Investor Day 2022 Evolution of Portfolio Management: Q&A summary

Date: December 2, 2022

Speaker: Tetsuya Shigeta, Representative Director, Executive Managing Officer, CFO

<Q1>

Can you tell us about the changes that have taken place since the introduction of ROIC? In your presentation, it was mentioned that ROIC is being used as a mechanism to motivate business units to recycle assets on their own initiative. CEO Hori also explained that the current level of asset recycling is higher than in the past, and in a situation where asset values are as high as they are now, there will be more profit on asset recycling. Can we assume that the introduction of ROIC has raised the level of asset recycling to another level and that this will continue in the future?

<Shigeta >

Historically speaking, the current amount of asset recycling has exceeded previous levels. I think this is partly because recycling has become a habit in each business unit. It remains to be seen whether this will rise further quantitatively, but we feel that our way of thinking up until now is becoming more firmly entrenched. In line with Mitsui’s approach, business units cannot use the cash they earn through recycling at their own discretion, but we have seen that recycling has become an essential part among chief operating officers of each business unit for the purpose of improving their business portfolio’s quality.

<Q2>

With regard to the historical ROIC trends as shown in Appendix 2, 'Trend of ROIC at Company level', we recognize that there has been a significant pick-up in FY22/3 and FY23/3 due to inflation, rising resource prices and a weakening of the yen. Although it is debatable whether this impact is temporary or not, please tell us what level of ROIC, excluding major external changes like those mentioned above, have improved quantitatively compared to the pre-COVID level (e.g., 4.7% in FY19/3 and 4.6% in FY20/3)?

<CFO>

The numerator of ROIC is profit after tax, also referred to as net income, for the sake of convenience. With regard to the changes in net income for the year, we have seen an increase in the earnings base and cash generation during the current Medium-term Management Plan. We feel that we have been able to improve the level of net income without building up invested capital, which is the denominator for the ROIC calculation. This is despite a temporary increase in working capital etc., while constantly implementing asset recycling as explained earlier. The level of ROIC at 8.8% in FY22/3 and 8.7% in FY23/3 as shown in Appendix 2 cannot yet be considered as a base level, but we feel that the level has improved from the previous Medium-term Management Plan. Also, from the perspective of achieving a stable and constant ROE of greater than 10%, we do not manage ROIC, which is the base of that, in the form of having a uniform percentage target, but we have stabilised the level of ROIC in each of the underlying business areas and have a portfolio that can certainly capture the upside when there are tailwinds from market conditions and exchange rates. I personally recognise the formation of this kind of portfolio as an achievement of the current Medium-term Management Plan.

<Q3>

I think that business segments with many long-term investments that do not immediately contribute to earnings may have lower ROIC at certain times, but what kind of discussions are taking place to raise the figures on a company-wide basis? I think each business area with different growth potential will have different ROIC levels required in the short term. Can you tell us whether each segment would be responsible to maintain that ROIC level for each year?

<CFO>

Although ROIC as an efficiency indicator is easy to understand, its shortcomings are also becoming apparent as a measure of our diverse business development. Therefore, at management level, we will implement a balanced approach of diversifying business areas considering several factors such as ROIC levels, cash-generating ability, and time line. In addition, it is necessary to discuss the strengths, weaknesses, and growth potential of each business area. We are increasingly taking on challenges in new areas where we have no track record. We are focusing on raising the overall level of ROIC and the underlying Core Operating Cash Flow, which we regard as our strength and focus on as a KPI, while appropriately discussing the time line and the likelihood of growth potential.

In addition, although each business unit has a different target for ROIC, the yearly cycle is such that each business unit is responsible for the results and accountable to management by setting targets and confirming action plans during business plan discussions in the form of targets for next year and three years after, rather than the present year only.

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