Financial Results Announcement for FY Ended March 2019

QA session summary (translation)

Time and Date: May 9, 2019 (Thur.) 10:00 – 11:30

Presenters: President and Chief Executive Officer, Tatsuo Yasunaga,
Senior Executive Managing Officer, CFO, Takakazu Uchida,
Managing Officer, GM, Global Controller Division, Tetsuya Shigeta
Managing Officer, GM, Investor Relations, Yuji Mano

[Speaker 1]

Q1: Policy on shareholder returns. Why is the dividend unchanged at 80 yen despite the growth you described in non-resources areas? How do you plan to use the 130 billion yen in three-year cumulative free cash flow after shareholder returns?

A1: While our shareholder returns policy has not changed, accounting reclassifications of the repayment of lease liabilities by the newly adopted IFRS 16 increased core operating cash flow by 50 billion yen. Core operating cash flow should be an indicator of earning power, but this 50-billion-yen increase is the result of changes to accounting standards, and as such we do not consider it a basis when thinking about shareholder returns. At the same time, with the introduction of share performance-linked executive remuneration, our management approach will be more share-price oriented. Our commodity price assumptions are conservative, reflecting the uncertainty caused by trade frictions between the U.S. and China, but basically we aim to reflect cash-flow growth from market upturns in shareholder returns.

Q2: Lifestyle and Innovation & Corporate Development segments are seeing performance growth, and you are forecasting an increase of 15 billion yen in core operating cash flow for the Lifestyle segment in particular. What is driving this increase?

A2: Multigrain had been a negative factor, and with the withdrawal from it, we are now able to reassign personnel from crisis response to revenue increase. An exceptionally positive cycle is seen, particularly in Food and Retail, where the growth is a result of the accumulation of these factors.

[Speaker 2]

Q3: Supply and demand of iron ore has tightened as a result of the Vale incident, driving up prices. Will any associated increase in core operating cash flow be allocated to shareholder returns in the form of share buyback or dividends?

A3: Over the past three years, we have made significant efforts to reduce costs in resources areas. We have created an environment in which revenue is maximized when market conditions are rising, and even in a downturn we can achieve expected levels of revenue. This has put us in a position to raise the minimum dividend level in the next medium-term management plan. This fiscal year, which is the last year of the medium-term management plan, we will make sure the 600-billion-yen level of core operating cash flow is reliable as the final assessment, and allocate one-off surpluses to share buybacks and stable surpluses to dividends.

Q4: Excluding special factors, Chemicals look significantly behind the targets and seems to realize annual PAT of 30 billion yen and core operating cash flow of 50 billion yen after deducting special factors. What assumptions of the medium-term plan have changed?

A4: With regard to Novus, we are confident in the outlook for methionine itself based on the growth in demand for poultry meat in Asia and Africa. However, the balance of supply and demand is loosening as a result of excessive production increases by competitors. Furthermore, U.S. plant construction costs remain high and as such we have reassessed our plan to increase production capacity. In other businesses, trading is strong and profit growth at the methanol business has exceeded assumptions. We are also making steady progress in the strengthening of new profit bases with paint manufacturing and crop protection businesses.

[Speaker 3]

Q5. Which projects will contribute to profit this fiscal year and the following fiscal year?

A5. This fiscal year there will be full contributions from Helios, the additional investment in IHH, and Hans Kissle. Projects that will begin to contribute in the current fiscal year are Cameron Train 1, Greater Enfield, Tempa Rossa, power generation businesses in Thailand and Malaysia, and KSP in Thailand. Making contributions from next fiscal year onwards will be: Cameron Train 2 & 3, South Flank, Robe River JV, Mozambique Area 1, FPSO, and others. We plan to strengthen the profit base in non-resources areas while seeking balance between investment in large platforms such as IHH, which need a period of years to achieve profit, and smaller bolt-on investments that produce earlier profit.

Q6: What is the likelihood of achieving forecasts for cash flow allocation in the current fiscal year? Also, will the 50 billion yen that arises from the changes to lease accounting be taken from free cash flow after shareholder returns to repay interest-bearing debt?

A6: Cruising speed for investment & loans is 500 billion yen annually net of asset recycling. With respect to shareholder returns, in formulating the medium-term management plan, we began with a minimum total annual dividend of 100 billion yen for a cumulative total of 300 billion yen. This subsequently increased to the current 450 billion yen. Based on that, free cash flow after shareholder returns is 130 billion yen. The 50 billion yen resulting from the change to lease accounting will be used to repay debt.

