

## Question & Answer at IR Meeting on Financial Results for FY2018 2Q

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[Presenters]	Masayuki Hyodo	Representative Director, President and Chief Executive Officer
	Koichi Takahata	Representative Director, Senior Managing Executive Officer, Chief Financial Officer
	Hideki Yamano	Representative Director, Managing Executive Officer, Chief Strategy Officer and Chief Information Officer
	Hiroyuki Sugai	Corporate Officer, General Manager, Accounting Controlling Dept.
	Tatsuro Tamura	Corporate Officer, General Manager, Investor Relations Dept.

### List of Questions (Detailed Question & Answer follows)

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<Q1>

- Please explain the current progress and the possibility of upward adjustment. Also do you see any specific signals with regards to macro economy?
- Regarding Ambatovy, please tell us the current situation and prospects of operation.

<Q2>

- Is there any change in the concept of “Medium-Term Management Plan 2020” over the last 6 months?
- What is your outlook on the profit trend of tubular products business?

<Q3>

- Please explain the mineral resources price assumption.
- Regarding Fyffes, what is the reason of downwards adjustment on annual forecast and the outlook from next quarter?

<Q4>

- What is your thoughts on the balance of upstream mineral resources asset portfolio?
- Please explain the investment for the emerging field.

<Q5>

- What are the areas where you expect the profit growth for next year while the environment could be in downtrend?
- Please explain the outlook for profit growth in power infrastructure business.
- Regarding digital transformation, is there any possibility to have alliance with any established company?

<Q6>

- Are there any plans to review the current power business portfolio or to accelerate the shift towards the renewable energy in your “Medium-Term Management Plan 2020”, considering the rapid change in the headwind towards coal?

## Question & Answer

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**Q1:** First of all, while we had a great quarter with robust progress, you explained that your forecast be unchanged, including that of macro economy. It would be great if you could explain, from your point of view, on the current progress and the upward adjustment, and also if you see any specific signals with regards to macro economy.

My second question is regarding Ambatovy, which we get an update about every quarter. The forecast has been downgraded this time, and it is based on the assumption that you will increase the production volume towards the second half. May I ask you about the signaling trend during this July – September period, or the possibility of improvements towards the second half of this fiscal year, please?

**Hyodo:** Thank you for your questions. First, I will answer regarding your first point, where we are with our progress, and if we have any concerns as we enter the second half.

Luckily, our initiative on evolving the management foundation, which we have been working on for the last two medium-term management plans, have bared fruit for us. I feel that we have been able to have a steady growth while taking in the positive aspect of the macro environment for the last six months. If this positive macro environment continues, I believe the trend itself may continue as is.

However, as I explained earlier, considering the uncertainty in the economy, not only in Japan, but also around the world, I think, as Sumitomo Corporation group, we should not have our management based on an assumption that such upbeat performance will continue. Hence, we should anticipate a certain scenario. For example, mineral resources prices fluctuate. However, as shown in your handout, assuming that there will be mineral resources' price fall trend, the price would continue to stay low in the future, and the first half showed some price movement that was over-achieving our forecast which may not continue in the second half. Therefore, we are making forecasts based on an assumption that our current number will stay unchanged. You could say this is a conservative assumption, but we are keeping some buffer, and not changing the number.

Also, we think the market trend is affected directly and indirectly by the US and China trade issues. If the China market experience a downturn, obviously the demand for the steel resources will fluctuate. And also, the money flow will change in the financial market. Given the current status, there was a discussion internally that it is reasonable to expect a downward pressure against market conditions.

There are other factors, such as the trade issues between Japan and US that are currently under a continuing negotiation between the governments. We don't know how it will evolve, while we're hoping that it will be resolved. But regardless, we have to prepare for certain situation.

If you ask if there is any impact already, I think at this point of today, it is even.

Now I would like to answer your next question on Ambatovy, which is an extremely important project for our company. When I explained to you this spring, we were hoping to have the plant running at a higher rate at an earlier point in time after some repairs were over. Although it has taken longer than expected, production has gradually stabilized.

