

FY March 2024 Q1-3 (April-December 2023) Financial Results Announcement Q&A Session

[Date]	February 2, 2024 (Friday) 16:30-17:30
[Speakers]	Tetsuya Shigeta Representative Director, Senior Executive Managing Officer, CFO Masao Kurihara Managing Officer, General Manager of Global Controller Division
[Moderator]	Hideaki Konishi General Manager of Investor Relations Division

<Q1>

Although Core Operating Cash Flow (COCF), which forms the basis for shareholder returns, was revised upward by 40 billion yen, no additional shareholder returns were announced this time around. I assume that additional shareholder returns were discussed as an option for this financial results announcement, but would I be correct in saying that additional returns were not announced after considering factors like comparison between Medium-term Management Plan (MTMP) target of 37% of COCF and your market capitalization? Please walk me through your thought process.

<Shigeta>

Regarding shareholder returns, we would like to wait until the end of the fiscal year. We specified the target for the shareholder returns ratio as a percentage of COCF was *around* 37% and not a definitive number. This time it was around 37% which was in line with our expectations. As of the end of Q2, we had decided to payout returns at a pace that exceeded our target, but this time we decided to postpone that decision until the end of the fiscal year. For example, regarding the upward revision of 40 billion yen this time, there was some discussion as to whether it is necessary to review shareholder returns on a quarterly basis, but we think it is necessary to instead review this over a certain period of time and not necessarily make sure we are at 37% at the point of each and every quarter.

<Q2>

Regarding the YoY factor comparison slide on page 17 of the presentation material, I have two questions regarding base profit on the far left.

For my first question, regarding returns from new investments that I think are probably hidden here, I believe you had explained that more than 30 billion yen of the 60 billion yen by the end of the MTMP is accounted for. Are you able to give us an idea of the scale of the results?

My second question concerns the sustainability of earnings in the automotive and truck-related businesses in the Americas, which has continued to perform well this fiscal year.

<Shigeta>

We would like to enhance our base profit by 170 billion yen over the three years of the MTMP. We are on track for about half of the 60 billion yen coming from new investments, and we have been announcing projects that have begun to contribute to earnings. However, since the goal of achieving the 60 billion yen level is for FY March 2026, the final year of the MTMP, I don't have a meaningful figure to share with you as of now, but I can say we feel that we are making steady progress toward FY March 2026.

Penske Truck Leasing, our truck leasing business in the US, is showing signs of a drop from the very strong performance which was boosted by post-Covid-19 pent-up demand. However, the business model is sustainable and cost competitive, so the profit level has changed considerably compared to the pre-Covid-19 levels, and we expect this to continue to a certain extent. In addition, although the automotive business in North America may have varying performance across individual businesses, the US economy is being well managed by the financial authorities, and we are close to being confident that the US economy will not go into a recession. Under the current state of the US economy, we have a certain degree of confidence in the level of profitability and sustainability of the North American automotive business as a whole.

<Q3>

Please tell us about the underlying profit of Machinery & Infrastructure. Also, please provide additional information on the impairment at Mainstream.

<Shigeta>

Mainstream is facing some difficulties in its Chilean projects. Mainstream is working to improve the profitability of the business by negotiating terms with Chilean authorities and reviewing costs, but this time an additional impairment was recognized.

<Kurihara>

With regard to Machinery & Infrastructure, of the full-year revised forecast for profit of 255 billion yen, approximately 190 billion yen is the underlying profit that is excluding one-time items such as *asset recycling* and *valuation gain/loss and special factors*. The previous forecast was 170 billion yen in underlying profit and 100 billion yen in one-time items, but the new forecast is 190 billion yen and 60 billion yen, respectively. Regarding underlying profit, we were conservative in our assumptions for the automotive, ships, and construction machinery businesses, which maintained their strong performance, resulting in an increase in profit. By netting the shift in timing for the sale of Paiton, we are expecting a decrease of 15 billion yen from the previous forecast of 270 billion yen.

<Q4>

Regarding Energy segment, please tell us whether LNG trading performed better than you had expected. Also, please tell us how far you see the downward trend in volume continuing into the next fiscal year.

<Shigeta>

As for the increase in profit from LNG trading, we believe that our estimate at the time of Q2 was a bit conservative.

<Konishi>

Our latest forecast for volume in the Energy segment has not changed significantly from our view at the beginning of the fiscal year. This is because when revenues change, how they are allocated to the volume and price factors is quite complex, and some of the factors that are represented as volume factors include factors that by nature could be allocated to price, so in some cases, when you only look at the volume factors, they appear to be large. In reality, when we assume that the additional cargo sold at last year's high spot price will be eliminated this year, the negative impact is allocated to both the volume factor and the price factor, so we need to look at the total of these two factors.

As for the trend leading up to next fiscal year, this will depend on various factors such as weather and climate at that time, so we need to carefully assess this.

<Q5>

I have a question regarding Arctic LNG 2, for which an additional provision has been recorded. You mentioned that the impact on profit and loss is 12.3 billion yen. Please tell us your view on whether it is correct to assume that the additional risk has been reasonably factored in and that market participants could recognize that there is little likelihood of a large additional amount of loss being incurred in the future. Please tell us how much of that risk has been factored in this time, even if it is a qualitative explanation. We are aware that there are confidentiality obligations, etc., and within the scope of those obligations, is it correct to say that you have incorporated as much risk as possible based on the economic sanctions imposed, and came to a conclusion of the amount of provision amount recorded in the Q3 results?

