Q2 Financial Results Briefing for the Fiscal Year Ending March 2023

Q & A

[Date]	November 2, 2022 (Wed.)	10:00-11:15
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[Moderator]	Maroshi Tokoyoda	General Manager of IR Division

<Q1>

Regarding the Management Allocation, although I can understand the idea of securing liquidity on hand to strengthen the company's financial position given the current environment, I believe that the stance up until now of securing two years' repayments with liquidity on hand has not changed. Also, although it depends on the extent to which liquidity could dry up from the market, I do not see much of a problem given your current cash situation and having a Net DER of 0.62x. Based on this, what is your current thinking on the weighting of the current Management Allocation of 1.74 trillion yen between shareholder returns, investment in growth and strengthening of financial position?

<Hori>

We have been using the Management Allocation as a framework over the past 3 years of the current Medium-term Management Plan, and our earnings power has been shifting upward and the overall cash inflow has increased. I think we are in a good position because we can broaden our menu amidst uncertainty in the current business environment. We can also carefully consider growth investments while strengthening our defenses, and we have more options to further enhance shareholder returns.

Regarding the allocation weight, I would like to talk about specific projects once they have been finalized. As I said at the beginning, we are currently looking at investment projects all over the world, and we have a number of projects under consideration. To be clear, many of these projects are adjacent to assets of businesses we are currently working on. Also, there are projects that have come up while having constant dialogues with existing partners, as well as opportunities leading to major supply chain reforms, or ones emerging from requests from customers to create a backup plan for their supply chain.

We also have quite a few opportunities to invest in the way we create more robust supply chain to increase margin rates by combining necessary logistics assets and others. We are therefore confident that we have large, medium, and small investment opportunities in hand for businesses that can contribute to further enhancing the supply chain functions, with sufficient margin and profit potential.

On the other hand, we would like to negotiate well in current uncertain times, and to find the best timing for contract agreement and execution. We will conclude what needs to be concluded now, and some things will be better to execute after a little more negotiation and other preparatory work, so I think it will be important in the future how we accumulate quality deals through the application of the Management Allocation.

In addition, strengthening our financial position is about the level at which we maintain cash on hand. Due to the weaker yen, it is probably better to have slightly more liquidity on hand, as this can lead to mobility and downward resistance in times of emergency.

We should be able to achieve a shareholder return of 33% on the cumulative 3 years Core Operation Cash Flow, including the new share repurchases of 140 billion yen, but would like to consider further shareholder returns, taking into account what I have just explained, with an appropriate time-line in mind.

For example, it is possible that the closing of a deal may be delayed to the next Medium-term Management Plan, but please understand that this will be done to ensure we can maximize the success of the deal. I would like to continue to explain the progress and status on a quarterly basis or at any major event.

<Q2>

I would like to know about your current thinking from the perspective of both the financial and non-financial aspects of what you feel you have achieved so far under the current Medium-term Management Plan, and what you are trying to overcome for the next Medium-term Management Plan?

<Hori>

We have seen a stable and sustainable earnings power in this Medium-term Management plan compared to the previous one, and even if we assume the commodity market and exchange rates as constant, we can probably see an earning base increase of over 100 billion yen in net income. We also have the feeling that we will be able to add even more during the remainder of the current fiscal year. I hope that you understand that the revision of the forecast has factored in foreign exchange and other items, on top of the earning base increase. As we move towards the completion of the current Medium-term Management plan and the formulation for the next one, I would like to talk about how much we can grow based on this new profit level with a sustainable upward shift, firmly incorporated into our strategy and action plan. As I explained earlier, I believe that the method of building up our margins beside and adjacent to our existing businesses, and in a way that increases our return on invested capital, is very effective at the moment.

We would also like to add the broadening of our global revenue streams, which is a major feature of our company. Regional diversification is becoming more and more important, especially in the midst of geopolitical developments. We are also seeing upside in our US business, so we would like to combine all these factors as we move towards our next Medium-term Management Plan.

<Q3>:

Regarding energy trading, I understand that profits are weighted towards the second half of the fiscal year, but I also have the impression that profits are also derived from the price differential between Asia and Europe. Should we be concerned about risks such as losses if this price gap shrinks as European market conditions fall?

<Hori>

In LNG trading, arbitrage trading focused on the price differentials you mentioned is very limited. Basically, we use hedging mechanisms to capture commercial opportunities in our global activities. The fluctuations of profit generation during the first and second half of the year has been explained earlier. This periodic fluctuation in profit or loss is expected to be eliminated upon completion of physical delivery and we expect the yearly forecast to be achieved as planned.