While it is not perfect yet, production level has recovered to around 70% of design in October. We are currently implementing various initiatives on the ground to increase this to 80% or above, and we expect operation to be more stable from now on.

**Q2:** First question is, about the medium-term management plan concept. You didn't show a specific profit goal for the three year term, in your medium-term management plan, which was released 6 months ago. It has been 6 months since you were appointed as the CEO and I think you have some observation now. What kind of investments or projects do you see improvements in, compared to what you have expected? Or what kind of change, or profit increase you have experienced which led you to have more confidence, over the last 6 months?

My second question is, I would like to know about the tubular products business. The basic profit is solidly increasing; first quarter, 4.7 billion yen; second quarter, 5.1 billion yen. The background is that the rig count has been increasing continuously and you are steadily accommodating the demand. However, the current rig count growth has been rather slowing down. Please share your thoughts on this trend, how it will affect the tubular products business profit, and if we can still expect profit growth somewhat.

**Hyodo:** To answer the first one, it has been six months since I have become the CEO. We hold strategy meetings internally with each Business Unit, and we just held one this October. Each Business Unit had many unique ideas of establishing new business, in our current medium-term management plan. Considering the current macro trend, we will not accomplish them within the next three years of the "Medium-Term Management Plan 2020", but we will make them become the pillar for next 10 to 20 years.

We have to apply stringent selective process, which is not easy, but there are significant number of candidates, which is quite encouraging.

On the other hand, more importantly, from my point of view, the three-year term of medium-term management plan is rather short. So, considering that, while achieving the number solidly, we should secure enough funds to invest.

And also replace any existing business, as necessary, and direct collected funds to new investment opportunities. We have to accumulate such capability. These short-term challenges need to be tackled. In such view, I am sure that 320 billion yen for this fiscal year, should be achievable.

On the other hand, the numbers for the second and third year have not been released in this medium-term management plan. As I have explained the concept earlier, if we manage our business solidly to match the current financial or investment planning for three years, approximately 900 billion to 1 trillion yen will grow on the balance sheet. Of course, it has to be a healthy growth.

As a result, if we can achieve 4% or more in ROA, which we are currently targeting at, we will end up with a reasonable number. Therefore, having such thing in the mind, we are not showing numbers for the 2nd and 3rd year. I have been in sales for more than 30 years. From that experience, I know we tend to focus too much on the numbers shown in front of us.

Rather, we think the important thing is, managing good balance in business. Looking at this with a mid-long term point of view, once you start a business you need to stay in the business regardless, for 10-20 years. From that point of view, instead of having net profit as a goal, rather, it is more important to have a solid management benchmark, considering what the essentials are, that leads to an improvement in numbers. This is our basic approach.

The second question, as has been pointed out, the demand for tubular products in North America is driven by the shale oil and shale gas development in North America, which clearly is shown by the increase in rig count. In the tubular products business in the market, when we think about the essential ups-and-downs, I think we need to focus on the volume and the unit price of the tubular products. Looking at what is happening in the first half of this fiscal year, the volume has been certainly increasing. However, there is the effect of trade policies, we observed a so-called last-minute demand in the tighter market. Therefore, I don't

think it is reasonable to assume that this unit price will continue as is in the future. We have to assume that there will be some overshooting, and we should reflect the possibility of unit price decreasing slightly in our plan.

On the other hand, it is anticipated that rig count and drilling business to continue at a certain level. This will of course be affected by the oil price fluctuation, however, we came to this forecast, taking this and such other factors into consideration.

**Q3:** The first question, you mentioned that this year's performance were conservative. It seems that the mineral resources price assumption has been reviewed across the board and were realized close to the actual numbers. While the coking coal alone is revised and showing a downward outlook, I wonder if this is detached from the actual market price. I feel that there may be some space for upwards adjustment. If you could share the rationale of setting the current prices in coal business, and the possibility of an upwards adjustment, that would be great.

My Second question is, the full-year forecast has been significantly adjusted downwards for Fyffes. Could you share your view on what is happening and what sort of measures are you implementing from now on? Also, how do you anticipate it would look like from next quarter? Thank you.