<Shigeta>

For Arctic LNG 2, in light of the impact of economic sanctions, we see a higher probability of having to fulfil obligations for some of the guarantees we have provided, and due to this we have recorded an additional provision for loss. In addition, we have also reviewed our loans and guarantees to J-Arc. As a result, we believe we have made appropriate accounting provisions based on our best estimates as of Q3.

Looking ahead to Q4, we will continue to take appropriate action, observing the rights and obligations of Mitsui and J-Arc under each contract, in cooperation with the Japanese government and other stakeholders. Among other things, we will appropriately take the best possible action based on the premise that we are committed to comply with sanctions and laws. Due to confidentiality obligations, please understand the limitations of our ability to disclose details regarding the guarantees, etc.

<Q6>

Looking at the full-year revised forecast in Q3, the underlying profit of Machinery & Infrastructure have increased, while Chemicals seems to be weak. I understand that both of these segments are significant factors for profit growth in the current MTMP. Please tell us what you think regarding whether the underlying profit of Machinery & Infrastructure is becoming stronger than initially expected. Also, Chemicals seems to be getting weaker, but do you think the YoY decrease was of one-time nature and that now you will see an accumulation of profit from here on out? Or do you feel you may need to make a revision to the forecast for this segment?

<Shigeta>

I already feel positive regarding Machinery & Infrastructure. On the other hand, compared to other segments, there are more trading, raw materials, and materials businesses in the Chemicals segment. Although we are struggling with the impact of the declining demand and sluggish market conditions, we have already made new investments in the previous and current MTMPs that are expected to contribute to earnings from a relatively early phase. We want to achieve the quantitative plan for FY March 2026, the final year of the MTMP, by harvesting, picking, and accumulating earnings from these investments while contributing to the enhancement of business value after investment.

<Q7>

With regard to the progress rate for profit, there are differences by segment. Among them, progress in the three segments, Energy, Iron & Steel Products, and Innovation & Corporate Development, are a little weak, and I would assume that this may be due to seasonality. What is the outlook for these three segments to catch-up in Q4?

<Shigeta>

There is indeed a difference in progress rate in profit. First of all, in the Energy segment, there is seasonality in the LNG-related business, and profit tends to increase in the second half of the year, due to the winter season in the Northern Hemisphere. Although the progress rate was below 75% as of Q3, we see it being on track considering the seasonality.

We must admit that there are still some challenges in the segments where the progress rate is relatively low, but since this is the forecast as of Q3, we will make every effort to achieve the goal.

<Q8>

I believe that growth investments have been made at an aggressive pace up to Q3, partly due to the investment projects that were pushed back from the previous MTMP period.

However, looking at Q3 alone, it appears that the pace of investment has slowed slightly. What are your thoughts on the pace of investment in Q4, the next fiscal year and beyond, given the current business climate?

<Shigeta>

As you pointed out, regarding the pace of growth investments, some that were scheduled to be implemented during the previous MTMP period were pushed back to Q1 of this fiscal year. We have explained that we had about 400 billion yen of such growth investment opportunities at the end of March 2023, and since they are included in the figures for the current MTMP, the pace of progress is very high.

Growth investments will not continue at this pace for three years, and we intend to maintain a strong cash flow allocation framework throughout the three-year period of the MTMP. We have a robust pipeline of growth investments, but we will be very selective in the investments we make, and we do not expect the overall cash flow allocation to change significantly from the three-year MTMP or the three-year forecast at this point. We believe that we are on track, although the pace may slow down slightly.

<Q9>

You explained that *valuation gain/loss and special factors* includes the actual amount up to Q3. Am I correct in understanding that within the full-year forecast of 950 billion yen, there have been no additional buffer or risk amounts factored in?

In addition, you mentioned that the sale of Paiton has been shifted, but I believe you have previously explained that the only thing left was the signing process. Please tell us about the current situation.

<Shigeta>

First of all, the 950 billion yen full-year forecast does not include any "buffers" so to speak. Although there are some positive and negative factors that were factored in, they are not large, and we have not factored in a buffer in the sense of preparing for the possibility of an overall downturn.

Regarding Paiton, the same situation as previously explained is continuing. We are still in the process of obtaining one last signing of the closing documents, but we have not yet closed because we have not been able to obtain signatures from the counter party of a long-term power purchase agreement. Since the current forecast is that the closing will probably take place in the next fiscal year, we have made the decision to remove it from this fiscal year's forecast and incorporate it into the next fiscal year's plan.

<Q10>

From a quantitative perspective, please tell us about the progress made in strengthening existing businesses in order to enhance the base profit.

<Shigeta>

For strengthening existing businesses, although this may be a qualitative explanation, we are seeing good signs in the mobility, healthcare, and retail businesses. For efficiency improvements and turnarounds, progress has been made in turning around loss-making businesses, including the coffee business, and several exits from loss-making businesses have been completed. Although we haven't done a quantitative compilation this quarter, we are making good progress and will keep you well informed of our progress.

<Q11>

There are situations where ship operations have been hampered by conflicts in the Middle East and droughts in the Panama Canal. What is the impact on the ships business and various trading business?

<Shigeta>

The demand for ships and chartered ships is increasing due to heightened geopolitical risks and changes in shipping routes, and we are responding by firmly supporting the supply. In the current fiscal year, the tanker market has remained high and the number of ships delivered has increased, both of which are favorable factors for the ships business. And, across each trading business, there are earnings opportunities that can arise from an increase in demand.

<Q12>

What is your view of the iron ore price, which was a factor in the upward revision?

<Shigeta>

Iron ore price in Q3 was higher than expected. Given that the pace of China's economic recovery is not that fast, and given the Chinese market has a large impact on iron ore price, we expect price to decline gradually in the short- to medium-term from Q4 onward. That was the expectation as of Q2, and it is still the expectation after our current review.

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