Q3 Financial Results Briefing for the Fiscal Year Ending March 2023

Q & A

[Date]	February 3, 2023 (Friday)	16:00-17:00
[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>

You explained about the balanced allocation relating to the Management Allocation as shown on page nine of the presentation material. Is it correct to say that the Management Allocation as a whole for this Medium-term Management Plan has been completed after evenly allocating one third, or 590 billion yen each, to shareholder returns, growth investments and strengthening of financial position, and this led to your decision for the additional share repurchase of 100 billion yen to make up the difference?

<**Shigeta>**

You are correct, but just to make sure, please allow me to provide a supplementary explanation. Regarding the additional share repurchase of 100 billion yen which we have decided this time, if we evenly divide the amount in the period we have set, we can expect that approximately 25 to 30 billion yen will be executed by the end of March, although we cannot be certain as we are leaving the implementation to a securities company. As explained in the footnote, this amount will be factored in as cash allocation for this current Medium-term Management Plan. As for growth investments, we expect 280 billion yen to be completed by the end of March, and we have approximately 400 billion yen in the pipeline that we wanted to execute during the current Medium-term Management Plan but will be carried over to the next fiscal year, although this amount is not shown in the presentation. We would then like to temporarily allocate the remainder for short-term liquidity.

<Q2>

It's my understanding that of the 110 billion yen increase in base profit excluding one-time items on page 16 of the presentation material, 80 billion yen comes from the Energy segment. What is the background of the increase in offtake volume from Cameron LNG? It's my understanding that the increase in the offtake volume from Cameron is a further increase from the 10 million tons of LNG trading volume (for the fiscal year ended March 2022) that was explained at the recent Investor Day. If the tight supply-demand situation continues to some extent, will you be able to maintain this level of LNG trading volume?

<**Shigeta>**

The increase in base profit from the annual forecast at the time of the H1 results is partly due to the fact that the forecast at the time of the H1 results was slightly conservative. For LNG, we have Cameron's tolling business, which earns tolling fees, and our trading business, which sells LNG that comes out of that tolling business. Amid tight supply and demand for LNG, we have focused on increasing production as much as possible, and the resulting increase in our offtake volume has directly linked to an increase in our basic earnings power. In addition, the strong performance of each LNG project in which we participate has led to an increase in dividends. The upward revision in Energy consists of these two factors.

Profits increased due to the impact of high LNG sales prices in Europe and Asia, in the midst of the emergence of geopolitical risks. Regarding the sustainability of this situation, it is difficult to assume that the situation will continue for a long period of time. On the other hand, although not a desirable situation at all, we assume that changes in the supply chain caused by the risk of the current geopolitical risk becoming more apparent will continue, and that the volatility of the energy market itself will continue to increase, leading to an increased need for supply and demand adjustment functions in the global market. Under this assumption, there will continue to be many opportunities for our LNG trading business. Our strength lies in our ability to provide functions, such as managing vessel allocation schedules through our fleet of LNG carriers and adjusting price formulas for our customers. While it is difficult to say whether profits themselves will be in the same range as this year, we anticipate continued profit opportunities.

<Kurihara>

In addition to LNG trading and LNG dividends, the volatility of the market has been a factor for profit increase in commodity trading as well. In the shipping business, the tanker market has been a very strong factor for profit increase. In the food business, there was a one-time tax refund in the grain collection business in Brazil, coffee trading recovered and grain trading was also very strong.

<Q3>

Regarding LNG trading, if spot prices continue to return to their previous levels as they have now, will the level of earnings decline from the beginning of the next fiscal year? What are your thoughts on the timing of the return of earnings to their previous levels?

<**Shigeta>**

The time lag issue in which the loss was recorded in advance up until the end of Q2 was completely resolved in Q3. We do not anticipate a time lag for Q4 going into the next fiscal year. Since the volume of delivery is large in Q4, mainly due to seasonal factors, the expected profit in Q4 is larger compared to other quarters. Unlike the E&P business, LNG trading profits are not determined by volume multiplied by price. It is very difficult to calculate because the frequency of profit making opportunities is determined by the increase of volatility.

If management requests for stable profits, it could lead to traders also taking unexpected risks, thus we would like to avoid making such requests. We will aim to achieve sustainable profits by performing our functions and making profits while managing risk. We do not believe that we will record big losses, but we honestly do not have that much confidence in our ability to sustain this fiscal year's level of earnings on a stable basis. It is difficult for us to answer the question of sustainability because spot contracts other than long-term contracts and sales associated with increased production will increase, and it will be a matter of how to secure profit.

<Q4>

You have revised your earnings forecast upward and now expect profits of around 240 billion yen in Q4, assuming that the high level of profits will continue, but are there any signs of a slowdown in your businesses? Are there any slowdowns in the US business in particular?

<**Shigeta>**

Regarding signs of a slowdown, we believe that prices are normalizing to some extent in various commodities, materials and raw materials. On the other hand, looking globally, there are many customers who are struggling with supply chain disruptions in across regions and products, and we will continue to provide services to maintain supply chains, in other words we have factored those in to our earnings base.

In our forecast for Q4, we assume that sales will continue to be strong in the US automotive and other sectors. On the other hand, due to the normalization of prices and the adjustment of raw materials as explained earlier, we expect a slight compression of margins in the trading and manufacturing businesses for chemicals and other products compared to the previous quarters. Although we are not yet concerned about an overall slowdown, there are a few segments where margins have been compressed to some extent. In terms of the outlook for the future, we would like to maintain our profit-securing structure by thoroughly demonstrating our functions in order to contribute to the maintenance of the supply chain.