**Takahata:** For the mineral resources, the market trend and the quantity are all shown in your handout, page 31. Not only the coking coal, but our assumptions made for the first half is the actual, and second half is a revised current price. So, some are spot price, some are long-term. We have these numbers based on an assumption that these will stay the same.

As our CEO just explained, it may continue to remain at the same level, or it may go down further. With our first half result, there is a risk of the price coming down further. So, we have made adjustments for such factors. Basically, our forecast is based on the assumption that revised spot will continue for some time.

**Hyodo:** I would like to answer the second question, about Fyffes. Fyffes is a fruit wholesale business operator. Largely, there are three main products. First category is Banana and pineapple. Second is Melon, and the third is Mushroom.

For banana and pineapple, in the past, we had poor harvesting due to the severe climate change. However, this year, it has been going well so far. Due to several factors, the performance of melon and mushroom is down. Mushroom is made in the plant with stringent quality control, leading to a high-grade mushroom production. However, there was a partial malfunction of the production equipment. In the main plant, we needed to repair and upgrade equipment, but there was no immediate resolution. As long as we repair the equipment properly, it will definitely contribute to the performance. Meanwhile, we need to be profitable with other products.

The impact as whole, quantitatively, is 63 million euros on EBITDA basis, as an initial forecast of this term. This impacted the forecast to go down to 5.6 billion yen from the original 8.3 billion yen in profit.

And also, about melon, we were affected by the market shift, and we had poor quality melons which were not sellable, that ended up as long-term inventory. Optimizing the supply chain is very important.

We have analyzed the cause, and we need to improve our logistics allowing some margin in the capacity, so that we will be able to handle unexpected overflows and control the quality. We have identified issues and details already, so by making a reasonable size of investments and reinforcing the facilities, it should lead to a stable profitability. If we could approach this properly, we can expect a continuous contribution.

**Q4:** First one is about your policy on mineral resources asset. This quarter you sold the Pogo Gold Mine, and also made an investment in Yanacocha Copper mine which is a long-term project. And in the long term, handling the San Cristobal project in Bolivia.

Looking at mineral resources long-term, what is your policy on the asset balance and how do you act on this? Do you weight more on a specific metal, maintain the current metal portfolio, or weight on steel products and such initiatives?

The second question is regarding the business growth you explained. Any new initiatives take time. I would like to know, in your medium-term management plan, your view on the lead time it starts to make profit. What sort of perspective determines an approval of investments?

**Hyodo:** Thank you. The mineral resource asset, I think this includes energy resources as well. Before discussing about portfolio, the essence of investing in mineral resources, or an investment in the upper stream, it is to hold long-term inventory for mineral resources that we spend costs for rigging.

Naturally, we can profit off of total cost, rather than sellable price. The assets that can endure fluctuation, the portfolio should consist of resilient assets. In a nutshell, it is important to purchase a good project.

On the other hand, we have a policy to maintain our financial rule properly. We have to consider the cash flow. As a policy, we have to have a cash flow for each business, which they have earned and then, the next investment should be made within such earnings. And we have to comply with the policy.

And for the mineral resources, it tends to end up purchasing at a high price. Earning cash when the price is high, then when earnings are high, the money is spent. To resolve this contradiction, while a certain fluctuation is considered, we pick up a good project, at a timing that can purchase good assets, that's the basic concept.

Therefore, to set a certain level target, such as 10% or 20% for the portfolio, it is not set as our target.

On the other hand, from the point of view of the risk management of the whole company, we also have a challenge of how to manage the volatility properly.

As a group of Sumitomo Corporation, as a whole, it is important to have a portfolio, to generate a certain level of profit steadily. This applies not only to the mineral resources. Considering the risk and volatility of each business, the asset should fit in the risk buffer and being maintained.

This applies to all business, including the mineral resources as a whole. But this is my answer to the questions.

On the other hand, the mineral resources, it is vital that it contributes to the industries and the society, not only in Japan, but also for the developing countries, or regions. This aligns with our corporate philosophy and materiality, and we will continue our endeavor in this business.

Next, to the investment envelope for the growth strategy, and the timeline for decision making. A difficult question to answer in a simple way as one policy.

