Q3 Financial Results Briefing for the Fiscal Year Ending March 2021
Q & A

[Date]	February 3, 2021(Wed.)	16:45-17:45
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	Tetsuya Shigeta	Managing Officer, General Manager of Global Controller Division
[Moderator]	Masaya Inamuro	General Manager of IR Division

<Q1>:

The core operating cash flow forecast was upwardly revised to JPY600billion, increased by JPY200billion from JPY400 billion which was the initial forecast at the beginning of the fiscal year. Can we expect additional shareholder returns?

<**Uchida>**

Core operating cash flow recovery exceeded our expectation. During the previous medium-term management plan period, core operating cash flow was in the range of JPY560 billion - JPY660 billion, excluding the impact in regards to change in lease accounting. We have a feeling that it has now returned to that level. We recognize that the recovery of our cash generating capacity is stronger than expected and thus we will continue to look into the possibility of additional shareholder returns, considering the expected result in the end of 4Q. There is no change in our concept of balanced allocation between new growth investment and shareholder returns while taking into account the progress of new investments, especially in the Strategic Focus areas, and we will make management decisions by comprehensively considering both factors.

<Q2>

I understand that there was progress in portfolio review in 3Q, such as revaluation in Tempa Rossa project based on lower oil price projection as well as in Moatize and Nacala project. Please tell us about any potential project or business in which portfolio review will be conducted in 4Q and its expected profit impact. Have you factored in certain impairment amount for railways business in 4Q?

<Uchida>

As we recognize that the Medium-term Management Plan announced in May last year did not sufficiently take the impact of COVID-19 into account, we had discussions with each business unit as we were compiling the 1st half financial results. Through those discussions, we came to a conclusion that the basic direction of the Medium-term Management Plan should remain unchanged, while we identified that in some areas we require more in-depth damage control. One of those is Moatize and Nacala project whereas we had various negotiations and discussions with Vale, and finally laid down our lines as released in January. In the E&P business, although not all of the impact was caused by COVID-19, we have been reviewing our existing E&P

strategy in light of the plunge in prices and the decarbonization trend, and we are still reviewing the organization and structure of our business. In terms of overseas railway business in the Machinery & Infrastructure Segment, which we referred to in the announcement of our financial results in 2Q, we are still negotiating and working on damage control. Portfolio review may sound as though doing a desktop review at the head office, however, we are actually working on business restructuring, cost reduction, and necessary negotiations at each site. Time frame differs between each business, so it is not possible to solve all at once. While the yearly forecast for the Machinery & Infrastructure areas is set at JPY35 billion, the figure of 3Q already reached JPY35 billion, and we left this this figure unchanged considering future impact of the portfolio review.

＜**Q3**＞

Iron & Steel Products and Lifestyle businesses, which had been struggling until the first half of the fiscal year, improved considerably in 3Q. Does this come from the improvement of your earning capability? Please share with us how you see the continuity of this good performance.

<Uchida>

Performance of iron and steel products, as well as chemicals which are both materials-related, have been very strong, especially since the middle of the fiscal year, driven by the recovery of the automobile production and manufacturing industry as a whole. In the first half of the fiscal year, Gestamp, which is the mainstay of the Iron & Steel Products Segment, recorded a rather large restructuring cost and the recovery was impacted by that restructuring costs to some extent. However, we think that the recovery of the third quarter came from improvement of our earning capability due to the recovery of production activities. Similarly, in Lifestyle, food and distribution as well as IHH, in the healthcare sector, turned into the black in 3Q. Those businesses has been strong, although the COVID-19 impact has not gone away. In terms of the earning capability, demand was pushed back by COVID-19 and a large gap between supply and demand was created, and then all of a sudden in 3Q, or maybe from the middle of 2Q, we saw a rapid recovery in demand, resulting in high margins in some of the businesses.

＜**Q4**＞

I understand that the company's policy is to make shareholder returns by approximately one-third of the annual core operating cash flow, which has been the track record in the past. On page 14 of the presentation paper, share buyback of JPY40 billion which was announced in last fiscal year and implemented in this fiscal year is included in this fiscal year’s forecast. It seems that the intention is to explain that there is no large room for additional returns even if core operating cash flow reaches JPY600 billion. Please tell us how the JPY40 billion will be handled and whether or not there is a room for any additional returns. In the IR meeting for the first half of the fiscal year, there was not much of positive comment about returns, even though cash inflow was above the forecast. As a result, the share price dropped and performance declined within the sector. Although you have revised the forecasts upward today, the share price does not rise and I believe that this is the honest reaction of the market. It would be great if there are sufficient returns on your investments, however, I have an impression that you would rather record many impairment losses. Therefore, I feel that you are losing trust from the market. It is understandable that you would look at the issue in a three-year band of the medium-term management plan, but it would also be worthwhile to be aware of such severe voice of the market.

