

Question & Answer at IR Meeting on Financial Results for FY2019 Q1

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List of Questions (Question & Answer follows)

<Q1>

- As for Metal Products Business Unit, Transportation & Construction Systems Business Unit which had been in particularly poor progress in non-mineral resource areas, please tell us about the outlook for the second quarter and beyond.
- About for Nickel mining and refining business in Madagascar(Ambatovy), how do you see the forecasts if the current market conditions and the operating rate persists?

<Q2>

- What is the breakdown as there is a slight downward pressure on the car business in particular?
- What is the outlook for San Cristobal silver-zinc-lead mining project in Bolivia, as the progress seems to be slow?

<Q3>

- I wonder if Ambatovy would fall a little short of the target, which part of Mineral Resources, Energy, Chemical & Electronics Business Unit will be a factor that will lead to a slight upside in order to fill the gap?
- If Transportation & Construction Systems business unit and Metal Products Business Unit fall a little short of the plan, how do you intend to achieve the plan for the entire company? Please also tell us about the outlook for the one-off profit for the second quarter and beyond.

<Q4>

- What is the first quarter's assessment of Infrastructure Business Unit and Media & Digital Business Unit, as well as the possibility of exceeding or failing to achieve the full-year plan?
- It seems to be a little weaker in terms of progress, but does this fiscal year's dividend ultimately depend on profit? Please tell us about any change in thinking about the dividends for the next fiscal year considering the last quarter.

<Q5>

- What is going on with TBC now because it seems to be somewhat behind the improvements? Please tell us where differs from the plan.
- Regarding Ambatovy, is there a possibility that you will increase your funding to them in the future since there was a rubber lining failure?

<Q6>

- I would like to ask about the background of the sales of Sumifru Singapore and whether it was taken into consideration in the plan at the beginning of the fiscal year. Can you also tell us about the profit from the sale, if possible, and how much can you expect to earn?

<Q1(Additional)>

- What is your plan including the return for the Q-park business?

Question & Answer

Q1: I have two questions.

The first one is about Metal Products Business Unit and Transportation & Construction Systems Business Unit which had been in particularly poor progress in non-mineral resource areas. If you see some factors to catch up from Q2 onward, would you clarify on that? You said you would expect a recovery of the tubular products business from the second half of the fiscal year. Please tell us more about the background to this.

The second point is about Ambatovy. In the first quarter, the project posted a loss of 4.2 billion yen, while a one-off profit of approximately 3.0 billion yen was recorded. Does this mean that the loss was 7.2 billion yen in real terms? The current market conditions and the operating rate for the April-to-June quarter underperformed. If this continues, to what extent would the deficit expand from the deficit of 17.4 billion yen forecasted at the beginning of the period?

Takahata: As for the first question, the progress in the Metal Products and Transportation equipment businesses is not showing a good start compared with the results in the same period of the previous fiscal year and our annual plan as well. Unlike the past two years, our original plan at the beginning of the fiscal year was based on the assumption that the environment for the current period would become slightly more difficult due to the trade problem. However, I think that it was a little more severe than this assumption, and I think that the figures are speaking for themselves in general.

Metal Products Business Unit includes tubular, steel sheets and aluminum products. Of these products, steel sheets in particular are largely affected. The operation rate has been falling gradually in automotive-related business, so-called steel service centers, in China, and this is having such an impact. I think it will continue to take time to resolve the trade problem, so the operation rate of the steel service centers will not increase as easily as it would have.

In regard to the tubular products, the market was tightened by Article 232 of the US Trade Law in the first and second quarters of the previous fiscal year, and this resulted in increased prices and shipments. Now, it seems to have a reaction to that. I think the capacity of pipelines in the area of so-called Permian, which had been a bottleneck in some parts of the production of shale gas and oil, is expected to increase slightly from the second half of the fiscal year. As a result, activities are likely to increase slightly. There is a view that this will turn to profitability in the second half of the fiscal year.

In the first quarter of the fiscal year, the businesses other than the US began to recover slightly. There are some uncertainties regarding the future of oil prices. However, in the second half of the fiscal year, we expect that the environment will be better than it is today.