As a responsible player in LNG, we are able to constantly enter new projects and work in a longer supply chain because we comprehensively contribute to the contract structuring, including price negotiations and variety of stable supplies. In addition, due to Cameron's operations being very stable and increasing off-take volume from the project, we have raised profit contribution.

<Q4>

The environment is changing and there appears to be a sense of slow-down, especially in non-resource areas. Segments, such as Chemicals, Iron & Steel Products and Lifestyle, have conservative second half forecasts. Please tell us if there is anything we should be aware of as a risk from a first-hand perspective, including the outlook for the US.

<Hori>

With regard to the environment, I think there is continued solidity in the combination of the current overall portfolio, for example, in automotive and chemicals. Regarding the forecast for the second half of the year, I think we are being a little conservative in terms of the current situation because of the highly uncertain business environment. On the other hand, I do not necessarily feel that our businesses are slowing down, and we would like to achieve a strong finish this fiscal year.

As for the US, I have just been there last week, visiting various sites and talking to many partners and people in our group companies. Certainly, the overall tone is that we should be careful, especially in the macro environment, and there are more matters that we may want to pay attention to. While there is an impact from inflation and interest rates, I think it is very positive that there has been a recovery from COVID and that US companies are now thinking about how they should seek out new ways to be innovative and globalization in a new form.

Against this backdrop, I think the Biden administration's Inflation Reduction Act will have the effect of encouraging business opportunities in the US toward decarbonization in a realistic manner that will generate a higher return on investment. I have a renewed sense that we can broaden our business offerings in the US, not only in renewable energy related businesses, but also in the mobility industry as well, and expand there.

<Q5>

Please tell us a little more about your thoughts on investment. While cash inflow is higher than initially expected, the amount of investment has not changed much from the initial forecast, so your Management Allocation is increasing.

Are you thinking of increasing the amount of investment in the next Medium-term Management Plan? Also, regarding the target area, please tell us your thoughts on investment in terms of whether Strategic Focus areas will continue to be the main focus, or whether you are considering newer areas to invest in.

Also, please tell us your thoughts on the global economic outlook, which will be the basis of the next Medium-term Management Plan. Considering the rise in your real earnings power, cash inflow will increase, but I think the size of investments will also increase.

Looking back on history, during the global financial crisis, your company was different from other companies in that it limited investment from the beginning of the period, and as a result, it turned out to be the right thing to do. Please tell us whether it is time to increase investment in the current highly uncertain situation, and what you think about the economic outlook that is the basis for that.

<Hori>

Regarding investment, within Strategic Focus areas, energy solutions and healthcare and nutrition, both of which I touched upon in this presentation, have seen an increase in good candidate projects, and I believe that there are high-quality projects valued at over 1.5 trillion yen out there.

In terms of areas adjacent to existing businesses, we will extend our value chain of hydrogen and ammonia to make the project bankable, and although it may require time, I hope it can be completed relatively quickly.

Also, in order to make the returns from renewable energy businesses more attractive, we need to work in clusters, such as by adding electricity-related trading and renewable energy-derived hydrogen businesses. While I do not currently assume a significant size of capital required to this area, we'll need to carefully select which projects to get involved in.

In addition, there is a growing interest in natural capital, and even in agriculture, the input business is becoming more sophisticated, and there are investment opportunities here. We are beginning to see areas with heightened needs, from the input stage up until eating itself. In this year, being the third year of the current Medium-term Management Plan, I believe that there will be a limited number of projects that will be completed but I believe that there is a high probability that the next Medium-term Management Plan will bring about fruitfulness and a certain number of projects we will be able to act on.

On the other hand, I believe that we should strengthen our investment discipline even more. For that reason, there are some projects that we will decide not to do, and some other projects that we will spend a little more time doing warm-up exercises before working on them. In other words, our way of thinking is that in some cases we would like to take our time.

We will not be driving investment just because we have more leeway in our Management Allocation; instead we will carefully select quality deals that come about in our day to day business activity, which is being able to draw upon our Management Allocation. I strongly believe that this is the correct order to do things.

Of course, I would like to seek for solid shareholder returns. Here, I think the discussion comes down to weighting, but I would like to make decisions regarding this considering the overall perspective.

