Q&A at IR Meeting on Financial Results for FY2016

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[Questions and Answers]

Quantitative targets of Medium-term management plan (BBBO2017)

Q. Please tell us about the assessment of the current progress and prospect towards next year in BBBO2017.

We do see the outcome of effort in strengthening earning power, but it's not a level to be satisfied with. We believe that the profit can be further increased if the power infrastructure business progresses and geopolitics risk around the Middle East decreases.

Q. What is the reason that profit increase is smaller in Non-mineral resources businesses in FY2017 compared to FY2016? Which businesses will contribute to the profit growth in FY2017?

Profit increase in FY2016 includes the effect for acquisition of Shop Channel shares by J:COM and one-off profit in aircraft leasing business. In addition, finance-related investment profit and capital gain from sales of private equity are also included in the Corporate and Elimination segment.

In FY2017, while existing businesses steadily grows, the amount of profit increase will be smaller. This is because of the costs for new business subsidies, taxes imposed on the Corporate and Elimination segment, costs for HQ relocation, and smaller amount of one-off profit compared to previous fiscal year.

As to future profit growth, we expect the growth in automotive forged parts business in Germany in Metal Products Business Unit, and the automobile business in the Middle East are expected to recover in Transportation & Construction Systems Business Unit. Also, in Environment & Infrastructure Business Unit, we expect contract progress in power infrastructure business, water infrastructure business in Brazil, and offshore wind business in Europe will contribute to the profit. In Media, ICT, Lifestyle Related Goods & Services Business Unit, Summit, J:COM, and Shop Channel will continue to deliver strong results. Furthermore, in the real estate business, we started to improve the business efficiency by utilizing the capital of others, and we also plan to extend the same idea to power infrastructure business in the future.

Q. Is it already decided which businesses will use the Costs for strategic asset replacement?

Costs for strategic asset replacement are included in the budget for executing the asset replacement certainly under the policy for replacing non profitable and low efficient businesses. Although there were no major losses associate with it in FY2016, we included it in FY2017 plan in order to encourage further asset replacement. But there is no firm business decided for using it.

Q. What is the ROE target after the BBBO2017?

We would like to aim two digits number as a minimum, but it will be set along with the discussion of the next medium-term management plan.

Q. What is the downside risk in view of FY2017 price assumption of mineral resources compared to recent market prices?

Some commodity prices declined slightly after the time of budget planning in Feb to Mar in 2017, and we'll watch closely for that. Please refer to IR supplemental material for the price sensitivity on the profit.

Q. What are the reasons for increase and decrease of profit in FY2017 plan against FY2016 result in Metal Products, Environment & Infrastructure, Media, ICT, Lifestyle Related Goods & Services (Global basis), and Americas segment (Segment basis)?

In Metal Products Business Unit, we expect that Tubular products business will gradually recover from the 2nd half of the fiscal year and will be plus minus 0 in basic profit. Also, in addition to steady growth is expected in steel sheet related and non-ferrous products & metals business, and there were one-off losses posted in FY2016, such as impairment loss for Edgen Group due to delay in demand recovery.

In Environment & Infrastructure Business Unit, it is planned to be nearly flat. Although the profit level of overseas power infrastructure business will slightly decrease, construction in EPC business will progress.

In Media, ICT, Lifestyle Related Goods & Services Business Unit, in addition to domestic major group companies to continue to deliver strong result, profit increase in food and agriculture business is expected since SC Foods and grain business in Australia will recover and grow. Also, real estate business will increase the profit including value realization.

In Americas segment, the profit will increase owing to recovery in tubular products business in North America and absence of one-off losses from Edgen Group and San Cristobal.

Cash Flows Plans

Q. What is the progress against the plan, and how do you plan to allocate cash in FY2017?

At this moment, free cash flow after dividend is around plus 550bil. yen, most of which is turned to repayment of interest bearing debt. In addition, while increasing the basic profit cash flow by 100bil.yen this time, cash in decreased by 100bil.yen due mainly to increase of working capital expected from recovery of market condition including tubular products business. Overall, the investment plan of 1,000bil.yen will be covered by basic profit cash flow and cash in from asset replacement. Although there is a possibility of increase and decrease in working capital, we will manage cash flow within the revised three years plan.

Q. What is the level of certainty for the three years investment plan of 1,000bil.yen?

We have done 610bil.yen of investment in last two years. We'll continue to carry out the investment with a priority on thorough investigation whether it is appropriate or not, rather than achieving numerical target itself. There are several deals on the table, but it depends on our investment discipline and how the negotiation goes. So we estimate 1,000bil.yen will be maximum case.

Q. Considering the balance with investment, how much do you think is appropriate to reduce the interest-bearing liabilities?

We have reached the plan, and will keep progressing as per the plan. Interest-bearing liabilities has been decreased considering the balance with cash generating ability, and we will further judge the level of debt looking at balance between the level of profit growth, stability in cash generation, and investment for growth.

Based on current business environment, we do not foresee to depend heavily on having finance from outside for investment, and basically think that investment and return on shareholders will be mainly covered by cash generated.

