Question & Answer at IR Meeting on Financial Results for FY2020 Q4

[Date] **May 7, 2021**

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List of Questions (Detailed Question & Answer follows)

<Q1>

・As to shareholder return, it is added “maintaining at least JPY70 per share.” Can it be taken in the same sense as the so-called minimum dividend? If the business environment become worse than expected, is there a possibility of reducing the amount of shareholder return?

・As to the results of structural reform, about JPY70 billion of profit improvement effect is expected. In what kind of business and in which fiscal year we can expect the effect during the period of this new medium-term management plan? Also, where do you factor in the costs associated with withdrawal? Will these costs be completed in FY2021?

<Q2>

・As part of one-off losses in FY2020, will there be additional losses if EPC projects further delay?

・Metal Products segment had originally produced JPY30 billion or JPY40 billion. Even when the environment returns to normal to some extent, should we understand that the profitability will decrease to the level of JPY20 billion or so as the cruising speed?

<Q3>

・What is the impact of COVID-19 pandemic out of the results of JPY350 billion one-off loss in FY2020? How the profit increases once these negative impacts disappear in FY2021?

・Having one-off losses in FY2020, how the future profit improvement and cost reduction are incorporated in the FY2021 forecast? How much is the exposures for specialty steel business in India, businesses in Myanmar, and Northern Europe parking operator business?

<Q4>

・How much profit contribution is expected as a result of JPY920 billion of investment and loans carried out during “Medium-Term Management Plan 2020”?

・In Transportation and Construction Systems segment, large profit increase is planned in FY2021 for and FY2022 plan excluding one-off profits. In what specific businesses do you expect the profit increase?

・In Transportation and Construction Systems segment, which business will contribute to large profit increase from FY2021 to FY2022?

Question & Answer

<Q1>
Questioner 1: Please confirm the concept of shareholder return on page 10. The phrase “maintaining at least JPY70 per share” is added this time to the phrases from the previous medium-term management plan. Can it be taken in the same sense as the so-called minimum dividend?

If the business environment become worse than expected, is there a possibility of reducing the amount of JPY260 billion which is planned over the next 3 years? I would like to know about your priorities for capital allocation, taking into account the possibility of future changes in business environment.

Shiomi: As to the dividend plan, the phrase “maintaining at least JPY70 per share” is used. We do not use the term “minimum dividend”, however, for the period of the new medium-term management plan, it can be understood as the “minimum dividend” in a practical sense.

The Company's basic policy remains the same which is to pay stable dividends over the long term and to increase the amount of dividends through profit growth. In this context, in cases our financial structure is exposed to a very dangerous situation, where financial soundness is deteriorated and the balance between core risk-weighted assets and core risk buffer is significantly reversed by deterioration of our capital, in case we fall into a business environment that causes a great deal of stress, we do not prioritize the return of profits to shareholders.

The consolidated dividend payout ratio of the previous medium-term management plan was approximately 30%. We have not changed this and we are determined to make every effort to bring it to a profit level that is same as FY2018 and FY2019.

The plan that I have just presented is for JPY230 billion (FY2021), JPY260 billion (FY2022) and JPY300 billion or more (FY2023). These figures are based on full consideration of the uncertainty of the future business environment. In a sense, I hope you can understand that we have incorporated our management will into this shareholder return policy of “maintaining at least JPY70 per share”.

Questioner 1: As to the results of structural reform on page 8, profit improvement effect is about JPY70 billion. In what kind of business and in which fiscal year we can expect the effect during the period of this new medium-term management plan?

Also, you are planning to withdraw from 69 companies going forward, where do you factor in the costs associated with this withdrawal? There is around JPY23 billion of loss in Corporate and Eliminations excluding one-off profits/losses for FY2021 and FY2022 which is larger than usual. Is this loss related to the withdrawal costs?

Yoshida: For the details of this JPY70 billion, please see the page 9, as you can see the main increasing factors in the box of dotted lines in the waterfall chart, the profit plan incorporates the effects in each fiscal year and in each business.

