a single-month basis. With regard to aluminum wheels, AAP St. Marys Corp. implemented the highly efficient *monozukuri* management reforms of Waupaca Foundry, Inc., the world's best casting manufacturer, resulting in higher production efficiency. With a jump in costs for secondary materials including graphite electrodes and heat-resistant materials, earnings have been pressured in the specialty steel business in particular, but in fiscal 2018 our customers agreed to the

\*1 Refers to electric vehicles (EVs) including hybrid electric vehicles (HEVs) and plug-in hybrid electric vehicles (PHEVs).

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introduction of a surcharge system as a new method for setting prices. This allows fluctuations in raw material prices to be reflected in product prices and minimizes the impact of those fluctuations on the Company's operating results.

At the same time during fiscal 2017, we made solid progress with three cross-organizational reforms. Along with research and development, *monozukuri*, and sales being carried out based on common, companywide policies at the four internal companies—Specialty Steel, Magnetic Materials, Functional Components, and Cable Materials—management is becoming highly transparent. The *monozukuri* innovation that we initiated in fiscal 2016 has been further strengthened from April 2018 with the shift to a structure whereby the Technology, Research & Development Division has primary responsibility for “Technological Innovations” and the newly established GEMBA Innovation Management Division primarily responsible for “GEMBA (Workplace) Reforms.” With regard to sales innovation, employees are experiencing major synergies through the handling of companywide product groups as sets that transcend the divisions of each internal company. The research wing of the Global Research & Innovative Technology center (GRIT), a companywide R&D organization, was completed in April, and many customers have already visited the facility and directly seen the extent of the Hitachi Metals Group's potential.

During fiscal 2017 we also emphasized the strengthening of communication with stakeholders. In terms of senior-level sales, I personally visited customers, and for investor relations, we held numerous small meetings with analysts, briefings, and other events to engage in direct dialog with investors. We also held roughly 50 town hall meetings globally, which provided opportunities for direct dialog with close to 10% of the Hitachi Metals Group's global workforce of approximately 30,000 people.

Although our operating results are not yet satisfactory, the direction we are taking is clearly being understood across the Group, communication is improving, and technological innovation like EVs is boosting the Hitachi Metals Group's prospects.

### Key issues for fiscal 2018

The first key issue for fiscal 2018 is to implement price revisions. Jumps in prices for raw materials and secondary materials in fiscal 2017 depressed operating income by roughly ¥6 billion. Measures and new products introduced at the specialty steel business over several years are showing results, but there has been a large impact from the steep rise in prices for secondary materials, and we have been unable to have our strengths fully reflected in operating results. Through dialog with customers, we were able to introduce a surcharge system

in July 2018 in which price fluctuations for secondary materials are reflected in product prices.

We are also emphasizing the early deployment of our strategic capital expenditure. Major investments made during the April-June quarter are successively nearing completion, including the GRIT research wing, the innovative production lines for ferrite magnets and rare earth magnets at the Kumagaya Works, the new continuous casting and rolling line for wire and cable conductor materials at the Ibaraki Works, and the Yasugi Works' 10,000-ton free forging press. The new line for cladding materials at the Tsuchiura Works will commence operations early in 2019. In addition to increasing production capacity, the early deployment of these major investments will increase marginal profit rates by improving yields and reducing variable costs in other ways as well. At the same time, we will aggressively pursue orders to increase the effect of increased production capability, thereby increasing total marginal profit.

Magnets are a business bound to gain importance as the shift to EVs progresses, and by having production capacity prior to the emergence of demand, we will gain the trust of customers for our degree of stability in procurement in addition to product quality. The innovative production line for rare earth magnets has been approved by customers and begun full-scale operations. This line applies heavy rare earth diffusion

technology, uses IoT for process management, and automates inspection processes. We will increase and strengthen these lines going forward, with the aim of rapid growth.

### Progress in R&D innovation

Internal companies' research labs focus on refining existing products and medium-term product development, while GRIT pursues the challenge of technological innovation with a view 10 to 20 years into the future. Changes in technological trends pose a major threat to the special materials handled by the Hitachi Metals Group, but by introducing our own technological innovation in terms of both materials development and process development, these changes can become major opportunities for growth. We are also pursuing product areas we have not previously handled and aiming for open innovation with customers, the Hitachi Group, and research institutions. GRIT has incorporated the former Production System Laboratory and the Magnetic Materials Research Laboratory has moved to the same floor. We expect this to lead to internal, cross-organizational innovation.

With the market undergoing major changes and cross-sales beginning to show results, GRIT's promotion function is also important. Promoting product groups across internal company boundaries makes it possible to combine or upgrade current products with a view to meeting market need 10 to 20 years

### Summary of FY2017

- Implemented measures against three negative factors for profits (heat-resistant casting components, aluminum wheels, rise in raw materials prices) and expect the factors to be solved.
- Accelerated three companywide initiatives (R&D, *monozukuri*, sales).
- Strengthened communication with stakeholders (town-hall style meetings: direct communication with more than 2,000 employees; increased direct dialogue opportunities with investors; aggressive sales by top management).

