Question & Answer at Investor Day 2022 Part 1
(Transportation & Construction Systems Business Unit)

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	Kenichi Hyuga	**General Manager, Construction & Mining System Div.**
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	Yoshinori Takayama	**Corporate Officer, General Manager, Investor Relations Dept.**

< Questioner 1 >
The fields of leasing, renting, subscription, etc., all would be included in the circular economy category. I have the impression that because you have been firmly involved in this category you could make a better appeal in the process. Could you please specifically tell how you are thinking about this issue?

< Takayama >
First of all, I would like to talk about the circular economy as a whole, not only the Transportation and Construction Systems Business Unit, but also Mineral Resources, Chemical & Electronics Business Unit, especially the division that handles basic chemicals, has established a development organization that looks at the entire circular economy, including green chemicals.

< Kusaka >
In terms of Lease, Ship & Aerospace Business Division, all our new initiatives are based on ESG-driven investments and businesses.
Specifically, for commercial aviation field, the part-out business in which we have recently decided to invest is a recycling business. Also, under such circumstances in which aircrafts have been increasingly made of composite materials, how to reprocess the CFRP (Carbon Fiber Reinforced Plastics) from the retired aircraft is another major social issue and a major challenge. In this area, we would like to promote verification with our partners in Japan such as Japan Airlines to check the business feasibility.
We have a large aircraft leasing fleet, so we believe that decarbonization efforts in this area are inevitable. Having said, it would be unlikely that aircraft are hydrogenated or electrified in the near future, because, in addition to the technology issues, the industry takes 5 to 10 years for the certification process for the safety assurance.
In this environment, in aircraft leasing business, we have been working to create a business model with new aircrafts. We plan to make over 80% of our portfolio with newest aircrafts.
Moreover, until truly zero-emission airplanes become available, the major theme could be how much sustainable aviation fuel and biofuel can be used. As a part of our company-wide efforts, we are also pursuing a model to generate sustainable aviation fuel and use it for our aircraft fleet. We plan to promote cross-selling carbon credits to airline companies along with aircraft leasing.
In ship business area, to accelerate the decarbonization, we work with Corvus Energy, a company developing battery systems for vessels, to provide its battery systems toward the marine industry including pleasure boats.
Also, taking advantage of our close relationship with various shipbuilders and our status as a shareholder of Oshima Shipbuilding, we are working on initiatives to provide near-carbon-neutral vessels such as ammonia-fired vessels as soon as possible.

< Wakasugi >
I would like to talk about our automobile-related efforts as well.
We are engaged in the automobile sales, leasing, and rental businesses globally. EVs become increasingly popular, and we work to promote their widespread use.
Especially from the circular economy perspective, it is important to consider how to utilize used batteries with an eye on the battery life cycle, as opposed to the past practice of just selling or leasing EVs. We are considering working on the battery life cycle management business in cooperation with other business units.

I will talk about the promotion of electric buses in Japan. One new electric bus cost about JPY40 million. To promote the use of electric buses at a lower cost, we take initiatives to send used diesel busses from Japan to one of our portfolio companies in Taiwan that manufactures and sells electric busses. We convert used diesel busses to electric buses at this company and bring them back to Japan. That would enable to introduce electric busses at a considerably lower price than purchasing new electric buses.
In addition, we have recently invested in a company in the UK that specializes in EV leasing business. We would like to develop our business not only leasing EVs, but also providing peripheral services related to the battery lifecycle management.

< Nonaka >
The example of electric buses mentioned earlier is our initiative working with Nishitetsu Bus in Fukuoka. One used diesel bus has already been converted to electric bus and is already in operation.
In addition, we have been working with Nissan Motor since 2010 on a company called “4R Energy” that relates to the battery life cycle management business. This business was initiated by our business unit and is now handled at Energy Innovation Initiative.

< Takayama >
We have introduced some specific examples at Transportation & Construction Systems Business Unit. As the Company’s overall approach, as Mr. Higashino explained in the opening part, we have defined several key social issues, and placed the circular economy as one of them. We have set long-term goals and medium-term action plans, and integrated them with the business strategies of each SBU, as we have shown with some concrete examples.

< Questioner 2 >
Regarding the aircraft market, I think that demand for aircraft is coming back mainly for small aircrafts. How about the situation of medium and large-sized aircrafts? And could you explain why the ratio of narrow-body aircraft is so high in your portfolio?
Also, I don't think this is directly related to your aircraft business, but could you tell us about your view on the recovery on the aircraft manufacturing side?