However, challenging new areas is a must. Doing business as a professional, we should manage and engage in such business management.

Therefore, the new business that we have no experience in, we really have to have a comprehensive point of view. Whether we do it alone, or together with a partner; business decisions.

Many meetings, this will be decided through multilateral discussions through Business Unit/Company Investment Committee, Management Council, and Board of Directors. This may lead to a criticism of taking too long. But the necessary discussion should never be compromised.

However, on the other hand, the definite result needs to be realized. And, along the growth, we have to pay better dividend to the shareholders, and achieve solid growth. We have to make the correct management decisions.

Then, the Sumitomo Corporation, the three years medium-term management plan. 1.8 trillion yen, I think. The prediction of cash in and cash out, 1.8 trillion yen. First of all, dividend, and then improvement of the financial status, and then, the strategy for the growth, and the new challenge, of 300 billion yen is included.

We should not aim to use up all the commitment for investment. We should consider the priority of the management. First of all, dividend, and then financial improvement and pay off the debt, and we should have a good selection on how to utilize it. After three years, it is possible that we may end up not using the entire 300 billion yen.

Or, on the other hand, maybe we will be positive in having a lot of new good projects. So, next two and a half years, through dynamic management discussion, we should accumulate one-by-one and we should maintain our company policy. And then we should look into the future.

**Q5:** Number one, I'm afraid it is about short-term. I have studied the first half financial statement and non-ferrous metals have declined, and feels like Transportation and Construction Systems hit the peak.

This year's planned gain includes the profit of the sale of real estate. What are the areas where you expect to grow by your own business endeavor in the next quarter, under the changing environment? Probably improving Ambatovy? That's my first question.

The second question, which is related to the infrastructure, the progress in Tanjung Jati is great. And I have heard it will continue into next year.

The EPC projects are currently accumulating. Are there any projects that will be realized in the medium-term management plan? If you could please confirm the status.

And the third question, within your medium-term management plan, you are mentioning a digital transformation plan. Today, there was a news about KDDI partnering up with Rakuten. I'm sure Sumitomo Corporation has a relationship with KDDI. Maybe you may work with a startup or any established company to partner up. Depending on your capability that you can provide.

In the new way of alliance, is there any room for you to be involve? If you have any news to share about that, please explain. Thank you.

**Hyodo:** Thank you. I understand your question is whether Sumitomo Corporation alone has enough capability to realize a solid performance, even though the environment is in a downtrend. As I mentioned before, the Metal Products Business Unit, for example, we established a joint venture with a local specialty steel business company in India, called Mukand. It's been solid.

Or, in Brazil, a company called Gerdau, which is a group that specializes in manufacturing, forged and cast products and has industrial operations in North America. A joint venture company that we are partnering up with. Recently, President Trump's trade policy has a positive contribution factor, and with their strong manufacturing power, the performance is solid.

Not only currently, but we have already made an investment considering the needs in Brazil for casting and forging in the future.

These are just two examples of the businesses we have been considering over the last medium-term management plan. There are many projects that we have invested in and have been evolving. So, we are working on those projects in each business unit and should be realizing profit.

I believe we can introduce this as an example of an added value to existing businesses. We need such businesses to continue seamlessly.

In regards to the real estate business, we are always conscious about refreshing and replacing the real estate. And then to optimize our management resources, maintaining certain properties. Once the value has increased to a certain level, we can actually realize it.

Actually, there was a project contributed to the profitability in the last fiscal year. Individually, they are small. But, as a whole, underpinning the company's performance. It is a promising area for the business.

Regarding the transportation business, this will be affected at a certain level. Therefore, as you pointed out, there are businesses that are on a declining trend. On the other hand, aircraft business continues to stay solid, and we are having an expectation on the Aviation Capital jointly run with SMBC. Given all these, overall, we are expecting high performance.

Moving on to the second question about power infrastructure. I believe that, for EPC, we realize the profit as the construction progresses. Once it is completed, then the profit becomes zero. That's not the only thing we are doing. For example, not only the Northwester2 project, the windfarm in Europe, but also Race Bank and Galloper in England which we invested in last year are completed and they are ready to start contributing to our profit.

