Investor Day 2021 Part 2 Details for Q&A session

Date / Time : June 1st, 2021
2 : 50pm – 3 : 25pm Q&A

Panelists : CSO/CIO, Hideki Yamano
Senior Managing Executive Officer, GM of Infrastructure Business Unit, Tsutomu Akimoto
Executive Vice President, Head of Energy Innovation Initiative, Shingo Ueno

Q&A

Question 1:
I only have one question. On page 25, the Appendix of this climate change review, let me ask one question related to this section. In the updated policy, coal-fired power plants are to be withdrawn by the late 2040s, and the equity production of thermal coal is to be reduced to zero by 2030, I get the impression that in IPPs, the contracts are basically not renewed, and in general charcoal, the end of mining is foreseeable, considering mining life. Therefore, when I compare them to other trading companies, I get the impression that they are a little different in nature from proactively promoting divestment. Especially in the case of your company, the weight of coal-fire IPPs and equity production of general coal is overwhelmingly larger than that of other companies, so I have the impression that unless you encourage more active divestment, your message will be a little weak. On the other hand, the sustainability of the host country also needs to be considered, as I mentioned earlier. What is your company's current position on this somewhat conflicting issue? What are your thoughts on this point?

Yamano: Thank you very much for your question. As for your question, I think it is the timing and the path of withdrawal from coal-fired power generation and thermal coal. As you mentioned earlier, we have a responsibility to fulfill the contract and to supply the products, and we cannot decide to withdraw from the project based on our own judgment. However, for example, we are considering the timing of our withdrawal from coal-fired power plants, and we are also considering some of the options that we can take to reduce CO2 emissions in the future. We will consider the timing of our withdrawal while constantly exploring the possibility of such options.

Akimoto: As I mentioned earlier, our power generation portfolio is not concentrated in a single country, but rather scattered across various countries, so we are subject to the energy policies and other circumstances of each country. Therefore, if the environment surrounding the power plant permits, or as long as we can obtain the consent of the stakeholders involved, we may sell some of our interests or withdraw from the project ahead of the current estimated project period, and we do not exclude this possibility. However, we cannot unilaterally make divestment that ignore our stakeholders or the environment. I also think that unilateral divestment proposals should not be made to the host country or to the people of that country. As far as divestment is concerned, I think we need to push for new engagements. In this sense, we will not only make unilateral divestments, but will also work on projects that contribute to the low-carbon energy policy of the country at the same time. Also, if the host country wishes, we can introduce renewable energy sources such as solar power, geothermal power plants, and wind power plants. We would like to create new engagement as well as divestment by supporting the introduction of new technologies, which we will be promoting together with Ueno. This is a very difficult issue, but we are determined to tackle it.

Ueno: I am Ueno, who is also looking at resources and chemicals. As you asked earlier about the upstream of general coal, or concession business, the goal of zero production by 2030, as stated here, is not something that can be achieved naturally. Therefore, we are aiming for zero production in 2030, which will naturally involve the sale. However, we also have partners, so we are aiming to achieve zero production by 2030 through a combination of sales and end of mining, in consultation with them.

Question 2-1:
I have one question, please. When you explained about EII earlier, you told us that the scale of profit will be considerable in 2030. What is the current scale of investment that EII has and what will be the main businesses that will be profitable in 2030? What is the image there?

Ueno: The current scale of investment is mostly in existing businesses. The forestry and biomass projects that I mentioned earlier are projects that we have been working on since the beginning. A unit of that business will come to EII and expand the business there. Or they are here to provide solutions to other businesses. We are currently calculating the scale of future investment including this, but we would like to invest JPY50 billion to JPY100 billion in the future. That's what I'm hoping for. EII is an initiative. An initiative is neither a department nor a headquarters. In other words, we will collaborate with other divisions and departments to build an EII, or a decarbonized or recycling-oriented energy system. It doesn't necessarily have to be a business within EII, but if we can provide a solution to that problem for other departments' businesses there, we are more than happy to do so. In addition to the above, I would like to include the capital invested in this project in the sense of scale as mentioned earlier. I would like to see our revenue base expand to the same size as other units or even larger in the future by 2030.