For Transportation & Construction Systems Business Unit, finance-related businesses are going very smoothly, and construction machinery is also going very smoothly. However automotive-related business is in a difficult environment. Recently, we have been making various efforts in relation to the manufacturing of automotive parts, but this situation has also been affected. I do not think this will be resolved as easily as possible. It is not just overall economic trends that have an effect. There are some areas where we have to put in thorough efforts, such as our new business in progress, less-than-expected production, and unsuccessful cost control. By doing so, we should have better performance amid the harsh environment.

Second, TBC was reorganized with Michelin, taking a number of steps over the last year, such as reducing the number of employees and recording costs while consolidating its wholesale business. We expect the effects to come out this year. Even though the first quarter is still losing money, we assume that the benefits of the merger will come from wholesaling, retailing, and so on in the second half of the year onward. We believe that the second half of the fiscal year will see an improvement. Overall however, the environment for automobile-related businesses is a little more severe than initially anticipated, so we recognize that downside risks remain in this area.

As for Ambatovy, your understanding on the loss of 7.2 billion is correct. Other than this point, the production volume still has not recovered in the April-to-June quarter, producing 8,500 tons, averaging below 3,000 tons per month.

Repeated temporary shutdowns caused by pipes that have been worn out remains as one of the bottleneck to the operation. In order to achieve a high-level stable operation, we intend to solve this issue by taking measures such as proactive maintenance. With other various measures taken, we continue to look to achieve stable operations and catch up with the planned 40,000 to 44,000 tons of nickel production,

Q2: I have two questions.

As you explained, there is a slight downward pressure on the car market in particular. What is the breakdown in the first quarter like? For example, in the metal business, the profit decline for automobiles at steel service centers was this much or something like that, and in the case of transportation equipment segment, a variety of businesses are involved in that, such as production and export. Could you tell us what areas of business have had a big impact on profit? This is the first one.

Second is for San Cristobal silver-zinc-lead mining project in Bolivia. Profit levels appear fairly weak compared to the annual plan. I think there are some factors here. Please tell us what factors are considered in this plan.

Takahata: The profit of Transportation & Construction Systems Business Unit is down about 3.6 billion yen year-on-year. A negative factor is almost all the production of automobiles.

This is the main point, and in the same period of the previous fiscal year, most of unfruitful business in this segment is related to the manufacture of automobiles in Mexico and the manufacture of parts. So, here is not a trade problem in the United States and China or a decline in production in China, but a difficult situation due to the unique circumstances of each business.

As I explained this a while ago, we expect the TBC merger to bring us some effects but have still not seen that in the form of figures in the first quarter. However, in the second half of this fiscal year, we expect to get back to the planned pace. This is about automobiles.

Q2: As for the metal business, almost all of the causes of profit decline come from the steel sheets segment, right?

Takahata: No. The metal business showed strong performance due to the influence of Article 232 of the US Trade Law in the first quarter of the previous year, but when the reaction was put in, the tubular products also dropped in this year. In the aggregate negative, the tubular products and the steel sheets seem to be just about half the way. This is an image of the size.

Regarding San Cristobal silver-zinc-lead mining project in Bolivia, as you have pointed out, progress in this fiscal year is a low 12% on a profit basis. However, production has been steady so far, and shipments in the second half of the first quarter have been delayed to the second quarter. The figures for the first quarter alone are extremely small. Therefore, although the progress rate seems to be low, production shipments will be in line with the plan, so looking at the whole year, there is no concern about this. Since prices are declining somewhat, the impact of this decline might be seen. Overall however, we believe that the plan will be achieved for the full fiscal year.

Q3: I have two things to ask.

For the first point, please tell us a little more about Mineral Resources, Energy, Chemical & Electronics Business Unit. You explained at the outset that the mineral resources business is proceeding largely as planned. In the meantime, from your explanation, I wonder if the Nickel mining and refining business in Madagascar would fall a little short of the target. Which part of this Business Unit will be a factor that will lead to a slight upside in order to fill this gap? As you mentioned earlier, San Cristobal silver-zinc-lead mining project in Bolivia will proceed in line with the plan. Then, in what respect do you think that the mineral resources and chemicals business would be in line with the plan?

Second, your explanation gave me an impression that the non-mineral resources business would be slightly weaker, which probably includes the Transportation & Construction Systems, and Metal Products that you explained. If these areas fall a little short of the plan, how do you intend to achieve the plan for the entire company? One-off profit has already been recorded for this first quarter. I thought this profit was not factored in for the full-year forecast, so I wonder if this unplanned temporary profit would work as a positive effect on the company's net profit plan. Please also tell us about the outlook for the second quarter and beyond.

