

## Question & Answer at IR Meeting on Financial Results for FY2018 3Q

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[Presenters]	Koichi Takahata	Representative Director, Senior Managing Executive Officer, Chief Financial 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 tell us about the current situation of the Transportation & Construction Systems business. And what is the one-off profit/loss expected for the 4Q?
- What is the background of sale of BTPN?

<Q2>

- Please tell us the current outlook towards the end of fiscal year for each Business Unit.
- Is there any change in business environment for tubular products business as the crude oil prices decline?

<Q3>

- What is the background of impairment loss in Ambatovy project? And what are the outstanding issues in the operation?
- How do you see the profit forecast for coming fiscal year?

<Q4>

- As there has been some acquisitions and mergers in the steel business, please tell us if there are any challenges in metal products business and any initiatives planned in the future?
- What is the progress in overall investment budget of 300 billion yen stated in the medium-term management plan?

<Q5>

- Regarding the cash flow, what is included in "Others" of cash in, and what is your view towards the end of this fiscal year? How do you understand this slow pace in investment?
- What is the reason that Fyffes turned to red? And please tell us the possibility of impairment loss in the future.
- What is the background of additional purchase of interests in thermal coal in Clermont?

<Q6>

- What is the medium-to long-term price assumption and supply-demand outlook for nickel?
- Regarding San Cristobal, what is the upside potential in the annual forecast and outlook on the production in the next fiscal year?

<Q7>

- What is your policy with regards to the thermal coal business, and is there any quantitative target?

## Question & Answer

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**Q1:** I have two questions, both about the Transportation & Construction Systems business unit. On page 9, there is the outlook against the initial forecast, where you anticipate some one-off profits or losses for the 4Q. I'd like to know if you know the amount of loss you are expecting.

The 3Q figures don't seem to be very good. Please tell us about the current state of the Transportation & Construction Systems business, including whether there has been negative external impact from factors like trade friction.

My second question is about the sale of BTPN. As far as I understand, you have been talking about horizontal expansion in Asia together with the bank and OTO/SOF in Indonesia. What is the background of this sale, and is your position in Asia going to change, given that you have been trying to expand in Asia in partnership with bank? I would like you to provide additional information, including the current situation.

**Takahata:** Thank you very much. First of all, regarding the overall Transportation & Construction Systems business unit, I will say that the result for the 3Q is slightly weaker than the plan. The main businesses here are the leasing business, construction equipment, and automotive business. The first two are going very smoothly. Regarding the automotive business, in particular, the environment around sales in emerging countries has not changed yet, and in manufacturing, the impact of the slowdown in economic growth seems to be gradually appearing. Even in the normal course of business, the outlook seems a little weaker than the initial plan.

In the 4Q, one of the one-off factors is the exiting of BTPN, which has already been conducted and recovered. In line with this, we will lose approximately 10 billion yen. This is something like a loss from the realization of T/A due to the diminished rupiah between the time of investment and the time of collection. But it is almost certain that it will be recorded in the 4Q.

Apart from that, as we continue to reorganize the leasing business, SMFL, there are some temporary tax benefits expected in 4Q. But anyway, as a whole, I think performance is weak against the plan.

We explained the background of BTPN at the time of investment, but we were originally operating the OTO/SOF motorcycle and automotive financing business in Indonesia by ourselves. In addition to that, we set out to create a platform to gradually expand our finance-related business in Indonesia and to other Asian markets through cooperation with banks and participation in investments. We started by supporting the growth of BTPN in which we invested, alongside enhancing cooperation with OTO/SOF. However, it had not grown in line with the original plan.

In particular, the environment surrounding loans for pensioners, where this bank had a strong presence, became very difficult, with intensified competition and slowdown in asset growth. Since it is a financing business, yields cannot be generated when assets lack growth. Facing this situation, the SMFG Group decided to consolidate and reorganize the overseas operation of the respective banks.

On our side, in light of our original investment objectives, we sorted out the situation and confirmed that cooperation with OTO/SOF is possible to go on without continuing the investment. And we confirmed our policy to maintain a strong relationship with the SMFG Group in the financing business, both domestically and overseas.