The importance of cash flow management has been commonly understood within our company, and it will continue to be so. As the business model changes time to time along with environment, there is no definitive and fixed level on the cash flow balance, and we'll discuss it along with next medium-term management plan.

Q. How do you consider the dividend policy, after some improvements in business environment and other peer companies revised their dividend policies?

We will consider it along with cash flow status, when the profit largely exceeds the plan. But first of all, we need to focus on achieving the plan itself, which we'll endeavor to do.

Projects

＜**Tubular products business**＞

Q. How do you expect the timing of profit recovery in response to the market recovery?

The main market for this business is North America, and we do see the market situation has bottomed out, as the rig count is recovering and market stock is decreasing. On the other hand, there is time lag for the price to recover after the demand recovery. The timing for profit recovery is affected by various factors such as oil price, rig count, and the situation of E&P companies, but we expect it to be after the second half of FY2017.

＜**Ambatovy**＞

Q. Please explain the reason of the impairment loss in FY2016 and the risk of another impairment loss in the future.

During the construction period, KORES and Sumitomo provided funds to Sherritt in the form of a non-recourse loan, which uses cash generated from the project as a source of repayment. Like we do for equity, we have carried out impairment tests on the loan on a regular basis, with an effective interest rate since it is a financial asset. 4.8bil.yen of impairment loss was accounted for in FY2016 due to the rise in US interest rates.

Although there were facility troubles in February, the annual production volume for FY2017 is planned at around 50KT, which is an operating rate of over 80% of design capacity. The project has increased its cost competitiveness, having achieved a net direct cash cost of US$3.1/lb in Oct to Dec in 2016. As for the nickel price, in line with some analysts, we forecast that it will rise in the next several years. Therefore, we do not consider that there is an increased risk of impairment loss under the current situation.

Q. Will the change in capital structure have any impact on the roles among shareholders? What is the reason for making the change at this point in time?

There is no change in the policy to support the project with all three partners together. The structure change will stabilize the partnership among the shareholders and we will work further to enhance the competitiveness of the project. Sherritt will resume funding as per the 12% share and is committed to continue its role as operator. We continue to expect contribution mainly on the technical side on their part.

Our share will be 47.7%, and our involvement in the management of the project will increase. In terms of profit and loss, although we expect the loss to increase in the short term, the profit gain will expand largely when the project becomes more profitable. The operation itself has increased its stability and we believe in the competitiveness of the project.

For some time, the three partners have continued discussions on the partnership structure, while taking steps to stabilize operation, increase production, and reduce cost, in preparation for the recovery of the nickel market. And finally in May 2017, we were able to announce that an agreement in principle on the way forward has been reached among the partners. The agreement is still subject to certain internal and third party approvals and documentation, following further discussions.

Q. Despite the increase in the share, why the loss in FY2017 is same level as FY2016?

In FY2017, on a 32.5% basis (without considering the effect of our share increase), the loss would be around 11.5bil.yen due to increased production. The difference of around -6bil.yen from our final profit plan is comprised of (1) the effect of our share increase, and (2) the decrease in interest income, which is due to the transfer of Sherritt's non-recourse loan to equity after the closing of the deal.

＜San Cristobal＞

Q. Please tell us the reason for the profit increase in FY2017 and the future production plan for FY2017 and afterwards.

The production volume is expected to increase for silver, zinc, and lead in FY2017 mainly due to higher ore grade. But on the other hand, the ore grade will gradually decline in the future, and as a result, the production volume is expected to decrease along with that.

＜TBC＞

Q. What is the reason that impairment loss became unnecessary?

In FY2016, it progressed almost in accordance with the plan due mainly to increase in sales volume and operation efficiency, although market was still weak and selling price was not recovering. At the end of FY2016, we reviewed the necessity of revising business plan, and it was judged that impairment was unnecessary on the premise that demand will recover in 2018.

＜Telecommunication business in Myanmar＞

Q. Please update the current status and forecasts.

We have stable market share, and ARPU is gradually recovering from the decline caused by intensive market competition. The profit level cannot be disclosed, but there is contribution at a certain level, which we expect to be around the same in FY2017.

＜Fyffes＞

Q. How does the Fyffes acquisition impact on FY2017 forecasts?

Fyffes annually generates around 3~4bil.yen of net profit. But the impact on our FY2017 forecast is limited due to one-off cost will occur in relation to the acquisition.

A meeting was held with Fyffes top management the other day, and we could reconfirm that this is a steady business supported by solid management based on reality.

Others

Q. Please tell us an example of a business model case that can be applied to other projects in the future.

The “model case” differs depending on the view point from PL, BS and CF.

For example, in the aircraft and automobile leasing business, our company was originally consolidating all the assets on our BS. But it succeeded to expand the business as well as improving ROA by inviting partners in this business. On the other hand, in the case of subsidiaries such as Fyffes and San Cristobal, we can expect cash generation, which is limited in the case of affiliated companies. Like aforementioned, we are discussing about the business portfolio to have appropriate combination of various businesses.

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