

## **Question & Answer at IR Meeting on Financial Results for FY2019 Q3**

<b>[Date]</b>	<b>Feb 7, 2020</b>	
<b>[Presenters]</b>	<b>Koichi Takahata</b>	<b>Representative Director, Executive Vice President, Chief Financial Officer</b>
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	<b>Masahiro Yamane</b>	<b>General Manager, Investor Relations Department</b>

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

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#### **<Q1>**

- Please tell us what are situations for each business of Metal Products BU and Transportation & Construction Systems BU which are struggling under the current performance.
- Please tell us about the dividend payment policy, specifically whether you have intention not to changing the “performance-linked” payout or flexibly adjust the payout ratio and maintain the current DPS for next fiscal year?

#### **<Q2>**

- Please update us on the production status of Nickel mining and refining business in Madagascar (Ambatovy Project) for next fiscal year as the full year forecast is revised downward for this year.
- Please tell us about the potential growth driver for next fiscal year. Please also share us the reason why TBC or Fyffes are not improving its performance.

#### **<Q3>**

- I understand that the Ambatovy project will improve its production in Q4 after undergoing the recent repair works. What was difference in the recent repair compared to ones in the past?
- I understand that regarding the policy on the thermal coal mining business, your company states that “we limit our equity share coal production to our current levels, and desist from new mine development” on your current policy on the climate change and not mentioning on its reduction. Can we understand that it is not “to reduce” but “to maintain” its production level?

#### **<Q4>**

- Regarding Transportation & Construction Systems BU, please tell us about the factors for improving the financial figures from Q2 to Q3? Also, please tell us what would be the exposure and the financial impact from the ongoing coronavirus issue.
- Please tell us how the performance will evolve next fiscal year for Infrastructure BU including increase/decrease factors for next fiscal year as it seems that performance of Q2 was its peak.
- Please tell us what would be the plan for asset replacement next fiscal year.

#### **<Q5>**

- Regarding fruits distribution business (Fyffes), please tell us the current status and actions. Please also tell us whether we can expect to have certain profit level from this business next fiscal year.
- Regarding your shareholders’ return policy, please tell us whether there is a possibility of changing the balance among each component, such as reducing the amount for investment or changing direction on having higher credit rating, as it seems that the situation is severe for achieving the revised target.

<Q1(additional)>

- Regarding Food and Agriculture Business, what is the position of this business among management members?

## Question & Answer

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<Q1>

**Questioner:** I have two questions.

My first question is about the Metal Products and Transportation & Construction Systems BUs, where performance has continued to be sluggish this fiscal year. I would like to know more about each business group included in these two segments—for example, the tubular products, steel sheets, and automotive businesses. From what I see in Q3 results, I do not see signs of the bottom deepening or the momentum deteriorating significantly from Q2 to Q3. Do you think each business has bottomed? In other words, do you think they will continue to hover at low levels, or do you see brighter prospects in the future? Please give us an idea of the momentum in each business group.

My second question is about your thoughts on dividends. Since announcing the downward revision on dividend three months ago, I assume many discussions have taken place internally. I am well aware that it is difficult to estimate next year's earnings at this point, but please talk a little more about your approach. Will you stick to a performance-linked dividend policy? Or, do you want to maintain the same level of dividends as this fiscal year, with the intention to flexibly adapt the dividend policy? Please tell us about your thoughts right now.

**Takahata:** Thank you. First, as for your question about the Metal Products and Transportation & Construction Systems BUs, the operating environment of these two businesses has changed considerably since around the end of Q1, compared to the situation when we announced the initial plan. That was the main reason we revised our Companywide forecast to JPY300 billion from JPY340.0 billion. For example, in terms of the Metal Products BU, we initially expected supply-demand for US tubular products business to recover from around the second half after the oil price stabilizes at a certain level. But the recovery has been slower than we anticipated. Thus, we do not yet see sign for recovery.

Oil prices have remained low and stable, or rather, they have been fluctuating in an extremely unstable manner at low levels, so demand has been slow to recover. Pipe manufacturers in the US are working hard to raise pipe prices, but they haven't made much progress, so we expect the recovery to take longer than we initially expected. Conditions in the pipe business will probably not worsen further, but we do not see prospects for a recovery in the near term.

That said, we already know the numbers for exports from Japan other than to the US, such as to the Middle East and Europe, to a certain extent, and these numbers do not indicate that the overall trend is headed toward a deeper bottom. But, we also do not see signs of an upward trend toward recovery.