Change in corporate culture:  
Transparency and reliability of management, sharing of values, improved motivation of employees

A positive corporate culture that is oriented to the creation of new value

### Priority Issues of FY2018

#### ► Price revision

Corporate-led pricing that “maximizes the aggregate of marginal profit”

Review and expand application of the surcharge system (price revisions for products not covered by the system)

#### ► Early launch of investments and harvesting gains

Specialty Steel Products	10,000-ton class free forging press, cladding materials, rolls for steel mills, etc.
Magnetic Materials and Applications	Innovative production line, acquisition of Santoku, etc.
Functional Components and Equipment	New casting line for piping components, etc.
Wires, Cables, and Related Products	New continuous casting & rolling line, innovative production lines for magnet wires, etc.
Corporate	Opening of new building at GRIT, corporate research lab

The first year of “New Hitachi Metals”

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into the future. With products like materials indispensable for clean engines and materials that contribute to the shift to EVs, the Hitachi Metals Group is a genuinely development-driven company paving the way for the future with both current products and innovative advanced materials.

### Progress in *monozukuri* innovation

*Monozukuri* innovation comprises both workplace reforms and technological innovations, and significant progress is being made in workplace reforms in particular. We are using the “2S-3F” concept (Sort Out, Set In Order, Fixed Location, Fixed Quantity and Fixed Item) to clear up workplaces through bottom-up activities and working to make activities “visible,” and spreading this globally through workplace exchanges. This is stimulating employees to learn from each other across internal companies, and a new Hitachi Metals Group culture is taking root. It is extremely important for everyone, including senior management, to have a common understanding of what might happen in the workplace, including safety-related activities. The GEMBA Innovation Management Division, reporting directly to the President, was established in April to accelerate this process.

Technological innovation has also achieved successes including the introduction of an innovative production line for magnets, and in fiscal 2017 a concentrated investment of

management resources was made for *monozukuri* innovation in HERCUNITE™. We are putting renewed effort into technological innovation in fiscal 2018, as we strive to strengthen *monozukuri* innovation in this area as well as workplace reforms.

### Progress in sales innovation

Hitachi Metals provides customers with technologically advanced, unique products with industry-leading production capability and cost competitiveness. This is, in essence, “the mass production of high-quality materials” that we seek. The idea of selling technologically advanced products at high prices and maintaining profit margins would limit areas where we can be globally competitive, and high growth cannot be expected.

Under the Business Activity Power Up Project, cross-organizational functions like the common understanding of our basic policy for pricing as “maximizing the aggregate of marginal profit” are being strengthened, and staffing at sales divisions is being increased. In terms of efforts to develop new products and new markets using companywide resources across internal companies, we have launched a project for next-generation automotive parts and materials, led by younger employees. Over the long term, we will closely follow long-term trends in technology and market growth, including

the shift to EVs and weight reduction in iron castings, and work with GRIT to create a roadmap for a product portfolio strategy and new business creation.

### Capital strategies and shareholder returns

Capital expenditure will remain at the ¥100 billion level in both fiscal 2017 and fiscal 2018, focusing on proactive investment for growth and investment for streamlining to strengthen workplaces, but we see this as the peak and plan to implement capital expenditure not exceeding the amount of depreciation and amortization from fiscal 2019. With respect to shareholder returns, our policy is to emphasize a balance between investment and returns to shareholders, and we have raised our dividend payout ratio target to 30% from the previous 25%.

### Corporate governance

Hitachi Metals is a company with a nominating committee, etc., and our organization is managed so that management oversight and operational execution function effectively. This year we have reviewed the roles of the Board of Directors and Executive Committee, which executes business operations, so that deliberations of the Board of Directors will not duplicate those of the Executive Committee, leaving the Board to focus on long-term business strategy and engage in active discussions on the direction Hitachi Metals should take.

### Becoming the world’s leading high-performance materials company

The Hitachi Metals Group seeks to increase its corporate value by using unique products to create new value for customers and contribute to resolving underlying social issues.

To achieve this, we are working to instill a vibrant corporate culture in which each employee is a soldier fighting on the front line of the workplace, with a sense of determination to implement the strength of “One Force for Change.” This means using diversity to achieve successive innovations that other companies cannot match and create unique products, for continuous growth to become a high-performance materials company unparalleled in the world. We ask that you look forward to that.

#### Acceleration of Growth by Strengthening Corporate Functions

R&D (GRIT)	<ul style="list-style-type: none"> <li>Promote creation of new business with a view to threats and opportunities.</li> <li>Strengthen human resources development/education functions (sales divisions, group companies).</li> <li>Enhance the process of identifying and evaluating new technologies and R&amp;D speed in cooperation with sales.</li> </ul>
Sales	<ul style="list-style-type: none"> <li>Carry out multilayered proposal activities including top management, utilizing GRIT.</li> <li>Strengthen relationships with customers by establishing an account sales system.</li> <li>Carry out cross-sectional projects.</li> </ul>
<i>Monozukuri</i>	<ul style="list-style-type: none"> <li>Carry out activities based on the two pillars of “GEMBA (workplace) Reforms” and “Technological Innovations.”</li> <li>Establish the GEMBA Innovation Management Division.</li> <li>Implement technological innovations for the entire materials flow using IoT.</li> </ul>

A genuinely development-driven company

The mass production of high-quality materials