Many people are analyzing global business sentiment, but I think that in the end we have to diversify by region. At the same time, we would like to make investments that find the way to effectively diversify ourselves on global basis and strengthen our internal structure. I think that we must do this in a way that allows us to have solid financials to the extent that we can move flexibly in times of emergency. I would like to proceed while consulting with stakeholders on this point.

When the global economy is uncertain, it is an opportunity for us as a trading company, so we would like to expand our menu and diversify globally, secure income in the key global currencies, and respond while combining discipline and contingency plans.

<Q6>

As for growth investments, I understand that there will be investments in bolt-on and peripheral areas of existing projects that are expected to contribute to profits in the near future, and investment in areas of Strategic Focus with a longer timeframe. Please explain your thoughts on how to allocate funds to each of them as well as their scale.

Also, please tell us about the policy for development projects in Mainstream. Will Mitsui have additional funding for each development project? Also, regarding the time frame, will these development projects start at a similar time towards 2030? Or can we expect gradual development speed evenly year by year?

<Hori>

As an example of growth investment, I would like to talk about Mainstream Renewable Power. Mainstream's business model had been "Develop & Sell", but since we joined the company as a shareholder, we have formed a partnership with its parent company, Aker, and the current policy is to extend the period of holding businesses and develop a portfolio that generates cash flow during such period.

Page 25 of the presentation materials shows the current pipeline. If pre-development projects are included, the total capacity will be over 27GW. By around 2030, many of these assets will generate cash flow and will become a pillar of earnings. Of course, profits will be gradually generated before that, and I would like to be able to show partial success in order.

For example, in South Africa, which I visited recently, we are working in a way that is firmly integrated into the electricity business of the whole country. In fact, we are envisioning further enhancement of profitability by adding power trading business to it. Projects in Chile are also progressing, and we will work to increase the order rate in combination with our activities in the country or combine them with peripheral businesses.

In addition, we are basically thinking about profit coming from our equity stake in Mainstream, but also, we may occasionally make investments in individual projects if we can be certain to be able to provide our function.

Like Mainstream, new businesses for low carbonization are also important constituents of Strategic Focus areas. We are working on it with the expectation that it will become a new pillar of our earnings by securing a stream of profit flows in the future. In addition to renewable energy, we are also working on ammonia and hydrogen as well.

On the other hand, as a foundation for working in the Strategic Focus areas, it is necessary to ensure that bolt-on investments are profitable and to have a solid footing. Based on this foundation, we will steadily monetize long-term transition projects such as LNG while fulfilling our responsibilities for stable supply. If we work on such a combination, we will be on a growth path as a whole, and our policy is to reconfigure our portfolio in the energy and industrial fields in particular over a slightly longer time frame. In the next Medium-term Management Plan, we will dig deeper into these issues and discuss them further.

<Q7>

What is your view on future price trends for iron ore and metallurgical coal?

<Hori>

Although we do not disclose the price assumptions for iron ore and metallurgical coal, our forecast is rather conservative for the second half of the year, while being conscious of current prices. We are also aware of upside movements in the coal market, thus I will ask the CFO to add some additional information on that point as well.

<Shigeta>

We expect iron ore prices to remain weak until the end of the year, as there are no strong upside factors in the short term due to the current decline in global demand for steel products, especially in China. On the other hand, we need to take into account the possibility of slight price movements depending on weather conditions, which is an uncertain factor in any year. In the medium to long term, we also expect demand in China to gradually decline, as a result of the shift to electric furnace-based steel production due to environmental reasons, i.e., greater use of scrap as raw material.

However, since our iron ore business is highly cost competitive as a whole, we will be able to secure a higher return on investment than our competitors even if prices decline to a certain degree. Our view of metallurgical coal is similar; we expect prices to remain flat to decline in the second half of the year, depending on factors centering on the Chinese economy. We are also hearing factors such as demand recovery in parts of Southeast Asia or production slump in Australia, so there will be short-term ups and downs. In the medium to long term, we expect demand to remain flat to gradually decline in developed countries, while demand will remain strong in some emerging countries.

<Q8>

The scale of profits in the non-resource areas, particularly in Machinery and Infrastructure and Chemicals, have been increasing. Please tell us how you see the future growth potential in these segments.

<Hori>

We believe that there is growth potential in each of our business areas, including Machinery and Infrastructure as well as Chemicals. In particular, our automotive business in North America, South America, and Asia is performing very well, and we are looking forward to the future. As we are capable of bringing in such a successful business model to emerging markets, for example, we are also expanding from the US to the global market, by starting a joint initiative in Asia with Penske Group. In particular, we are now realizing that the downstream of the automotive industry will be increasingly value-added by providing a wide range of one-stop services, including rental, leasing, service, auction, and all other functions.