The steel sheets business has been affected by the overall sluggish trend for automotive manufacturing centered on China. In addition, although we cannot grasp the quantitative impact at this point, the recent coronavirus issues are emerging. Thus, we do not see prospects for a recovery in automotive manufacturing,

mainly in China, and correspondingly the manufacturing of parts and our steel service centers. These areas will probably remain sluggish for some time.

That said, we have been taking measures, such as restructuring our business, and we intend to continue to do what we can. In particular, for the manufacturing of automotive parts in relation to the Transportation & Construction System business, we intend to take continuous measures such as cost reductions and business structure reinforcement.

However, our understanding is that the tough conditions since the start of the fiscal year, particularly related to automotive manufacturing and OCTGs in the US, are still under sluggish situation.

As for other Transportation & Construction Systems business, the overall performance has been steady in the financing business thus far. Performance has also been steady so far in the construction equipment business, although prospects are still uncertain, mainly in China. Thus, we think performance in these businesses will be in line with the plan.

**Questioner:** How about the automotive business?

**Takahata:** One point to note is that SUV manufacturing and shipments have finally started at automobile assembly business in Mexico, so earnings have somewhat recovered from Q2 to Q3. These SUVs will start its sales to the US market from around January, so this is a positive factor, although we will need to watch if operations continue stably.

That said, when looking at each business, the situation of the TBC tire business is the same as what we have explained in the past. The initial struggle resulting from the merger with secondary wholesaler Michelin has continued. It is thus difficult to expect the merger benefits in the current fiscal year, and these benefits have been pushed back to the next fiscal year.

Regarding our dividend policy, we have continued to hold discussions about dividends, and we have subsequently had many discussions with you as well. But we do not intend to reach a decision without through discussion. As we stated during the briefing meeting for Q2 and on other occasions, our basic policy is unchanged: We will aim for stable profit growth over the medium to long term, and we will return those profits to shareholders by adjusting dividends.

However, we have been reminded that our business model as a trading company is extremely susceptible to macroeconomic developments overall, as in the current situation over the near term. Management members are continuously discussing ways to stabilize the amount of dividends, while absorbing those fluctuations to a certain extent. Discussions are also taking place in board of directors' meetings including outside directors.

We haven't reached the point of telling you our concrete measures at this point. We still need to assess the business environment, financial figures, and investments and loans as we head into the next fiscal year. In particular, the next fiscal year is the final year of our three-year medium-term management plan. We are now at a stage of discussing what kind of returns can be considered as a wrap-up of the medium-term management plan as we head into the end of this fiscal year.

<Q2>

**Questioner:** I have two questions.

My first question is about Ambatovy. Ambatovy revised down its earnings forecast, including the price and production plan. Ambatovy's Q4 losses will be JPY7.5 billion, and it is expected the losses will increase

significantly. Meanwhile, you mentioned the latest production levels have improved. What will be the production level in Q4, and will the production level improve further heading into the next fiscal year? Please update us on the current situation.

My second question is about your outlook on the next fiscal year. I understand you wouldn't know about the next fiscal year until later. But, based on what I see, I get the overall impression that the conditions are tough. As discussed many times at briefing meetings and other occasions, contributions from Tanjung Jati B will drop out of the infrastructure EPC business. Also, in the real estate business, earnings have been recorded in the current fiscal year, but profits with cash flow will drop out next year. What are the drivers for higher profits heading into the next fiscal year?

**Takahata:** We have summarized the overview of the nickel operations on page 16 of the presentation.

There were various struggles until December 2019. In particular, production stopped for three weeks due to a planned maintenance in November. As we experienced some issues restarting the plant, production was limited to 26,000 metric tons in the first nine months of the financial year. The annual production target for this financial year is 37,000 metric tons which will give us slightly more than 10,000 metric tons to be produced in the remaining three months. In January alone, production was near 4,000 metric tons. Although we understand there are still other issues to be dealt with, we will continue to focus on achieving this production level consistently at the earliest, to produce 50,000 metric tons per year of nickel as described in our slide.

**Questioner:** Then, based on the current price level, there is still a possibility that the profit level in Q4 will continue, correct?

**Takahata:** We estimate a production of around 10,000 metric tons in Q4. Therefore, if production increases more than that, loss will begin to shrink gradually.

Regarding growth driver, it is difficult to talk about the next fiscal year at this point. We have not done any large investments in this fiscal year that will contribute to earnings from the next fiscal year. As we have been mentioned before, continual efforts will be made to raise the value of not only the nickel business, which is one of the challenges of the medium-term management plan, but also the value of other existing businesses as much as possible. Verifications will be made on the degree of the cumulative effects of these efforts on each business.

