Q1 Financial Results Briefing for the Fiscal Year Ending March 2023

Q & A

[Date]	August 2, 2022 (Tue.)	16:30-17:30
[Speakers]	Tetsuya Shigeta	Representative Director, Executive Managing Officer, CFO
	Masao Kurihara	General Manager of Global Controller Division
[Moderator]	Maroshi Tokoyoda	General Manager of IR Division

<Q1>
Roughly speaking, what kind of businesses can be classified into those that were good in Q1 and are likely to continue to be good in Q2 and beyond, and those that are good now but are actually starting to weaken due to the economic slowdown?

<Shigeta>
Regarding the areas that have continued to perform well since Q4 of the previous fiscal year and will continue to be steady in the future, one of the areas is the automotive business in North America, centering on Penske. Not only limited to our initiatives with Penske group, we are seeing profit expansion of auto business in Canada, South America, and others, thus we believe that automotive business in the Americas will continue to be solid. We are also developing our healthcare business centered on IHH, as well as our healthcare staffing business in North America, as part of our wellness expansion, and we are confident that these businesses will continue to perform well, having shown significant growth in the previous quarter. Trading of raw and processed materials, etc. has been favorable in the last and this quarter. Assuming a slowdown in the economy and a decline in demand, there is some concern that the margins we have now could be compressed a little. However, this is not a point at which the profit will fall far below the steady level. I do not mean that they will be expired, but they might be influenced by economic recession, depending on its severity.

<Q2>
Please tell us about the concept of a minimum dividend in terms of shareholder returns. For example, base profit of JPY7 billion increase YoY looks small, but the derivative losses from LNG trading were pushing it down, and the iron ore dividend were not included. If we take back these factors, actual base profit would largely be built up. We recognize that stable Core Operating Cash Flow of JPY600 billion can be calculated by JPY120 per share dividend by 1.6 billion shares and 33% of total shareholder returns ratio. How do you feel now about the level of confidence to further raise the minimum dividend of JPY120 per share at this stage when the base profit is increasing.

<Shigeta>
Regardless of concerns about the environment, we are determined to achieve minimum dividend JPY 120 per share that we disclosed in business plan and Q3 of the previous fiscal year. Additionally, we are strongly

committed to achieve our target for total shareholder returns of 33% of Core Operation Cash Flow for the cumulative three-year period of the Medium-Term Management Plan. While we have not revised our annual forecast from the initial plan, In Q1, we have made progress of over 30% vs the annual forecast. We hope to increase the shareholder returns by firmly growing our Core Operating Cash Flow while achieving the 33% target.

<Q3>

Regarding the cost and volume impact on Mineral & Metal Resources segment and Energy segment, iron ore and coking coal appear to be lower in profit than initially expected in the budget, while energy appears to be improved. While I assume that increased labor and fuel costs will affect both segments, would like to know what the difference is and how you look at whether this situation will continue in the future.

<Shigeta>
As you understand, in the Mineral & Metal Resources segment, the cost increase in both iron ore and coal was due to higher materials and equipment costs resulting from accelerated inflation, as well as higher labor costs caused by the impact of stricter measures taken for COVID-19 and tightening labor market. On the other hand, in the Energy segment, depreciation and amortization cost decreased due to an increase in reserves in some projects. Also, OPEX decreased due to recycling of some projects. Therefore, there was not much impact of higher equipment, materials and labor costs, compared to the Mineral & Metal Resources segment. The volume of Mineral & Metal Resources segment was affected by heavy rains in Australia and delays in ramp-up of some projects.

<Q4>

Valuation loss was recorded only for Sakhalin II because of the reassessment, but not for Arctic LNG2. Why is there such a difference between the two projects? Should we be aware of the possibility of additional losses in the future depending on the situation?

<Shigeta>

Sakhalin II project will be affected by the Presidential Decree that was announced. The legal entity of Sakhalin II project is registered outside of Russia while legal entity of Arctic LNG2 is registered in Russia. For Sakhalin II, in addition to the increase of the discount rate due to downgrade of Russia's credit rating, the fair value of investments and loans was decreased to 90.2 billion yen, as a result of reflecting the weighted average of two scenarios; a scenario where the continuous dividend income is predicted and another one. On the other hand, for Arctic LNG2, we did not change its projections of future cash flows, and although there was a downgrade of credit rating and subsequent discount rate increase, the impact on the valuation was limited.