<Q5>

Shareholder returns will be a total of 480 billion yen plus the share repurchases to be made in March of around 20 billion yen. Adding 280 billion yen for growth investments to that brings the total to 780 billion yen. My understanding is that out of the 1.78 trillion yen Management Allocation, 780 billion yen will be allocated during this Medium-term Management Plan, and the remaining 1 trillion yen will be “temporarily” allocated to increasing short-term liquidity. Please explain the details of the expression “temporarily” you mentioned here.

On a separate point, in the next Medium-term Management Plan, I am hopeful the total return on Core Operating Cash Flow is to be 33% or higher. Please explain your thinking on the approximate 1 trillion yen that will be carried over from the current Medium-term Management Plan. This 1 trillion yen will reduce net interest-bearing debt, but in order to maintain ROE at a certain level, I believe a fairly significant amount of shareholder returns will need to be made. With this in mind, please tell us about the status of discussions on how to further increase ROE.

<Shigeta>

Your understanding is correct regarding the numbers. The meaning of the word “temporarily” here is intended to indicate that we are considering increasing the level of short-term liquidity in these uncertain times. We stated it in this way to convey our intentions; that once the situation has cleared, we intend to allocate funds to growth investments and to shareholder returns.

For example, the net DER is at a low level of 0.57x, but that does not mean we will lower it further or that we have changed policy to reduce leverage, but rather it implies that we will make a decision on how to deploy capital when things have cleared up.

With respect to shareholder returns, assuming share repurchases during the fourth quarter, we have factored in between 25 to 30 billion yen, and we believe that we can exceed a payout ratio of 33% of Core Operating Cash Flow. The remainder will be carried over, as you assume. I would like to add that we had also planned to complete the execution of growth investments by the end of March 2023, but of this around 400 billion yen will be carried over into the next fiscal year.

On the other point, we would like to start the next Medium-term Management Plan with a line drawn between

the next plan and the current one, in order to avoid confusion regarding which amount of cash flow came from which period.
We will discuss issues such as whether the current Medium-term Management Plan's level of 33% of Core Operating Cash Flow was sufficient, what this ratio should look like in the next Medium-term Management Plan, and whether there could be more allocated for additional shareholder returns in the future based on our financial strength and short-term liquidity.
Internally, we have been discussing in depth on how to increase ROE. Also, we are discussing what should be prioritized when it comes to growth investments, being conscious of the investment scale required to convince investors that we should make such investments. We consider ROE to be an important metric from the viewpoint of capital efficiency, but we do not focus our discussions on any single metric.

<Q6>
What is your company's view on the current rise in iron ore prices?

<Shigeta>
Looking back at the first nine months of the fiscal year, I think there is an element of resilience toward downward pressure in prices given the costs for producers, and even as China continued its zero corona policy, prices weren’t going lower.
I believe that if the Chinese economy begins to recover in the future, we can expect a certain degree of price increases. We will discuss the price assumptions for the next fiscal year's business plan and also look price trends at the time of announcing the next financial results, and make our decision based on this.

<Q7>
In the current Medium-term Management Plan, you have indicated Strategic Focus as the axis of growth investments, but from this fiscal year, you are emphasizing bolt-on investments in existing businesses and investments in adjacent areas. Has there been a change in your investment stance?

<Shigeta>
The focus on Energy Solutions, Healthcare and Nutrition, and Market Asia, as stated in the Strategic Focus, has been maintained during the current Medium-term Management Plan period and remains unchanged.
At the same time, we have been particularly careful from this fiscal year to provide evidence of the probability of success and instances where we have succeeded in growth investments. Growth investments are projects that are selected and executed after examining profitability, business potential, and future growth. While we are intentionally referring to bolt-ons, investments in adjacent businesses, or cases where we have joined with partners that we have established trust, as the common denominator for projects with high probability of success, but the investment approach remains unchanged.

<Q8>
I think that you made the upward revision of each segment's performance without taking into account the progress against the previous forecast. Could you please explain the background to that decision?

<Kurihara>
Please refer to page four of the financial results presentation materials: *Progress against Previous Forecast*.
While the Mineral & Metal Resources segment has made a high level of progress at 89%, the upward revision was limited to 15 billion yen. This is because the gain on the sale of SMC has contributed to the progress rate, and a slight slowdown in the metallurgical coal and iron ore businesses is expected in Q4.
The Machinery & Infrastructure segment and Chemicals segment each had a progress rate 75% and 78% respectively, and there was no revision to these segments.

Although the Iron & Steel Products segment has made a high level of progress at 98%, we have left our previous forecast unchanged, as we are factoring in lower sales volume of steel sheets for EV transformers.
The Lifestyle segment is also making a high level of progress at 85%, but we have left our previous forecast unchanged due to the inclusion of a one-time profit in the results recorded up until Q3, the good performance of the grain trading business which we expect to normalize, and the expected year-end demand seen in the fashion and domestic logistics businesses.

<Q9>
Looking at the Q3 results on a year-on-year basis, and the full-year forecast compared to the previous forecast, both show a decrease in profit related to resources-related cost factors. What is you view on the trend for the coming fiscal year?

<Shigeta>
In the Mineral & Metal Resources segment, a decrease in volume and an increase in unit costs are both factors for lower earnings, and in addition, there is a labor shortage and inflation in Australia, for example. Whether the trend of increasing labor and other costs will continue in the next fiscal year will depend on future trends in iron ore prices, but we will closely monitor the impact on our business performance, including trends on the production side.

[END]