Moreover, we decided to proceed with cash allocation as a company and as a business unit in order to grow, and given the discipline for cash, we decided to collect what we invested and shift that cash to other areas. That's the background of the divestment.

**Q1(continued):** Let me confirm: you had previously mentioned that there are various business opportunities for BTPN utilizing the range of information including customer data held by OTO/SOF, but has that turned out to be difficult?

**Takahata:** It's not that collaboration hasn't taken place at all. However, one fact is that we are not making progress at the speed we anticipated. And one basic factor is that circumstances have changed dramatically from the time we had envisioned BTPN's organic growth.

**Q2:** I'd like to ask two questions. First, please tell us a little more about the outlook on page 9.

Since the overall progress is 76%, I feel that your overall plan is likely to be achieved in terms of figures. However, there are some segments whose performance is slightly weaker, such as the Transportation & Construction Systems business unit that you just mentioned. So, could you tell me the current outlook on which areas are likely to be stronger or weaker? This is the first question.

The second question is on Metal Products, particularly tubular products. As crude oil prices have declined considerably, has this had any impact on tubular products orders or sales? Could you tell us your recent situation felt by the sales department? Thank you very much.

**Takahata:** By segment, the Transportation & Construction Systems Business Unit has a weaker outlook against the initial plan, as I just mentioned, and the segment with stronger prospects is the Metal Products Business Units and Infrastructure Business Unit.

Regarding Metal Products, the tubular products business you just mentioned has been in a better environment than we had expected. In terms of basic profit, the tubular products business is generating about 5 billion yen a quarter, so this is stronger than we expected.

Because of the recovery of oil prices and Section 232 of the US Trade Expansion Act, tubular products prices have been rising, and we have been making a profit. However, most recently oil prices are sluggish, and actually our customers are securing some inventory ahead of time. The price of tubular products is sliding a little, so we may not be able to maintain the current pace, but we do not think it will be worsening suddenly from here. On the whole, we are likely to end this fiscal year slightly above the plan.

In the Infrastructure business, which tends to make progress as scheduled, I already mentioned that large EPC orders are concentrated in the current and next fiscal year. The progress has been very smooth, with profits turning out higher than planned. So, although we have weakness on the Transportation & Construction Systems business, the Metal Products and Infrastructure businesses are likely to cover that portion.

In the Mineral Resources business, market conditions were very favorable in the first half of the year, and results were stronger than expected. However, market conditions have weakened slightly in the second half of the year, and there are some one-off costs from nickel that we had not anticipated. So overall, the results are likely to be largely in line with the initial plan, at 320 billion.

**Q2(continued):** Thank you very much. Could you tell me a little about the Infrastructure business? It's a business that has less tendency to diverge from the plan, but do you mean that construction is making good progress, and the results are actually better than you had planned? Do you mean that the construction process is going well, but the total earnings will not change so much, so it's just going to end somewhat sooner? Or are other businesses doing well, so the overall earnings are likely to increase in light of the medium-term management plan?

**Takahata:** Basically, with EPC in power plants, we have almost full visibility of the profit at the time of receiving an order. If the project is finished as scheduled, profits will be generated according to plan. Conversely, if it is delayed, there will be a negative impact such as liquidated damage, but in any case, the total profit or loss does not tend to change very much.

Another factor is the timing of the shipment of hardware. We have already used the percentage-of-completion method and recorded the profit at installments, but currently this is proceeding earlier than expected. Therefore, we can say that we are recording the overall profit ahead of plan.

**Q3:** I would like to ask two questions. One is about Ambatovy. First of all, is the background to the impairment test, the decline in prices, or other factors? In the HPAL part, you mentioned that it is still in the process of being improved and efficiency still need to get better. I'd like to know if there are any outstanding issues.

My second question is, I'd like to ask you about how you see the coming fiscal year as a whole, what kind of fluctuations may take place, given that you have some sense of how the current fiscal year will close. If you close at 320 billion yen, how much do you see as one-off profit or loss in the fiscal year under review, and based on that, how much upside or downside do you expect?