<Q5>

Please tell us about the latest situation of operation in Sakhalin II project, including insurance coverage for LNG vessels. Also, please update us on the situation for maintaining the interest of this project, as one month has passed since the announcement of Russian Presidential Decree on June 30. Furthermore, please tell us about the construction progress of Arctic LNG2 project.

<Shigeta>

Operations of Sakhalin II project, have been running normally and have not been faced with serious troubles. In terms of the Presidential Decree, we have not been contacted thus understand that the new company has not yet been established. We are working to understand the details in a timely manner by dispatching our staffs to Russia. While recognizing the importance of a stable energy supply to Japan, we will continue to discuss with the Japanese government and our business partners to take appropriate actions.

Construction of Arctic LNG2 is ongoing. There will be no change to our previously announced plan to start production of the first train in 2023.

<Q6>

Please tell us about the profit trends in the Energy segment. You mentioned earlier that there were derivative losses recorded in Q1, but at the same time, profits of projects such as Marcellus and Eagle Ford seem to have increased considerably. May I understand that the current profit forecast is exceeding the original business plan, considering that the loss on derivatives in Q1 will be well recovered in the full fiscal year?

<Shigeta>

Your understanding is correct. As there are positive factors such as oil and gas prices and FX, the profit of Energy segment is exceeding the business plan. Regarding the accounting, in theory, there is no guarantee that similar timing differences will not occur at the end of the fiscal year, however, we expect that most likely, the timing differences will be eliminated throughout the year and profit that more than offset will be recorded.

<Q7>

Regarding Mainstream and large-scale renewable energy project in India, please explain about the anticipated schedule and scale in terms of profit contribution.

<Shigeta>

Mainstream is positioned as a platform, and we are involved in onshore/offshore wind, as well as solar power under its umbrella. The company has strengths particularly in Central/South America, Africa, and Asia, we would like to take our time to develop greenfield projects, over a 5-to-10-year time frame.

The renewable energy project in India is a new initiative that will combine solar, wind and storage batteries to operate on a 24-hour basis. We expect this project to contribute overall as soon as it is completed. In the medium term, we are well on our way to building toward our goal of 30% renewable energy ratio.

<Q8>

Regarding Sakhalin II, please tell us about how we should look at the maximum risk.

<Shigeta>

In Sakhalin II, I believe that the impact over the FVTOCI balance of JPY90.2 billion should be limited as far as we can assume, while the details of the presidential decree is still unknown.

<Q9>

Please tell us the background of the one-time gain of JPY 9.1 billion on R-Pharm, which is explained as the valuation gain of put options.

<Shigeta>

R-Pharm, the Russian pharmaceutical products company, in which we have 10% stake, is treated as FVTOCI for accounting purposes. While we hold put options of R-Pharm's shares in rubles, the fair value in JPY of the put options has risen due to ruble appreciation over JPY, and we recognized a valuation gain of approximately JPY9 billion.

Although the accounting logic is a little complicated, if the fair value of R-Pharm stock itself declines, this is recorded as other comprehensive loss, and since the put option can be exercised at a certain price determined by a formula, a positive valuation gain is recorded as derivative.

<Q10>

Coking coal price has dropped significantly, while thermal coal price has been at a very high level. Is it possible to sell coking coal as a substitute for thermal coals to capture the price difference? Is there any discussions going on regarding such deal?

<Shigeta>

I have not heard of any plans to use coking coal as a substitute for thermal coal, and from the standpoint of quality and grade, it does not seem to be feasible to use coking coal as thermal coal. In addition, we have already withdrawn from thermal coal production business, and this is another reason we are not considering such business.

<Q11 >

Nutrition & Agriculture Business Unit in the chemicals segment looks to be doing quite well in Q1. Could you tell us how sustainable this is going to be?

<Shigeta>

In Q1, trading of fertilizer raw materials, especially molten sulfur performed solidly at the Nutrition & Agriculture Business Unit. In terms of sustainability, the Business Unit is expanding its global value chain for agrochemicals, fertilizers, and other agricultural materials. Regardless of the recent situation in Ukraine, we believe that we can continue to maintain profitable opportunities as we fulfill our global stable supply.

[END]