<Uchida>

As for shareholder returns, although the JPY40billion was announced in the last fiscal year, we have included this in this fiscal year based on the cash outflow timing. If we include dividends for the second half of the fiscal year, the total return will be approximately JPY175 billion. Rather than trying to allocate the entire cash inflow every quarter or every fiscal year, we will first look at it within the framework of our three-year cash flow allocation. There may be different opinions as to which period the JPY40 billion should be counted in, but the total return ratio for the fiscal year ending March 2021 is expected to be approximately 29%, while the average total return ratio of the three years of the previous medium-term management plan was 28% according to our calculation. In the Medium-term Management Plan, we set the goal of gradually raising the total return ratio while implementing the growth strategy, and this will be our guideline in thinking about returns. We have not made any major changes to our policy.

Thank you for your comments which are well received. We have not decided not to do anything, and our policy is to respond flexibly to buybacks. I wonder if quarterly targets would be beneficial to investors, especially those who hold the shares for a long time. Of course, we are conscious of stock prices, but rather than worrying about the short term ups and downs, we aim to put the company on a solid growth trajectory in the medium to long term basis in order to increase corporate value. We will plan and implement our return policy based on such concept.

<Q5>

Regarding the upward revision, please tell us about how you revised the figures for each segment, except for one-time factors. Especially in Mineral & Metal Resources Segment, while iron ore is good, you recorded large impairments. Also, although Chemicals and Lifestyle are recovering, how is the actual situation?

In addition, your forecast for profit is JPY270 billion for the current fiscal year. How much do you think it will be excluding one-time factors?

<Uchida>

Major one-time factors that we recorded in 3Q are, additional impairments of slightly less than JPY 50billion for Moatize and Nacala, an impairment of JPY23.4billion for Tempa Rossa, deferred tax asset of JPY 39billion as a result of reorganization of the US energy subsidiaries, and an impairment of JPY4.2 billion for MRCE rolling stock leasing business. In summary, netting out both positive and negative factors, it comes to approximately JPY40 billion loss.

As for Mineral & Metal Resources, iron ore price which was considerably higher than expected and the fact that Vale's dividend has been factored into 4Q are the two major factors for increase in profit. The upward revision of JPY35 billion was made by that amount offsetting the impairment factor of Moatize and Nacala.

As for Energy, the impairment of Tempa Rossa is not because of something that happened in the project, but because we reviewed the long-term oil price. We have reevaluated our assets based on the long-term oil prices in the range of USD50 to USD70, and as a result, Tempa Rossa was the one to be impaired. In addition to this, as a part of review of the E&P strategy, we are conducting the restructuring. In relation with this, a positive JPY39 billion has been recorded as deferred tax asset as a result of the reorganization in the US assets. The revised price assumption of crude oil and gas has also been a positive factor, though it has not risen that much from the previous assumption. Also, as a positive factor, Cameron LNG Project had to be shut down due to a temporary impact of the hurricane in the summer. We initially thought that the impact might be prolonged, but we were able to reduce the impact. Putting all of above together, we have revised the forecast of the Energy Segment upward by JPY20 billion.

As for Machinery & Infrastructure, as I explained earlier, there are still some uncertainties, and we will maintain the forecast of JPY35 billion.

As for Chemicals, there were positive upturns in markets such as methanol in 3Q and trading activities have been firm. In the nutrition and agriculture business, Novus is continuing its restructuring. As it is conducting the necessary reorganization of businesses, some of the structural reform expenses have been postponed, and this will be a burden later, but this is a positive factor for this fiscal year. Also, businesses related to fertilizers and agricultural materials have been less affected by COVID-19 than expected and are working positively. Together, we have revised the forecast of Chemicals Segment upward by JPY15 billion.

As for Iron & Steel Products, materials, especially automotive-related have been recovering, but we have recorded a lump-sum restructuring cost for Gestamp, resulting in upward by JPY5 billion.

As for Lifestyle, trading is steady, and the hospital business has recovered better than expected from the negative impact on IHH. As a result, profit turned to black in 3Q, which is reflected in upward revision of JPY10 billion.

As for Innovation & Corporate Development, commodity trading is firm and there will be an improvement in FVTPL, which resulted in an improvement of JPY5 billion.

At the time of 2Q, there were a number of variable factors to consider, including COVID-19 impact, other changes in the business environment, and potential major one-time factors. In this context, we have maintained our profit forecast of JPY180 billion unchanged, considering the extent of the impact of those factors. As for one-time factors, there are a lot of things that we cannot control in terms of timing, depending on the progress of various negotiations. To be honest, I have to admit that we are entering a very difficult phase for forecasting.

<Q6>

I understand that Moody's revised your outlook to negative in April of last year. Even though the company has impaired crude oil related project this time, it has revised yearly forecasts upward, so can we assume that there is no issues to worry about in terms of rating?

<Uchida>

As for the Moody's rating, we carry out a regular annual review with the rating agency, and we also had a review with Moody's. We had discussion on our progress, and it was accepted without any sense of discomfort. The outlook was revised to negative during the market turmoil last year, so we would like them to put us back to neutral soon considering our recovery, which we believe is at least not a negative factor.