We believe that there is room for growth in the shipping business also, as we are strengthening our market share and position in the overall supply chain.

In addition, we will continue to work on infrastructure, keeping in mind the reconfiguration of our portfolio and the major transition in energy. In the growing South American gas distribution business, our partner has recently changed to Cosan, and we are discussing various new opportunities with them.

As for Chemicals, areas such as ammonia for energy, clean methanol, and hydrogen are promising areas. For hydrogen, for example, it is important to incorporate the logistics of local production for local consumption, and we are currently working on this in various regions, including the United States, Australia, and New Zealand, which is very exciting.

In Chemicals, I believe we can make a variety of new contributions to the circular economy. We are committed to providing advanced solutions to global challenges not only with recycling of plastics, but also with the reuse of chemicals and value-added to bio-based products, and we are very much looking forward to the initiatives in this area as well.

<Q9>

It is stated in your data book that the foreign currency translation adjustment on balance sheet has ballooned to 880 billion yen as a result of weaker yen. I think it is one of the factors that is contributing to the improvement of Mitsui's financial position. Please tell us how you consider increase in foreign currency translation adjustment in terms of management allocation and various management decisions?

The exchange rate was in the range of 140 - 150 yen per US dollar for the foreign currency translation adjustments, and do you think there is a risk that it will shrink, or do you accept the balance sheet figures as they appear on the surface when making investment decisions?

<Hori>

Since there is a possibility that the current level of exchange rate may be temporary, we will follow the basics here, for example, we will do US dollar based financing for the businesses having its revenue currency as US dollar and conduct basic operations so that the exchange rate matches on both sides to the maximum possible extent. At the beginning of this presentation, I talked about US dollar while explaining the image of the share repurchases up to 140 billion yen, and I often say within the company that we must always keep in mind figures in the key global currency or otherwise we may make mistakes in our decisions.

Although this is apart from the financial statements, if we want to continue to hire talented people throughout the Mitsui & Co. group, we must consider conditions based on the local currency or a proper understanding of the market value of their skills, and I think it is very important not to make the wrong decision in such a volatile movement in exchange rates. We are also conscious of the fact that we have to carefully consider how our results will look on a global scale. I will ask the CFO to supplement this.

<Shigeta>

We do not use the thickness of shareholders' equity and equity capital due to foreign currency translation adjustments resulting from weaker yen as a risk buffer for making our management decisions, but rather judge them on the basis of flow. We will pursue a good balance between financial soundness, investment for growth, and shareholder returns within the cash flow allocation framework. This has been functioning well and we think that it is easy to gain everyone's understanding. Therefore, we are not making any risk-taking management decisions based on the logic that “we have more capacity to take risks due to the depth of our capital position resulting from the expansion of the foreign currency translation adjustments.”

On the other hand, we also need to be aware of return, ROE, etc., so we would like to reduce or manage the volatility of Translation Adjustment or FVTOCI a little more, but there is also the cost involved, so we do not intend to hedge 100% of our exposure.

Therefore, our current situation is to monitor and manage the appropriate level of equity and whether it is accompanied by an appropriate return by looking at these figures from multiple perspectives, while taking into account whether the final figures are in US dollar or other foreign currencies, or whether there are transitory fluctuations.

<Q10>

Regarding Sakhalin II, it was mentioned that there is no problem with the current operations at the new company. However, from a medium to long term perspective, I wonder that the exit of Shell as an operator may be regarded as a risk to the stability of operations. In particular, I am concerned whether it will be possible to handle without Shell when there is some kind of equipment trouble. From that perspective, what is your thoughts for the medium to long term operational stability of Sakhalin II?

<Hori>

As for Sakhalin II, of course Shell's contribution over the years has been significant, but Sakhalin II has also been operating quite smoothly for many years now. It is also a fact that the know-how that belongs to Sakhalin II and its capability to respond to issues that arise in its day to day operations have improved considerably. I am sure that the new shareholder structure will be clarified in due course of time, but I think it is necessary to consider about this at the joint venture level, while carefully self-examining its strengths and thinking how to respond to new shareholder structure. However, I think that Sakhalin II capability has been improved and that the technical risks you mentioned have been reduced to a reasonable level in our view.

[END]