These are quite liquid assets. We have to replace this, to realize value, as part of the business cycle to start undertaking new business and thinking about capital cycling. Like the REIT in real estate, we have to earn profit and create the assets consistently in a robust way and make a stable earning structure by having many of these cycles.

And these objectives are in concrete for infrastructure business. After the latter term, we should realize a certain amount of value and contribute to the next cycle, and that kind of initiatives are currently undertaken.

On the other hand, there is a long-bearing, coal-fired power project called Van Phong in Vietnam. Thankfully, it took more than a decade, but we've finally come to sign the contract for the sales of electricity. After the financial closing, the contribution will be realized at a certain level.

This is not the only project that we have. We have many more. We believe that, by taking these initiatives, we will continue making profit.

In regard to DX, recently, we heard the news about the partnership between Rakuten and KDDI, which we think is wonderful. We have an ongoing discussion with the CEO, Mr. Takahashi, about J:COM, our joint business, or telecommunications business in Myanmar and such initiatives.

From the stage of exchanging ideas to the individual function to be realized, such as Myanmar's project or J:COM's transformation to be realized. We are discussing much in details. Our actual digital transformation, the action side, our value to be added by utilizing our capability.

We firmly believe that these kinds of activities will lead us to realize the profitability in the next fiscal year, and the next mid-term so please look forward to it.

**Q6:** Are there any necessity to review the current portfolio to accelerate with renewable energy?

And your company also sets the target renewable ratio in the consolidated report, that by 2035, it will be 30%. But I think the trend of shifting towards renewable is getting strong, with headwind towards coal.

Considering this, the shift towards the renewables should be accelerated more? Your governance also mentioned emission credit to be monitored. But, from such point of view, could you share your perspective of current and future power business, or your current business portfolio, please?

**Hyodo:** Thank you. A very important theme, I think. It is one of management's challenges. And at a recent board meeting, we had a heated discussion.

Just answering, basically, we will accelerate, never decelerate.

On the other hand, within the infrastructure, lifeline itself, or a business close to lifeline, cases of business such as that, when we consider those businesses, we need to think in a broader view.

From the point of view to reduce the CO2 emissions for the environment, to shift to zero CO2 emission electricity is ideal, I believe. And to pursue and aim such target, is the correct status.

However, should we set that target now, considering the current status? For example, as Sumitomo Corporation, from now on, we'll never touch the development related to the electricity, creating CO2 emissions. If we say that, as a company policy, my view is no to that as well.

We need to pursue it with a very balanced point of view. Not to use this as an excuse, but in actual, we are making a good decision, Sumitomo Corporation Group, that is. We need to show that and need to get that reputation as well.

For example, in Japan, we have a domestic company called Summit Energy. We are a retailer, as well as obtaining our own electricity.

To develop, will they develop it by coal power? Definitely not. On the other hand, for example, perhaps, I hope you don't misunderstand me. There was an earthquake in Hokkaido. That power plant was affected and ceased the supply of the power generated by coal and LNG. This has caused many people in the local area a lot of trouble.

That was caused by the earthquake. But, if the supply shortage occurs and then the necessary supply in the community cannot be met, in order to resolve that, we develop the electric source. That is also very important. We need to decide case-by-case.

Obviously, we don't have enough time to discuss such theme. But in a nutshell, to respond to that community's needs, and considering the environment, to meet that required value, I think we have to provide the value the community is seeking.

Within the macro environment, as a whole, we need to develop the power source to meet the community's needs.

Therefore, even within Japan, it is not a discussion across the board, but it should be individually discussed. And for example, the Minamisoma solar power plant we developed was after a thorough discussion with the community and the local government, and we had close communication with the users. After they agreed and accepted, we worked together. And therefore, this solar power development was quite a successful example.

I'm sorry, this may not be a direct answer to your question. But, as our direction, we aim not to increase the coal power. But, as much as possible, lower the ratio, and to increase the ratio for the renewable. The example we showed today, the wind farm in Europe, and also, we could not show today as an example, in Japan, for renewable resource generation, we are going to pursue it to meet each community's needs.

[END]