As for the bigger picture, as stated before, it is certain that we have reached a turning point in our business model. While we raise the value of existing businesses, some businesses will decline unexpectedly. We will compensate for this by planting new seeds. The original picture was to deliver earnings growth in stages during the current medium-term management plan by doing so strategically. But, the transition has been slightly slower than anticipated, partly because of the tougher business environment. Not everything can be blamed on the environment, and there have indeed been delays in the transition and value enhancement of existing businesses. Decisions will be made going forward concerning the impact of these factors on the initial plan.

**Questioner:** Why do you think improvements have been slow at assets such as TBC and Fyffes? Is it because of the tough business environment that you can't do anything about them?

**Takahata:** No, the business environment is not the only reason. Measures were taken to realize the vision when merging TBC and Michelin. For example, the merger of secondary wholesale operations requires the integration of extremely large warehouses all at once. Some scrapping costs have been booked in advance, but the integration process has not gone smoothly. The difficulty in system integration has resulted in costs being incurred, without positive factors taking shape to offset those costs. It can't be helped if some people were to say that we haven't made enough efforts. But, we know what we need to do, and we will carry them out steadily. Therefore, the business environment is not the reason for the slow improvement.

As for Fyffes, we have countered the impact of falling prices in the current fiscal year by controlling transportation costs and bunker fuel using the volume of banana shipments, and we have been fairly successful. Also, in terms of mushrooms, measures have been taken to improve production, but their effects will not emerge until the next season, so we are still in a transitional period.

Everything will probably sound like an excuse without specific numbers. But, we want you to understand that we are not blaming external factors, and we have taken the necessary measures, so we believe we will be able to show you the results eventually.

<Q3>

**Questioner:** Thank you for your explanation. Also, thank you for enhancing the information disclosure for the Infrastructure BU from this quarter, namely the equity in earnings of overseas IPP/WIPP business. It was very helpful.

I have two questions. My first question is about Ambatovy. I believe the assumption is that production will be around 11,000 metric tons in Q4. I understand production will improve considering the planned maintenance, but can you explain what specifically improved? Maintenance and repairs have also been done in the past, but not all of them led to improvements, and therefore would appreciate if you can explain more on what was different this time around.

My other question is about your holding policy for thermal coal interests. Last year, your company announced a policy that the company will not invest to new mining project related to thermal coal and limiting the equity share coal production to the current level. On the other hand, your company did not mention about the reductions. I'm sure you are in the midst of strengthening your ESG measures. Why, then, haven't you announced reductions? Should we understand that your direction is to maintain the current level? Please explain a little more about this point.

**Takahata:** In terms of the nickel business, maintenance and repair works have long been conducted to counter problems. The environment of this operation is exposed to strong acid and extremely high temperatures and pressure. Therefore, some pipes have corroded throughout the years. Rather than replacing the pipe immediately, we decided to replace these pipes with higher-quality pipes in two stages last year and in November we completed replacements of pipes within the high priority area.

Also, the mindset of local team toward maintenance has changed. They are now focusing on minimizing problems by assuming what would happen in advance based on past experiences, rather than troubleshooting after the problem occurs. This mindset is gradually spreading among local employees, and along with the maintenance/repair works we have been doing, they have helped increase the stability of operations. Although we are still at a transitioning stage, I hope this explanation gives you an idea of which direction we are heading.

**Questioner:** Please tell us when you think the production target of 50,000 metric tons can be achieved, if you have any idea.

**Takahata:** We cannot answer it specifically at this point, but roughly speaking, a production level of 50,000 metric tons a year equates to the continual production of 4,000 metric tons a month. In January, we were already near that level. So, the rest depends on how long we can maintain that level.

As for thermal coal, our approach has been reviewed from time to time based on the external situation. Active discussion is taking place internally regarding the policy, including at the board of directors' meetings. We

decided that we would not undertake new developments of thermal coal and we would not exceed the volume we possessed at that time after a lot of discussions in the first half of last year. But there are still discussions about how to understand our obligation or responsibility toward customers to supply thermal coal.

The reason why we have provided a stable supply of thermal coal over the medium to long term has stemmed from our responsibility as a company to continue to supply thermal coal to customers. In other words, we believe we should keep the option of sustaining supply by purchasing existing mines to offset decreases in production, insofar as we do not exceed the volume that we possessed at that time. And it was last year that we disclosed this policy. But the social environment has changed significantly since that time, so reviewing the policy based on those changes is a topic that we have begun to discuss once again internally.