On the other hand, as for the withdrawal cost, in page 22 onward, there are series of summary of business results by segment. For example, in the Metal Products segment, we expect one-off loss of approx. JPY2 billion, and JPY12 billion of structural reform cost is included for the Transportation and Construction Systems segment in FY2021.

Questioner 1: Is it correct to say that these costs associated with the withdrawal of these 69 companies will be completed in FY2021? Also, how much of the JPY70 billion in profit improvement effect you expect to see in the major businesses?

Yoshida: As to the schedule for withdrawal, we are currently working on a schedule to complete the project within 2-3 years. The effect of JPY70 billion will come out in a wide range of businesses.

Yamane: Ambatovy is one of our major turnaround projects, so if you were to ask us in which company the effect will come out, I think Ambatovy would be the biggest one.

<Q2>

Questioner 2: As to the losses from the EPC delays and so on, can we see that the loss will not be added this year? Now that the mutant strains of COVID-19 have come out, I think there is talk of a lockdown in many places in the region. Although we understand that these are EPC projects, the amount of money is extremely large, could you give us supplemental explanation?

Yoshida: The EPC project has incurred a very large loss, and we apologize for the concern. Each of EPC projects has its own scheduled construction period, and the peak of the projects is just around the corner. Generally speaking, we have to build a power plant using a combination of boilers, turbines, and so on. Therefore, when we reach the end of the project, we need to produce the output firmly by making adjustment of these things.

In this situation, the construction had to be stopped because of the COVID 19 pandemic. There is also the cost of stopping the project and restarting it after it has been stopped, which is happening in the multiple projects at the same time. In addition, some of the projects have been experiencing technical problems and it is taking some time for resumption. As for the further losses in the future, we do not expect the loss in FY2021 to be as large as that of FY2020. Now that the construction work has resumed. We are going to focus on solving the problem on the operation site, and are planning to finish most of the projects in FY2021 and FY2022, so we will focus on completing them as scheduled.

Questioner 2: Other company doesn’t seem to have this much of loss, can we consider the loss has occurred with conservative assumption?

Yoshida: We think the fact that there are many projects ongoing simultaneously is one peculiarity. As for the EPC work, it is difficult to make a side-by-side comparison because each design is based on its own location, combination of machines, and other factors. There are some difficult situations in some projects, however, we will make sure to prevent further losses.

Questioner 2: Metal Products segment had originally booked the profit of JPY30 billion or JPY40 billion. The profit excluding one-off losses is recovering, but your plan for FY2021 is about JPY13 billion, and the plan for FY2022 is about JPY21 billion. You mentioned earlier that the business model change in the inventory business in the North America need to be happened. Is it correct understanding that even when the environment returns to normal to some extent, that the profitability will decrease because of the lack of risk taking, and the JPY20 billion or so will be the cruising speed?

Shiomi: In the Metal Products segment, the inventory was considerably reduced in the tubular products business in North America. In addition, structural reform has been promoted in the business. And as you know, the shale gas/oil rig count has recovered to the low 400s, but it is still far from the 1,000-plus rig count that it used to be. Partly because it is fossil fuels, based on the current rig count level, we are not planning to have profit from the tubular products business as it used to be in the past, after completing structural reform in North America.

On the other hand, steel sheets business are doing quite well, and the steel service center is operating smoothly. This is also a profit plan based on the structural reforms that have been carried out, so we are expecting this segment to achieve these figures. Also, some of our aluminum-related businesses have been transferred from the Metal Products Business Unit to the Mineral Resources, Energy, Chemical & Electronics Business Unit from this fiscal year. You will be able to look at the results excluding that in the Appendix on a new organization basis.

<Q3>

Questioner 3: What is the impact of COVID-19 pandemic out of the results of JPY350 billion one-off loss in FY2020? How the profit increases once these negative impacts disappear in FY2021?