**Takahata:** As we have significant exposure to Ambatovy, and there are also environmental changes, we conduct quarterly reviews including whether there are indications of impairment. The production plan is revised periodically, and so is the price outlook. The latest forecast by analysts has a slightly cautious outlook on medium-to long-term prices. Therefore, we re-assessed the value of the project based on the new production plan, taking into account lower prices on a medium-to long-term basis, as well as effects of the rise in the U.S. dollar interest rate. This resulted in the recognition of an impairment on a consolidated basis.

We believe the challenge is, after all, to continue stable operation. Looking back, the cyclone arrived at the beginning of last year, the plant was damaged and then repaired. We have been replacing various parts while operating the plant.

For example, in the 3Q alone, production was slightly below 70% of design. It is extremely important to stabilize the situation throughout the year at a higher level, and we are making efforts to this end.

Therefore, we have been working on various actions such as the replacement of parts, the review of processes, and making thorough preparations so that we can start-up the plant without much delay after turnarounds etc. Through the accumulation of such experiences, we will aim for overall stable operation throughout the year.

We haven't seen concrete results yet, but we are taking steps to achieve them one by one. And I believe we are doing it in the right direction.

We are currently evaluating on the assumption that we will produce approximately 46,000 tons of nickel annually over the medium to long term. We will hopefully reach and maintain this level as soon as possible. That's the situation of Ambatovy.

Regarding your second question, it is not that we already have a determined direction. We have now begun formulating budgets, setting next fiscal year's assumptions of GDP by region, exchange rates, interest rates, market conditions etc., so that the budget can be formulated at each section.

Rather than simply adding up numbers of income statements, we will review the cash flow, income statement, and balance sheet, to review our progress on investment planned in the three-year period, see what prospects we have, and determine what to do next if something is not working out.

We do not yet know how the numbers will add up.

However, our basic policy is to achieve sustainable and stable revenue growth as we have announced it externally. Therefore, we intend to aim for higher growth based on the targets for the current fiscal year. We are now working on the step before that.

**Q4:** I would like to ask you two questions.

First, I feel that there has been a succession of acquisitions and mergers in the steel business in Japan and overseas in recent years. There was the integration of the domestic tubular products business with Metal One Group, and investments in coil centers with NSSB.

What is your view on the issues related to the steel business in Japan and overseas, and what do you intend to do in the future? This is the first question.

The second question is about the overall investment budget of 300 billion yen stated in the medium-term management plan. Could you tell us what has emerged so far, if any, and what has been achieved?

**Takahata:** With regard to metal products, we are not pursuing a strategy based on mergers and acquisitions, but rather taking into account the future growth potential of each field and region, and our positioning in the industry. Where we have confidence, we will grow the business by ourselves.

Otherwise, in areas where the business needs to be maintained by improving efficiency, we are merely reorganizing our business through joint ventures with other companies. This is not because it is the metal products business, but rather because of our intent to grow in various businesses. We are acting as necessary based on changes in the macroeconomic environment, the existence of competitive peers, the situation of our partners, etc.

In terms of the 300 billion budget for the entire company, nothing large-scale has yet emerged as of the 3Q. However, as I mentioned before, among proposals discussed at the investment committee, technology x innovation and healthcare are new fields, and we are unlikely to suddenly start investing aggressively in those areas.

If a relatively large-scale investment is to be made, it may be in the social infrastructure field other than power plant and water, where we have not been working on in the past. We will consider the stability of portfolio revenues and the stability of cash flows, and there might be some developments here. The matter is being discussed internally.

In any case, we have yet to see any significant results in the 3Q.

**Q5:** Thank you very much for your explanation today. I have three questions. First, regarding the cash flow, you mentioned that “Others” of cash in amounted to negative 110 billion in the 2Q and negative 190 billion in the 3Q. I guess I don't have to worry too much since it is about real business, but given recent trends, I'd like to know the background.

And how should this look like in the 4Q, toward the end of the fiscal year?

My other question is about investment activities in the cash flow. It might be early to talk about, but as the progress of 200 billion yen still seems slightly slow for 3Q, how do you understand this slow pace? The first question is about the cash flow.

Secondly, what is happening at Fyffes in 3Q? The loss of 1.3 billion seems to be disappointed, so I'd like to know about the background to this situation.