<Q7>

While core operating cash flow has been increasing so far and you revised your forecasts upward, you have not made a decision on additional shareholder returns as of today. Is there any growing concern or risk for the next fiscal year?

<Uchida>

We do not have any particular concerns at all, for what we are aware about. Going forward, we would like to make the appropriate and firm cash flow allocation including additional shareholder returns. It looks as if we have returned to the pre-COVID-19 level with our core operating cash flow now achieving JPY600 billion where the price of iron ore has made a significant contribution. In the future, including the second and third years of the Medium-term Management Plan, we need to free ourselves from the impact of COVID-19 as soon as possible, and instead of returning to the original state, we intend to aim even higher. Again, there is nothing hidden or changing our stance in any way.

<Q8>

Please tell us the background of IHH recovery and its continuity.

<Uchida>:

The operational rate of IHH was quite low because they were concentrating on the COVID-19 countermeasure. It has now been recovering through various measures, while contributing to combating the COVID-19 situation by allocating various resources. Medical tourism is also coming back and in that sense, we think IHH is responding and recovering faster than expected.

<Q9>

The outlook for iron ore price has probably been revised upwards significantly compared to the price when you first announced the three-year cash flow plan. How do you analyze this factor? Please also explain what will be the impact in the second, third years and beyond.

<Uchida>

While we do not disclose our iron ore price assumptions, when the Medium-term Management Plan was developed last year, we assumed that the price will decline moderately over the three years period. Compared to that, as you pointed out, the market situation after 3Q of this fiscal year has changed drastically, so it is true that there is impact. We will factor this into the business plan for the second year when it is formulated. Regarding the outlook for iron ore price, since the market was overheated and has risen sharply since 3Q, we expect that it will settle down a little. Not limited to iron ore, we will conduct review of the Medium-term Management Plan announced in May last year, at the next business plan announcement. In this context, we will not change the framework itself for the management allocation, but the figures may need to be updated.

<Q10>

Regarding your asset portfolio replacement, please explain about the background of the recent sale of Moatize and Caserones, as well as your thoughts on coal and copper portfolio?

<Uchida>

As for our coal portfolio, our policy is that we have withdrawn from mines that produce only thermal coal, and we will not make any new investments. This is not the only reason, but the fact is that Moatize and Nacala

Project resulted in producing a lot of thermal coal. Rather than that factor, we made the decision to withdraw from the project, taking various perspectives into account, such as operations as well as Vale's own policy of withdrawal. Coking coal is also being discussed recently under the ESG trend. For the time being, we are working together on R&D, such as research on new reduction method considering the time scale and degree of technological innovation, although not yet on a large scale. As for coking coal, we will be thinking about it considering the change in environment in the future, while we will maintain the business for the time being as a raw material in need. As for copper, Collahuasi and Anglo American Sur will be the pillars of our business after withdrawing from Caserones. We will concentrate our resources which was devoted to Caserones on these two projects, while continuing to work on further copper businesses.

＜**Q11** ＞

I have a question about Mozambique. You explained that you were in line with Vale's withdrawal from the coal asset in relation to ESG, but I assume that there were also difficulties in the business in Mozambique, mainly in terms of country risks. For example, recently, there was news about insurgents attacking areas close to the project site of Area 1 LNG project, which resulted in the situation where people were forced to evacuate from the site. I would like to ask whether you need to reevaluate the risks involved in the pipeline project.

<Uchida>

,We have vast experiences in dealing with obstacles of doing business in emerging countries, not limited to Mozambique nor to Moatize and Nacala. In this particular case, while we have been taking various countermeasures during production ramp-up, there were some difficulties in procuring materials and equipment, and workforces were affected by COVID-19 as well, all of which made this project difficult. There is no major change in the way we proceed with the project while taking the necessary measures to mitigate or respond to the difficulties of each business in emerging countries.

<Q12>

Considering that many impairments has been recorded in the core businesses, it may be necessary to reevaluate the weight of capital allocation in the overall portfolio. Please clarify your view on this.

<Uchida>

As for recent investments in the portfolio, the fact is that we have made decisions to exit from large scale projects, such as Caserones, and if we look at the past three to five years, Multigrain can be included. However, on the other hand, there are many other projects that are operating very smoothly. Regarding Moatize and Nacala Projects, I would like to refrain from explaining the details at this point of time, as we have only reached a basic agreement with Vale, and there will be further negotiations with each stakeholder. We would like to continue on challenging in various aspects by making use of the lessons we have learned and linking them to our next step. We have been emphasizing the importance of return on investment and results, while also highlighting improvement of the quality of existing businesses for the past several years. We believe that we have achieved some results in those areas, and there is no change in the fact that we continue to work on forming and building a new foundation for growth especially in the areas of Strategic Focus set out in the Medium-term Management Plan.

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