<Q4>

**Questioner:** I have two questions.

My first question is about the Transportation & Construction Systems BU.

When looking at profit for the period, profit in the Transportation & Construction Systems BU was JPY11.7 billion in Q1, JPY9.8 billion in Q2, and JPY13.2 billion in Q3. It seems that the profit level has improved slightly from Q2 to Q3. Could you give us a breakdown of this improvement by business area, including automotive, construction equipment, ship, aircraft, and leasing? That said, the current profit level seems slightly far from the profit for the full-year in the Transportation & Construction Systems BU.

**Takahata:** The main reason for this improvement is automobile assembly business in Mexico where the production and shipments of CX-30 after a model change have begun. This is the main source of improvement.

**Questioner** So, does that mean automobile assembly business in Mexico accounts for most of the improvement, and the other businesses have not changed much?

**Takahata:** The non-automotive businesses have not fluctuated much from Q2 to Q3.

**Yamane:** The construction equipment and leasing businesses have also improved slightly. On a quarterly comparison basis, the construction equipment and leasing businesses have both increased.

**Questioner:** So, this means that profits in the construction equipment and leasing businesses have both increased in Q3, but the majority of the contribution came from the automotive business, the main source of which is automobile assembly business in Mexico, correct?

**Takahata:** Yes, that is correct. That would be the reason for the changes from Q2 to Q3.

**Questioner:** Could you also tell us your views on the full-year results for Transportation & Construction Systems BU, as well as the exposure to the coronavirus?

**Takahata:** I think it is undeniable that the progress toward the full-year forecast is somewhat weak. I don't think that the business environment warrants expectations that results would significantly improve at this stage. Although we have made efforts in the manufacturing of automotive parts, which performed poorly, the business environment deteriorating performance has not changed. Numerically speaking, we are only at 61% of the revised full-year target of JPY57 billion in this segment. If we were to be asked how certain we are about clearing this target, we would have to say that it is slightly weak.

Although we cannot share the details yet, we expect that there will be one-off profits that would be booked in this segment in Q4 attributable to factors such as the replacement of assets. Therefore, we would have to see how the profits would turn out after these one-off profits emerge.

**Questioner:** As for the exposure to coronavirus, for example, do you have any factories located near Wuhan?

**Takahata:** What worries me the most is the presence of production operations of Japanese car manufacturers in China, and the implications on their operations if the current situation persists. For example, there are steel service centers, automotive parts-related businesses, and businesses that deliver plastic parts in China. However, on the flip side, you would also be able to say that the impact would be insignificant because if you look at our Chinese businesses alone, they only amount to about 2% of both our total profits and assets. At the same time, it should not be forgotten that value chains are now interconnected globally. Thus, if a part of this value chain were to be suspended over a prolonged period, the impact could turn out to be slightly larger than the amount suggested by the profits and assets generated from Chinese businesses alone. That said, we are still not at the stage where we would be able to verify the impact quantitatively.

**Questioner:** My second question is about the Infrastructure BU. Profit in the Infrastructure BU, excluding one-off profits and losses, roughly equate to JPY14 billion in Q1, JPY17 billion in Q2, and JPY14 billion in Q3. I assume that the reason why profit peaked in Q2 partly reflects the dropout of contributions from EPC construction, and I expect profit to peak out and start to decline gradually. What are your views on the changes that will take place going forward? Could you tell us a little more about the factors that would raise or lower profit in the Infrastructure BU in the next fiscal year?

**Takahata:** I believe we also received a question about this at the time of Q2 earnings results. As you have pointed out, construction of existing EPC projects for power plants have already peaked in Q2, and they will gradually head down from here.

As projects that would cover the decline in those projects, we have been working on various renewable infrastructures, such as offshore wind projects in Japan and Europe. We have received orders for projects in the Middle East. However, the earnings contributions from those new projects will probably come with a time lag compared to the decline attributable to the power plant projects.

**Questioner:** I am not sure if this is related to the Infrastructure segment, but you forecast JPY23 billion over the full-year for one-off profits. Do you already have a list of assets that you plan to sell so that you could reach the same level of one-off profits in the next fiscal year? Could you tell us a little more about this?

**Takahata:** No, we do not control the net profit line by determining what to sell or keep over the medium to long term. That would be very difficult to do. For example, our approach to real estate and infrastructure is not one in which we would purchase assets and continue to hold them over the long term. We have already started to create an investment recoupment cycle, where we would sell these assets to investors and others and recover them as cash so that the additional cash would then be allocated to the next investments. There would probably be a few real estate and infrastructure assets that are sold every fiscal year, but it is not the case where these gains on sale would be recorded uniformly every fiscal year. The amount of gains would vary depending on the size of the assets, so I do not think that this is something that can be controlled.