I understand there is goodwill. Please tell us your current understanding of whether there is a need to make any changes to this. That's the second question.

Thirdly, apart from the financial results, I'd like to ask about the additional purchase of interests in thermal coal in Clermont, which was announced recently. Generally speaking, why did you decide to invest in thermal coal assets amid the adverse global trend?

**Takahata:** First of all, I think cash flow is the so-called working capital coming in and out, as I mentioned in the 1Q and 2Q briefings. When the business environment improves considerably, including for tubular products and other businesses, there tends to be a net cash outflow from inventories or account receivables.

Hopefully this will be followed by profits, but the problem is when inventory turnover is low and cash is released without generating profits.

Looking at the first half by quarter, we see that a large amount of cash went out in 1Q, in 2Q it recovered a little, and in 3Q cash is again going out. As far as the contents are concerned, the inventory turnover is not deteriorating, the revenues are not deteriorating, and I think that there is no major concern as a whole, as we are able to properly manage the positions of commodity businesses on a quarterly basis.

It's true that investment is still only 200 billion yen, which seems slow against the company-wide 1 trillion yen planned over three years. It's not our goal to fill all of this. There are a variety of projects in each field, and we are discussing cases in the investment committee or the management council. In some cases, even when we fight to win bids, we may still be defeated. In that case, we should simply move forward by reviewing our strategy, taking into account the background of our defeat.

As you mentioned, I think it is still a little too early to assess our situation, given that just three quarters of the first year have passed in our medium-term management plan.

As explained earlier, in terms of the plan for the next fiscal year and onwards, we are in the process of revising our overall cash flow plans, which will be subject to a reevaluation. So, at this point in time, we can't say anything definitive.

**Sugai:** Yes, I'll explain for the second question regarding Fyffes.

First of all, there are three causes. One is the melon market, which has been down since the previous quarter. In fact that, this is about winter melons, with no sales in summer. However, we're back to winter and prices are returning to a fairly normal state, and I think that they will rise a little going forward.

I also explained that the mushroom market was not in good condition in 2Q. We need to renovate aging equipment and some of our facilities, and we expect it will take some time for the business to recover.

The cost of shipping bananas, which is our main product, has actually increased slightly because of the increase in fuel prices. That has affected the business as well.

Altogether, the result is negative for the 3Q alone.

As a matter of course, we are currently considering how to improve the matter in light of these factors.

**Takahata:** Now about coal. In terms of the background to the purchase of Clermont, from the coal mining business, as well as, the power generation business, so-called decarbonization is progressing in faster pace, and we are acutely aware that the external changes have been more severe than we originally planned at the beginning of the fiscal year. In that sense, we intend to revise the plan as necessary.

Our current basic stance regarding coal is not to pursue new development projects, in light of the worsening of the climate change issues. However, with regard to existing projects, we intend to take up projects that will contribute to the stable supply to power plants, and if necessary, we will do so with regard to energy security and other matters.

The background to this Clermont project is that we decided to purchase this interest in a joint venture with Glencore, based on this perspective and also on the fact that it is extremely economical.

**Q5(continued):** Excuse me, please allow me to check.

Firstly, do you have an outlook on the negative 190 billion yen in "Others" of cash in for the end of the fiscal year?

**Takahata:** I don't have the accumulated numbers, but we don't have the image that it will accumulate more and more from here.

Some operations are based on the assumption that the position will be adjusted some business at the end of the fiscal year.

**Q5(continued):** Yes, I understand. Thank you very much.

And excuse me, am I correct to understand that your answer to the other question regarding investment was that, you will reconsider the overall cash allocation for the three-year period again at the beginning of the next fiscal year?

**Takahata:** It's three years, so we start with a cash flow constraint that takes into account the overall corporate situation and that of each division, and then we formulate the investments and loans plan for each division based on that discipline.

But it's three years, so there's something you have managed to do, and something you haven't been able to carry out. There are the sales of assets and replacements. And we have the ordinary cash flow, or operational cash flows that I just mentioned, and we have to consider and how we have to reallocate cash based on a review of the overall cash flow.