[Speaker 4]

Q7: While Chevron and Occidental are currently bidding for Anadarko, there have been reports that an FID ceremony is being planned for Mozambique LNG Area 1 on June 18. Is there any change in how you will be involved in this project given the possibility that there will be a new operator?

A7: I'm not in a position to comment on the bidding for Anadarko, but regardless of who the ultimate buyer is, the regulatory approval process will take a number of months and we have been assured that we will have the full commitment of the current team during that period and there is no change to the schedule. We see no issues with partnering with any of the current bidders. We've had a similar situation in the past with a change of operator at Sakhalin 2, and we are confident that this will not pose any problems for development.

Q8: What kind of governance will you be seeking at Vale in light of the dam incident? Considering that you have reviewed your materiality, how do you intend to oversee investments in Vale going forward from a non-financial perspective?

A8: In addition to ensuring a thorough post-incident response with priority, through the Board of Directors, we will monitor the recovery of southern and southeastern systems where production volume is currently reduced. We have yet to decide our medium- to long-term investment plans for Vale. Our relationship with the company is multitiered, including joint management as strategic partners in the VLI business, and our involvement will not simply be limited to presence on the Board of Directors as a shareholder representative. We have determined that there is significance in holding shares in Vale, including ancillary benefits such as demonstrating our presence in Brazil, and a base for the creation of new business.

[Speaker 5]

Q9: With methionine undergoing commoditization how would you plan to recover profit from investment in facility expansion at Novus?

A9: We do not think that the barriers to entry in Novus' business have necessarily lowered due to commoditization of methionine. The company maintains advantages over competitors, including local production for local consumption in the US, a major consumer market, higher brand recognition compared to Chinese companies, experience in handling raw materials, some of which are hazardous, and the liquid form which is easier for customers to use. Expansion plans are under reassessment, but we are also carefully considering the company's growth strategy.

Q10: What is the background to the introduction of share performance-linked executive remuneration?

A10: We had previously introduced stock options as a component of executive compensation, but this new system awards shares directly with the aim of heightening management sensitivity to the share price. The system was also recommended by the Remuneration Committee, which is comprised mainly of external directors, and its introduction will be put before the annual general meeting of shareholders.

[Speaker 6]

Q11: How do you decide the usage of free cash flow after shareholder returns? In your original cash flow allocation framework, which commitments did you have for each usage, and had you already determined the usage of free cash flow after shareholder returns?

A11: After developing our medium-term management plan, we made adjustments as the situation changes. We aim to optimize cash flow allocation by taking a rigorous approach to management of the cash we generate. With respect to progress on our investment and loans plan, we review this every quarter in a process that includes the portfolio management committee. In cases of very large investments, such as the additional investment in IHH, we manage the framework by updating the overall situation.

Q12: In the current environment, do you see much capacity to increase iron ore output?

A12: Last year, fire and cyclones damaged the Australian port facilities, which reduced supply, but recovery is underway. In our Rio Tinto operations, we have begun automated driving of railcars as part of steps we are taking to improve delivery volumes by increasing operational efficiency.

[Speaker 7]

Q13: Please explain your one-time losses last year, such as the Eagle Ford impairment and the ITC fire.

A13: At Eagle Ford, there was a significant downward revision as a result of the operator reassessing its production plan, which led to us recognizing an impairment loss. We will go ahead with the revised production plan, while also considering a change in the operator.

With respect to ITC, we recorded a one-time cost in the previous period to reflect the firefighting and clean-up costs associated with what was a large-scale fire. Although insurance covers a portion of it, the overall cost has not been confirmed so we are recognizing nil for ITC's plan this period. The cause of the fire is currently being investigated, and part of the operations have resumed.

Q14: What is the key point of your materiality review?

A14: The main point is that we have focused on taking ownership and 'creating' businesses. The core function of a trading company used to lie in businesses connecting buying and selling, but now we have reflected in our new materiality our intention to create businesses as the operator or navigator. As an example, for the Mozambique Area 1 project, we have developed this project from the ground up as the co-developer with Anadarko, playing a proactive role. We are confident to continue the joint management of the project, even if our business partner were to change.