Question 2-2:
Thank you very much. This is the picture for 2030, so it is very difficult to say what will be the mainstay of the project, since the results are based on the consideration of various investment projects from now. Nowadays, other trading companies are also involved in various fields such as the low-carbon society and new businesses, but when you consider the strengths of your company, what do you think is the strongest potential for growth?

Ueno: I were to describe our company's characteristics and strengths, I would say that we are the Company which takes care of the whole system. It's not that we provide the solution and then don't care about the before and after. Rather, we should look at the energy system as a whole, including the provision of new energy, the reduction of CO2 emissions, the sales of the products that come out of the system, and the transportation involved. This is our approach. And this organization, EII, which came from various organizations and various lines of business. Our strength lies in the collaboration with the Akimoto's organization, which I mentioned earlier. I believe that by deepening these efforts, we will be able to provide such comprehensive solutions. For example, one municipality told us that they wanted to create a zero-emission city. So, I was asked if I wanted to work with them. This is not something that can be cut off to hydrogen or only renewable energy. In addition to hydrogen and renewable energy, we will combine heat, electricity storage, and distributed power sources to meet the wishes of the local government. Or a company wants to convert their store into a green store. In response, we will not just put solar panels on the roof, which is a decentralized system, but we will develop it into a business model. We will sell surplus electricity to the outside world. Or we can propose a business model to circulate it. This is not just one business model, but a solution that can be achieved through a combination of business models. I would like to make more and more proposals for the construction of such energy systems and for the realization of a carbon-neutral society in the future, and I believe that there are business opportunities in this area. This is our idea, our strength, and our characteristic.

Question 3:
One question, please. In the second part of the presentation regarding the infrastructure unit, I think you explained that sustainability management can be a business opportunity. How will you contribute to revenue potential as you work on this? What is the cash inflow from the replacement of assets, what is the cash outflow required by the department, and how will this lead to increased profitability? I think that if you stop some of the businesses, profits will go down, but I would like to know what your overall sense of direction is in this area. Please.

Akimoto: When it comes to sustainability management, I think the first thing that comes to mind is how to deal with the issue of climate change. This is also a very important issue for our unit as well. Although it is an issue, as I mentioned earlier in my presentation, we do not see it as a threat, but as a key element of our next new growth strategy.
For example, as I have already mentioned, the power generation portfolio of this sector is moving towards carbon neutral in 2050, towards low carbon and zero carbon neutral. This is clearly a response to climate change and one of the pillars of sustainability management. At the moment, there's actually a lot of cash coming up from the fossil fuel power generation business, but we will shift more and more to renewable energy. This is exactly the same as replacing assets, but by upgrading the portfolio to low-carbon, the cash itself and the assets themselves will be shifted to renewable energy.
In addition, by shifting to social infrastructure, we will eventually achieve carbon neutral, which is one of the 6 key social issues of the entire company. We will continue to work to achieve this goal. As we conduct our sales activities in line with the 6 key social issues of the entire company, I am confident that our sales activities will ultimately contribute to the advancement of sustainability management.

Yamano: I believe that business opportunities will be created in the direction in which the world is moving and in the direction in which the world should be. When we talk about the realization of a low-carbon society, we tend to think of it as a restriction or a limitation, and our company tends to accept it as such, but this is not the case. We have been explaining to our employees that sustainability management is a growth strategy whenever we have a chance, because we believe that the new Horizon will expand there.

Question 4:
I understand that you are shifting your portfolio to low-carbon renewable energy and social infrastructure. Recently, all the companies have been talking about shifting to renewable energy, and the IRR for investment is in the single digits. If it's brown, I think it won't come out halfway. We have been told that you will be involved from the development stage, but other companies are also saying that the power generation capacity of each renewable energy project is not that large, and in terms of investment efficiency, it can lower the overall profitability. In the same way, social infrastructure has an image of being quite competitive, so when it is finished, I wonder if you should really do it when it becomes carbon neutral after the transition. It looks like a business that doesn't have much investment efficiency or upside. I have a feeling that if you sell off the management resources as is and put the exit money into that, it will simply be a business with a low ROA and not much cash flow. If you have any ideas how you manage that, please let me know.