**Q5:** I understand. Just one more point: is it okay to not worry so much about goodwill in Fyffes?

**Sugai:** This is currently being considered.

**Q6:** The first point is about San Cristobal. The initial forecast was temporarily lowered to 16.9 billion yen, and up to the 3Q, the figures are roughly close to that.

My first point is that I would like to have an update of the current situation, including room for upside, and if possible, the production status expected for the next fiscal year.

And related to Ambatovy, I think you have a medium-to long-term price assumption for nickel. What has been the trend and what are your prospects including medium-to long-term supply-demand outlook.

**Tamura:** This is Tamura, I will answer the question of San Cristobal.

As you know, there was change in the terms of the contract in 1Q, and the profits increased. However, in 2Q, the positive aspects of the conditions disappeared, and the market also declined in the same quarter. In the revised annual forecast, the budget 18.8 billion was reduced by about 2 billion.

In the 3Q, there was temporary reduction in the cost in the quarter, resulting in a 4.3 billion yen profit on a non-consolidated basis just in the 3Q. In total, we have almost reached the revised budget.

We expect a slight decline in absence of temporary cost reduction for the 4Q, but given the current situation, we think shipments will probably proceed at the same level as what we've seen so far.

As a result, we expect that the result would slightly surpass the forecast of 16.9 billion yen and is likely to return to the level of the initial budget.

From next fiscal year and beyond, I can't say anything clear as we are currently in preparation of the budget. As I have been saying, the quality has declined slightly since peaking around the previous fiscal year. Given the gradual decline, the level of revenues is viewed to be almost flat to slightly lower.

Regarding the price of nickel, we applied the long-term price of 7.4 dollars in the impairment test this time, but this is not just because we have decided to do so. Basically, for the long-term forecast, we have rebalanced your prices based on the numbers by other analysts.

From the current price of about 6 dollars, over the next four to five years, prices are assumed to gradually rise, putting the medium-to long-term price at 7.4 dollars from 2024 onwards.

The background to supply and demand lies in EV, and other unprecedented demand that is expected to be firm in the near future. Based on this assumption, I think the current situation is declining because the increase in demand is somewhat slower than we have expected.

**Q7:** I have just one question.

I understand Mr. Takahata's answer about the additional purchase of interests in Clermont, but I would like to ask you some more details. If that is the case, will you buy more thermal coal?

For example, there is a policy about the portfolio in power plant business, such as the weight of thermal power and renewable energy. What kind of quantitative target do you have for coal?

Are you going to make it in the future? Could you give me some ideas about this?

**Takahata:** We don't have quantitative targets or KPI regarding thermal coal, such as equity share of production, to millions of tons, or reducing the amount. Like I mentioned in the case of power plant



business, we don't have specific targets likewise gradually replacing the portfolio over a period of about 20 years.

However, this does not mean that we are going to buy more and more. First of all, we are going to deal with environmental issues and decarbonization, but as a business, it is important to have a stable revenue.

We participated in Clermont, and the operator is Glencore, but we know the contents, while the mine life was short, and we saw how much of the remaining cash would come out, so there was something we were familiar with, and there happened to be this opportunity.

We have also brought it to Japanese customers, so we discussed it within the company and bought it to ensure a stable supply.

It is not necessarily the case that there are a lot of projects that show revenue potential and that operations are firmly stable, and that we should fulfill our responsibilities as a supplier in such environments. It's not that we are going to buy so aggressively.

Excuse me, but I can only explain it qualitatively.

**Q7(continued):** Was there much opposition in your internal discussions?

**Takahata:** Do you mean whether there were objections to increasing the exposure to thermal coal?

There are various opinions. From the view of investors, some said we shouldn't be involved in coal, mentioning the trends in ESG investments and turn in direction of GPIF and so on.

However, there is no doubt that coal is necessary for power generation. In Japan, 30% of power generation is still dependent on coal. In light of this, we originally had a social mission as a trading company to provide a stable supply of raw materials, and there were opinions and that we should think about it.

This is why we have not yet made a clear direction as a company. It is necessary to conduct various discussions and to carefully review the situation in light of changes in the external environment, and I recognize that there are still issues to be addressed.

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