<Q5>

**Questioner:** I have two questions.

My first question is about Fyffes. When looking at the results for Q3 alone, I believe that profits were in the red. Could you tell us a little more about what kind of measures you are taking, the current situation of the business, as well as whether we can expect a certain profit level, for instance, in the next fiscal year? Also, please explain whether those initiatives taken right now will start having an impact during the next fiscal year.

My other question is about dividends. When looking at the situation from outside, it appears that the Company is struggling to generate profits. Therefore, my understanding is that the Company is being careful about the balance sheet and credit rating under a challenging situation where profits have been flat or slightly worse than the forecast.

In that case, I get the impression that even though you will do your best to return profits to shareholders, you would be constrained by other factors. For example, have you shifted to a policy where you are prepared to cut back on investments outlined in the medium-term management plan by a significant amount, or will you no longer be persistent about maintaining your credit rating? Please tell us if there have been any changes in the balance between those factors.

**Takahata:** I will start by answering the second question. Our management policy is to ensure medium-to-long-term stability, and our foremost priority is to raise the quality of the company. Although we are currently in a situation where earnings have fallen compared to the plan during the current fiscal year, due to sudden changes in the business environment, it does not mean that we would give up on trying to raise our credit rating. We intend to prepare for the next phase of the company by raising the rating wherever possible as early as possible, while properly managing the overall allocation. Therefore, it is not the case that we have changed the essential part of our policy.

Also, in terms of the next fiscal year, it will be decided based on the figures for earnings and investment plan which we will soon be aggregating. For the current fiscal year, we think that we would manage to distribute dividends and break-even in cash flows. After that, we would have to determine how we would ultimately allocate cash after assessing the expected investment and asset replacement, as well as the earnings and cash flow situation in the next fiscal year. I believe that we sufficiently possess the ability to pay back the JPY200 billion in debt, so the question would be what kind of steps would be taken in addition to that. This is something that we will determine after looking at the numbers.

Therefore, in essence, we have not decided on significantly changing our approach toward financial soundness, and we also do not intend to tighten our investments all at once. I'm sure there will be various areas that require minor adjustments, especially because the business environment is tough, but I think ensuring that financial soundness is well within our reach.

**Sugai:** Regarding Fyffes, to put it simply, the losses in Q3 were due to seasonality. First, the melons are winter melons shipped to North America, so they only contribute to earnings in the winter. Also, for bananas, there are seasonal factors such as bananas not being consumed in spring or summer. So, it is only by chance that the results have dropped in Q3. Of course, that would conversely mean that we have generated the expected profits in Q1, and we also expect to generate the expected profits in Q4. Therefore, I would like you to understand that the results in Q3 were due to seasonal factors.

**Questioner:** So, for Fyffes, could you tell us if any measures are being taken right now that will improve results in the next year, given that the figure for Q3 is in line with expectations?

**Sugai:** I believe we have been explaining from before that the mushroom business has been struggling. We have been taking steps to revamp this business, such as renewing equipment and securing personnel. Although it may actually take a little more time, we are now taking measures so that profit contributions would properly begin to emerge around the second half of next year.



Also, we have taken steady measures for the banana business as well since the time of our initial acquisition, such as linking the production sites to sales and optimization of logistics. I think these will begin to contribute to earnings gradually.

**<Q1 (additional)>**

**Morimoto:** I want to take this opportunity to ask you one more question. My question is about the food business in the Living Related & Real Estate BU. What kind of position does the food business occupy in the minds of the management team? Please tell us if there has been any discussion about this business.

**Takahata:** We have never possessed any large assets in the food business since the past, so we have tried to narrow down the areas where we conduct business from several years ago, such as fresh produce or meat, given the diversification of such products. Also, we have been working to concentrate all the businesses related to domestic distribution at SC Foods, and SC Foods has started to generate a certain degree of profits.

Another point to note is there are businesses that have pulled down profits. Internally, we have made some progress in discerning which businesses to keep and which to dispose of, so a decent amount of profits should emerge from the domestic operations at SC Food and fresh produce business as long as we properly execute this process. Thus, we aim to narrow down the business areas without broadening them too much and keep the businesses where we can put up a fight so that we can steadily generate profits in those areas. We are thus making efforts in this direction.

[END]