Takahata: Excluding one-off profit, profit from the mineral resources business is now posting 6.0 billion yen against the forecast of 44.0 billion yen. On the other hand, there is one-off profit of about 10.0 billion yen in the first quarter. In terms of ordinary profit and loss, this is a so-called iron ore business, we recognize revenues in 2Q and 4Q. These are expected to generate around 20.0 billion yen in the fiscal year.

In addition, gas trading in the US is steadily emerging thanks to better-than-planned operations in mid and downstream areas rather than upstream development projects. We believe that this will continue in the future and that demand for carbon-related products and needle coke for electrodes is rising. Considering the fact that this is stronger than the plan, I think that we are on track with the plan as a whole. That's the mineral resources situation.

In addition, in terms of the questions about how we achieve the targets if the metal business and transportation equipment business continue to experience a harsh situation centered on automobile-related area and how long downward pressure will last, we are still not able to come up with the figures. We are not going to make P/L from short-term perspective. Rather, we intend to change the various types of assets we hold to cash at the right time and reinvest them with the cash. For example, we have been doing real estate business for some time, but we are doing renewable investment in infrastructure as well. As planned, this first quarter also recognizes some of its profits, and we will continue to see so-called asset turnover.

At the budget stage, the timing and amount of each individual business are often uncertain, so it is difficult to tell how much one-off profit will be recorded for each of them. As a whole, it is included in each segment in the ordinary profit and loss. Some amount was actually recognized in the first quarter, and even after the second quarter, in addition to the collection of cash from such asset turnover, capital gains are expected. If some of them are certain and if we add them up, we can make up some of the downside in metal or transportation equipment businesses.

However, the timing and the amount of such temporary asset sales will vary, so we cannot be sure until such sales materialize. As for the outlook, I would like to see you think that such things are considered in the original plan.

Q3: In short, some of the temporary things that now occur in the operating segments are to some extent incorporated into the plans, right?

Takahata: That's right.

Q3: Was the temporary profit of 10 billion yen, which was 7.0 billion yen and 3.0 billion yen that came out from mineral resources in the first quarter, originally taken into account?

Takahata: We had already assumed the 7.0 billion yen due to the reorganization of the domestic LPG business. However, 3.0 billion yen from Ambatovy was not originally taken into consideration. As a result of the steady progress in the refund of the VATs, the revaluation of VAT's receivables resulted in a partial reversal of the reserve in a certain sense, which is completely transitory.

Q4: I have two questions.

First, what are the first quarter's assessment of Infrastructure Business Unit and Media & Digital Business Unit, the reasons behind the increase and decrease in profits, as well as the possibility of exceeding or failing to achieve the full-year plan?

Another point is that, it seems to be a little weaker in terms of progress, but does this fiscal year's dividend ultimately depend on profit? Since the beginning of the fiscal year, we have been interested in whether the dividend could decline if profits do not grow and the commemorative dividend disappears in the next fiscal year. But I feel that if the trend continues, we need to be vigorously aware of the risk of a decline in dividends for the next fiscal year. Please tell us about any progress in the last quarter.

Takahata: First, as for Infrastructure Business Unit, we are going very well against the plan, and both EPC business and IPP businesses are going well in line with the plan. Some asset replacement I mentioned earlier is proceeding as planned, and we expect to proceed as planned in the future. As a whole, I think that we will be in line with the plan.

The rate of achievement for Media & Digital Business Unit is 19%, which is slightly lower. However, our affiliated company SCSK is very good, and the number of orders received is increasing. There is no particular concern about this, as its profit tends to rise in the second half of the year. J:COM's profit seems to have declined slightly year-on-year. However, this is not a cause for concern, as depreciation expenses are being incurred in advance due to the current aggressive capital investment for the future. I think Infrastructure, Media & Digital, Living & Real Estate, which are categorized into non-mineral resources, are going very smoothly.

Q4: Is the situation in line with the plan? Should I expect it to exceed the plan?

Takahata: According to individual figures, it is difficult to evaluate the plan as a result of the end of the first quarter. When looking at the overall business environment, the situation is changing dramatically in the

automobile-related business from when the budget was made. This seems to be a trend. Otherwise, there has been no significant change in the business environment, and we believe that we are in line with our plans at this moment.