Shiomi: About the impact of the COVID-19 pandemic, although these are the very rough figures for one-off losses and may not be accurate, the impact was about JPY200 billion out of JPY350 billion, just to give you an image. As the breakdown, there was an impairment loss on Ambatovy, which was JPY85 billion due to the suspension of operation, the decline in mid-long term nickel price outlook, and the adjustment of the business/production plan. Also, there is Fyffes. The market was impacted by the COVID-19 pandemic, in which cargo was unable to unload or sales were slow due to demand decrease in U.S. market. And there was impairment loss about JPY38 billion. Then there is the OTO SOF in Indonesia. This impairment is JPY20 billion. In our understanding, these are the impacts of the COVID-19 pandemic and they are one-off losses.

In addition, factors other than the COVID-19 pandemic are roughly JPY100 billion. This is the cost of EPC for Infrastructure, which has been discussed earlier, Bluewaters IPP project in Australia, and so on. Also, I think there are about JPY50 billion in structural reform factors which is a collection of various small items. That is roughly how I see it.

On the other hand, in terms of the results excluding one-off losses and profits, as I have mentioned in the past, the 3 heavy material industries, namely Metal Products, Transportation and Construction Systems, and Mineral Resources, Energy, Chemical & Electronics, have been strongly affected by the COVID-19 pandemic. As the market gradually recovers globally due to the distribution of vaccines, we will be able to recover our profits in the past level. Also, by adding new businesses, we will be able to demonstrate our strength in this field, and we have factored in those steadily increasing profit amounts in the new medium-term management plan.

In addition, Media & Digital, which we had explained would not be affected much by the COVID-19 pandemics, has been performing well in FY2020 as well. In addition, although the impairment of Fyffes has had an effect on Living Related & Real Estate Business, profits were solid. And we have a plan to make these results increase steadily over the next 3 years.

As for Infrastructure Business, even though there was special factors of EPCs, the project will peak out and the profit level will decline slightly. We will take various measures to prepare for future profits from renewable energy and other sources in this medium-term management plan.

Yamane: It is difficult to estimate the exact impact of COVID-19 pandemic. For example, delay of EPC projects are partially impacted by COVID-19 pandemic, but in the explanation given now, it is categorized as factors other than the COVID-19 pandemic.

Questioner 3: It is about one-off loss on page 2 of the material. I think the one-off loss in FY2020 will improve the profits and cost reduction in FY2021. How is that incorporated into the FY2021 plan? In addition, earlier, in the EPC section, you mentioned how much risk is left. I'm wondering how much the exposures are in other part of projects such as specialty steel business in India, businesses in Myanmar, and Northern Europe parking operator business.

Yamane: As to how much the cost will be reduced, in terms of depreciation and amortization, as the goodwill impairment cannot to be considered, I think it will probably not reach the level of JPY10 billion. As to the exposure, specialty steel in India was impaired this time, but the remaining exposure is not so large. I think the original investment was around JPY20 billion. In Myanmar, the exposure as a country was about JPY73 billion at the end of September last year. Northern Europe parking operator business, Aimo Park, COVID-19 pandemic has had a negative impact on the parking lots rentals, but with the vaccinations in Europe, we are expecting a recovery. For this business, we refrain from disclosing exposure as we were not able to say how much we had invested in this project due to the reasons with our counterparties at the time of investment.

<Q4>

Questioner 4: Could you tell us about the plan for profit growth in the new medium-term management plan? As you said on page 9 of your presentation, if we exclude one-off profits and losses, it will be increased by JPY32 billion in FY2021, JPY30 billion in FY2022, and about JPY40 billion in FY2023. So I think you are expecting a total increase of about JPY100 billion in profits in this medium-term management plan. I would like to know one more factor for the increase in profit from a different perspective. It is written on page 17 of the presentation materials, investment and loan by segment was a total of JPY920 billion during the "Medium-Term Management Plan 2020". What is your analysis in terms of how much this will contribute to profits in this new medium-term management plan?