Akimoto: As pointed out, all companies, or rather the entire world, are making a major shift to renewable energy, and the competitive environment has become extremely severe. It is getting tougher and tougher every year. I share that understanding. However, as I mentioned earlier in my presentation, our strength is that we were among the first trading companies to enter the renewable energy market, especially offshore wind power, mainly in Europe. This is one of the reasons why the market has been so positive about our performance. And we have accumulated a lot of know-how, so now we can get into the early stages of development, and develop as a lead developer ourselves. In other words, we can add value ourselves. It is not a case of coming in later and paying a large premium, or coming in later and being a cash play, or being a finance play, but we ourselves will lead the project from the early stage while adding value. The development of offshore wind power in Japan is a perfect example of this. Although the results are not yet in, we will start from the initial stage, add value ourselves, and then realize the value by selling part of our equity interest at the time of financing close or completion. Also, as I mentioned in my presentation, we have set up a renewable energy fund ourselves. By transferring assets there, we will be able to realize value there as well, and by setting several value points in our development milestones, we will be able to support our revenues. In the area of social infrastructure, there is such a wide variety of opportunities that it is difficult for us to narrow down which ones we should focus on. There is an overabundance of demand for infrastructure all over the world, and what we pick up in that demand will become a very important part. Therefore, since we have finite management resources, I would like to limit my focus to investment opportunities where I can see a clear path to victory. For social infrastructure, I cannot say at this stage that we will concentrate on this field or segment with a winning strategy, but since we have finite management resources, I would like to put them to work in the right places.

Question 5:
One question, which may be related to previous question. This time, you're going to have to be very disciplined in your investments, and you've had some impairments from the infrastructure business in the past. I am wondering what the balance will be between managing the quality of investment and taking an aggressive stance. You mentioned that you are narrowing down your focus to specific areas, but I think it is very difficult to find the right balance in terms of narrowing down or allocating management resources, since the focus of this discussion is on projects with a long time horizon toward 2050. For example, I think there is a sense of direction in which we can set milestones and manage the time horizon more closely, and select more selectively, but I would like to know if you have any ideas on how to manage the allocation of management resources for growth in combination with investment discipline.

Akimoto: Regarding investment discipline, we recorded such a large amount of one-off losses last fiscal year. As I mentioned in my presentation, we are currently examining the main causes in depth with the entire department. I can tell you that what we thought that we followed the investment discipline in the past, but actually we didn’t. We are now trying to find out if there were any arbitrary factors involved in the process. I really believe that the principles and discipline of investment do not change with the times. We would like to raise our awareness of this issue with the basics and move forward with new investments.

MC: Thank you very much, Mr. Akimoto. I would like to ask you, Mr. Yamano, about the allocation of management resources.

Yamano: This is a difficult question, but if I were to make a suggestion, I think it comes down to maintaining a good balance here. In order to achieve a good balance, I think the first thing that is important in this medium-term management plan is to deepen discussions on strategy. Rather than making opportunistic investments or the like, we will make sure to identify areas where we can leverage our strengths and increase our value. Then, we create goals and incorporate them into our personal goals as well. In addition, after the investment is made, we will monitor whether the project is performing as planned and provide timely recovery and support if necessary. Then, the results are evaluated, and the organization or individual who achieves the best results is given appropriate recognition. You may say that this is obvious, but I think it all comes down to doing the PDCA cycle well. Deepen strategic discussions and develop strengths. We don't do anything opportunistic. We would like to work on this area as a basis.

Hyodo: I think it would be better to answer your last question a little more straightforwardly. In this specific case of investment discipline, Akimoto is the Head of the Infrastructure Business Unit , and I was also the Head of the Unit, so there is a problem with my judgment. To put it bluntly, a lot of things can happen to infrastructure assets if the cash flow, the lending side, is not stable enough to support the business mission of the infrastructure. It's a matter of course. Therefore, for the large impairment loss that occurred in Australia, the Company had assets that were assumed to be refinanced with short-term loans. Herein lies the biggest problem. We have also received comments from the market that coal is a stranded asset, relating to coal. Of course, there are elements of this, but the major element is that the basic structure of the loans on the lending side was not followed. Second, a large loss was recorded in the EPC this time. Although the contracts for each EPC project had been completed through professional contract negotiations, we had not anticipated the possibility of multiple projects being suspended at once, concentration risk. I think this is an issue that needs to be greatly reflected upon and reworked. If these two points had been addressed properly, this problem could have been avoided. This is something that we need to make the most of in the future. I wanted to add a little something here.

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