Regarding dividends, we are doing well as a whole even though there are downside risks. This means that we will continue to aim to achieve 340.0 billion yen, and we believe that this is still possible. It is not that we are thinking of what to do with a dividend in case of failing to achieve 340.0 billion yen. We will work to achieve the target of 340.0 billion yen.

As we always said, we will decide the dividend amount in view of the situations regarding cash flow, with a consolidated payout ratio of 30% as a guideline. At present, although operating income has declined slightly in some of our business, the recovery of dividends from investments accounted for the equity-method has been extremely smooth in line with the plan. The generation of total cash will probably continue as planned, so there will not be any problem in terms of cash flows.

Q4: I think dividends from investments accounted for the equity-method, which were mentioned earlier, have increased by about 10.0 billion year-on-year. Is this the result of your initiatives?

Takahata: There is no specific reason, but we intend to collect as much cash as possible as a whole. I believe that principle of steady collection is gradually spreading.

Q5: I have two questions.

The first question is about TBC. What is going on with TBC now because it seems to be somewhat behind the improvements that I have heard before? Please tell us where differs from the plan. This is the first point.

The second question is related to Ambatovy. There is a possibility that investment could increase in the future because of the pipe wear issue previously mentioned. On the other hand, since the operator Sherritt has refused to answer any cash call, how do you see your exposure to the project increasing in the future.

Takahata: Let me first mention Ambatovy. As a sponsor, we have decided on a framework for financing this business in a stable manner. We and KORES are proceeding with this process by providing funds according to investment ratio.

With the additional funds, we are planning to fully manage the additional Capex, such as replacing pipes to stabilize operations. We will provide financial support together with KORES.

Q5: I think you have contributed less than 10.0 billion yen annually, but if possible, please tell us specifically how much that would be.

Takahata: It is not the premise of such an extreme increase. I think it is about the same as before. If operations gradually stabilize thereafter, additional funds will disappear.

Yamane: Let me answer about TBC. First, TBC business is roughly divided into wholesale, retail, and franchise. It is the wholesale business that was merged with Michelin. As Takahata explained earlier, integration effect has not been seen in the first quarter of the fiscal year. In addition, there are still some costs associated with the integration in the first quarter. It should turn to positive in the long run, but in the first quarter, we still have not realized profitability due to the integration cost and have not seen any benefit.

Although we would like to see more growth in retail and franchise, the number of customers is still not increasing as much. However, as the environment is gradually improving, the number of customers is increasing, and we believe that the environment will recover considerably in the second quarter and the second half of the fiscal year from now on.

Q6: I would like to ask you one question.

It's about the sale of Sumifru Singapore. I would like to ask about its background and whether it was taken into consideration in the plan at the beginning of the fiscal year. Can you also tell us about the profit from the sale, if possible, and how much can you expect to earn?

Takahata: Yes. It's a long-running business where we're 49% and our partners 51%, and we have worked together to increase the value of Sumifru. We have worked together to increase its value, not only in Japan but also in Asia. However, we have seen some gaps between the partner and ourselves regarding the strategy, direction of business. We have been discussing the best thing for Sumifru over the long term, and ultimately, we have decided to quit and transfer the business to our partner. We thought it would be better for Sumifru to take steps for its growth strategy. That is the background behind the sale.

We still have a confidentiality obligation under the contract, so I cannot tell you the concrete amount of the sale.

Q6: Was this sale included in the initial plan?

Takahata: Not included at the beginning of the fiscal year.

Q1(Additional): Let me just ask one thing.

Taking this opportunity, I would like to ask you about the Q-Park business. In addition, as there is such a sense of uncertainty in macro economy, attention should be paid to how much returns will be generated in such an investment. As an investment, I believe that this investment makes up the majority of the investment in Transportation & Construction Systems Business Unit of 53.0 billion yen in the first quarter. When do you think we can confirm this return?

Takahata: The original intention is not to keep the parking lot long enough to increase the size of the parking lot but to make the so-called mobility as a service by adding new services to the parking lot platform. In a sense, we will conduct a demonstration test of this, and at present, we are working hard to determine whether it is the maintenance of automobiles, where to charge for EVs, or whether we will share car-sharing services that we have begun rolling out in Stockholm, or what sort of menu will allow us to add on such services. Therefore, it will take a little more time until it bears fruit.

Yamane: As for profit level, we may not be able to make much during the period of the current medium-term plan. However, we are planning to achieve EBITDA of more than 30 million euros by around 2022.

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