Shiomi: We can divide our investments into 2 categories. Investments in growth areas which we referred in the previous medium-term management plan such as Technology x Innovation, Healthcare, and Social Infrastructure. And investments in growth areas to further expand our existing businesses where we have our strengths.

For example, in the case of the specialty steel business in India, We have expanded our metal products business to India, which was originally Sumitomo's forte. The investment in Norwegian oil and gas related ventures is in the area of Technology x Innovation. We invested in a company called Sekal, which has a system to digitally manage the process of drilling in the offshore oil fields. This is currently being applied in some drilling areas. And this is exactly the case that shows applying new technology in existing business. There are venture investments in technology companies such as Sekal and Aimo-Park in North Europe for Social Infrastructure.

These are mainly an investment through corporate venture capital. In the next medium-term management plan, we are not expecting to make a large profit from these areas in this medium-term management plan, as they are categorized as seeding business. I think that these will probably follow a trajectory from the next medium-term management plan starting in FY2024 onward, with some growing significantly and others remaining steady. We are not expecting any significant profit in the next 2 to 3 years.

In the next 2 to 3 years, the profit will be generated from the investment to develop and grow the existing business fields. For example, the investment taking into account Technology x Innovation. Also, Sumitomo Mitsui Finance and Leasing Company, Limited is newly engaged in the real estate business. We aim to increase profits in areas where we can demonstrate our strengths. We will focus mainly on investments with high certainty.

Yamane: Just for your information, out of the JPY920 billion, about half is so-called replacement investment. This is the basis of growth in business.

Questioner 4: Please tell us about the Transportation and Construction Systems segment on page 23 of the presentation material. The forecast for FY2021 excluding one-off profits and losses is JPY37 billion and willreturn to the level of FY2019. After that, it will increase to about JPY53 billion in FY2022. It looks like profits will be even higher than before the COVID-19 pandemic, but what specific businesses do you expect to see increased profits here?

Yoshida: In terms of the recovery from the COVID-19 pandemic, I would like to mention the automotive financing business in Indonesia. The business is now gradually recovering, and we are predicting that it will return to normal. The automotive manufacturing industry is also recovering in many parts of the world, despite the semiconductor problem, so we think the business in this area will return steadily. These are the kind of projects that will return.

As for the projects that will grow further, as Shiomi just mentioned, we will continue to expand our leasing-related business in cooperation with Sumitomo Mitsui Finance and Leasing Company, Limited. Or as for TBC, we have been working on turnaround. In addition, we have sent new management team this time, and we will rebuild it firmly. We are working with partner, Michelin, to develop the business, so we expect that the growth will be greater than before the COVID-19 pandemic.

We also invested in the construction equipment sales and rental business in Southeast Asia in FY2020. In this business, we will use the Sunstate business model that has been successful in North America and expand it to Southeast Asia. We believe that this is one of the factors for growth

Questioner 4: In Transportation and Construction Systems, which business will contribute to large profit increase from FY2021 to FY2022?

Yamane: FY2021 will return to the level of FY2019, as you mentioned earlier. If you look at the table at the bottom of page 23, you will see that there are some companies that are not expected to return to that level yet. Sumitomo Mitsui Finance and Leasing Company, Limited, which was over JPY30 billion in FY2019, is not yet expected to return to that level. In this sense, automotive financing business in Indonesia also will not yet return to the original level although it will return to profit in FY2021. These companies will return to their original level firmly toward FY2022.

Shiomi: Thank you all for coming today. I would like to apologize again for the large one-off loss we had in FY2020 and also for the fact that we were not able to announce our annual forecast at this time last year, which caused a great deal of concern and anxiety to everyone.

During the last year, all the officers and employees worked together to complete the structural reforms, and although this is a self-evaluation, I am proud to say that we have achieved a certain level of results. I am confident that we will be able to show an upward trend in our performance under the new medium-term management plan. I would also like to take the helm of this project, and I would appreciate your continued support. Thank you very much for today.

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