< Kusaka >
The demand for the domestic routes are gradually recovering, and the demand for some areas are already back to the level of the pre-COVID-19 in 2019. On the other hand, the pace of recovery for overseas routes are very slow. Especially, the pace of recovery at the Asia-Pacific zone has been slower than in other regions due to the shutdown of China with its zero-COVID policy. The demand for international flights has not yet fully recovered, which means that the demand for medium and large aircraft has not returned to that extent, compared to small aircraft.
Then, I will talk about our aircraft portfolio. It is statistically clear that the liquidity of the narrow-body types of aircraft, the 320s and 737s, is extremely high. In addition, considering the needs of customers and the flight route settings of the airlines, there are many cases where it is judged to be the most economically rational to use this type of aircrafts. Therefore, we believe that highly liquid and young age fleet composition will support downside resilience. Since it is an industry with very weak event tolerance, based on lessons learned in the past, we believe that a business model using buy-sell model with such portfolio is appropriate for us.
In terms of the manufacturing side, there are similarities with other industries, such as the shortage of semiconductors and materials, for example, titanium. The airline industry has been relying on titanium from Russia for about 30%. Although the tempo of its production is slow due to such factors, it is gradually catching up. The performance of aviation-related manufacturers, especially engine manufacturers, is certainly up-trending accordingly.

< Questioner 2 >
I’m sure that there are many uncertainties, such as the situation of Airbus, Boeing, and small, medium and large aircraft, but what are your thoughts about development of the next-generation aircraft?

< Kusaka >
As far as I know, there is not much movement to develop from scratch. Boeing and Airbus have been enthusiastically working on developing better aircrafts to increase the passenger capacity or enhance the fuel efficiency by improving existing models such as 320 and 737 for about 15 to 20 years.
Therefore, I think that Boeing and Airbus are thinking from the direction of how to incorporate changes to the existing design to improve the internal combustion engine and fuel efficiency, rather than making major changes to the size or the structure of the aircraft. This is my feeling from actual conversations with them.

< Questioner 3 >
I would like to ask about your acquisition of Goshawk. My feeling that it is not always the case that acquisitions with the aim of expanding its scale has made great success. What do you think are the benefits or synergies about this acquisition?

< Kusaka >
One of the reasons why we chose Goshawk is that Goshawk is like a tiny version of SMBC Aviation Capital (hereinafter called as SMBC AC). That is, as I mentioned earlier, a company that is operating with a fleet configuration targeted at highly fluid narrow-bodies with state-of-the-art aircraft and keeping the vintage of the aircraft under five years of age. Therefore, the business model affinity is extremely high. From our experience, such companies are more resilient against economic downturns and events.
The other thing is that they have a fleet of 176 aircraft, and we recognized this as a major positive factor in terms of broadening our regional and customer portfolio. Although there is some overlap with SMBC AC, Goshawk has relationships with new regions, new airlines, and relatively high creditworthy, blue-chip customers for us.
The expansion of scale also allows us to make various bulk deals. The above points would be the advantages in selecting Goshawk and scaling up.

< Questioner 3 >
Let me ask about TBC. Since ocean freight rates have been declining, it seems that very uncertain factors or risk factors for future are disappearing. Can we expect some structural profit growth in the coming years?

< Kitahara >
For TBC, the steep rise in ocean freight rates in the last fiscal year was a great challenge. TBC now sells approximately 40 million tires per year, and the unit price of these tires was USD107 last year, but this year, the unit price has exceeded USD130. So, the price of the tire itself has increased by about 20%, and a good portion of that increase has been accounted for by this ocean freight charge.
Given the situation that it is settling down now, the supply-demand shortage in the US market has been resolved, and the market has almost returned to the normal balance of supply and demand. The key point is that under these circumstances, there is downward pressure on tire prices.
However, we have captured the market structure and has quickly put a pricing strategy into action ahead of the industry under TBC's new management team. And we have also foreseen the easing of the supply-demand balance, so we have been taking measures since the spring to push the break-even point down. Therefore, the number of sales of tires itself will probably drop by about 3 million per year YoY. However, since we have lowered the break-even point by cutting fixed costs considerably, we do not think that our performance will fall below the previous year's level.

< Questioner 4 >
How much are you thinking of taking risks and expanding the scale in the shipping, in a way that brings that ESG involvement into the opportunity?
Hydrogen ammonia ships will become available in the market around 2030 to 2035. And it will take another 5 to 10 years until the costs will become competitive. For such transition period, you will need to handle LNG-fueled vessels, or LNG-fueled vessels that can be transferred to hydrogen in the long term. As there could be tighter IMO regulations in the future, I think it could be an option to make aggressive risk-taking by investing in transition fuel vessels. Can you tell us about Sumitomo’s thoughts on this matter?

< Kusaka >
We recognize that the market expectations and customer needs on environmental-friendly vessels are very high. However, regarding ammonia for example, we need to consider things comprehensively including the supply chain of the ammonia, otherwise we could not operate the ammonia vessels. Therefore, we are proactively approaching not only shipping companies but also shippers to discuss these specifics.
In this process, we are gaining understanding of the shape and needs required by customers, and we believe that the key to success will be to materialize these needs. We will gradually increase the portion of such vessels in our portfolio.
However, it is not necessarily the case that we will take 100% ownership for such vessels and do business with it as did in the past. Such vessels could initially be very liquid asset, so we, as one of the options, will form an SPC, involving financial or strategic partners, and do it in the form of a joint venture.
One issue is how to look at transition fuel vessels until such opportunities become available, but we have been reorganizing our fleet and I believe that we have formed such an attractive fleet portfolio.

< Questioner 4 >
Are you saying that customers are becoming more interested in ammonia ships?

< Kusaka >
We are focusing on this area and exploring demand.

[END]