Question & Answer at IR Meeting on Financial Results for FY2021 Q2

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[Presenters]	**Masayuki Hyodo**	**Representative Director, President and Chief Executive Officer**
	Hideki Yamano	**Representative Director, Senior Managing Executive Officer, Chief Strategy Officer**
	Masaru Shiomi	**Representative Director, Managing Executive Officer, Chief Financial Officer**
	Yasuhiro Yoshida	**Executive Officer, General Manager, Accounting Controlling Department**
	Masahiro Yamane	**General Manager, Investor Relations Department**

List of Questions (Detailed Question & Answer follows)

<Q1>

・Considering the fact that basic profit cash flow is recovering more than expected, excluding the external environmental effect, how do you think about reviewing minimum dividends of JPY70 and share buybacks? Please explain your current thoughts.

・Please explain details on structural reform costs included in the forecast of Corporate and Eliminations in H2 and whether we can expect that this will have an effect on earnings improvement in the next fiscal year.

<Q2>

・H2 forecasts for Metal Products and Transportation & Construction Systems segments seems to be conservative. Is there any possibility that they will keep good performance in H2 as well? Also, please advise if structural reform costs are included in H2 forecast of Transportation & Construction Systems segment.

・For the next fiscal year, if downturn is due to a one-off non-cash loss, you may be able to maintain JPY90 for dividend amount, but should we consider that if profit excluding one-off losses decreases, is there a possibility that the dividend amount will be reduced from JPY90?

<Q3>

・By the improvement effort excluding external environmental effect, profit improvement is expected about JPY60 billion compared to the previous fiscal year. What kind of businesses are actually responsible for this improvement? And is there any possibility that profit level exceeds JPY260 billion in the next fiscal year?

・I think profit for next fiscal year will have to fall below JPY380 billion considering the external environment. As shareholders of trading companies want to hold the shares for a long time with a stability, they may not want to see a large dividend cut although the payout ratio is 30%. Are you considering making the dividends fluctuation mild in the next fiscal year?

<Q4>

・As to the efforts in Value Creation category, please explain about the path to raise the earnings level to the level aimed for FY2023. For example, can you expect improvement in Ambatovy, TBC, and Fyffes?

・Tubular products business is working on changing the business model itself. Under the market recovery trend, please explain how much contribution can be expected from tubular products business in the future.

<Q5>

・As to the strategy for nonferrous metals, having the announcement of sale of Sierra Gorda, please explain the strategy for copper business. Also, what is the strategy for silver-zinc-lead mining project in Bolivia in the future, as the mine life is becoming shorter?

・ Please advise what profit level that you are aiming for Fyffes in the 3 years in this medium-term management plan.

<Q6>

・For next fiscal year, if we assume the net profit to be JPY330 billion, dividend will decline to JPY80 per share based on payout ratio of 30%. The dividend policy states that it will be decided “taking into consideration the status of fundamental earnings capacity, cash flows, and other factors.” If the fundamental earnings capacity does not decrease so much in the next fiscal year, it could be considered that dividend will not be decreased to JPY80. Please explain how we should interpret this.

Question & Answer

<Q1>

Questioner 1: Although there was external environmental effect, you commented that you are confident in your ability to generate more than JPY300 billion in profit no matter what the environment is, and as you indicated earlier in your presentation on the progress of the Full Potential Plan, even if you exclude the impact of the external environment, the effect of earnings improvement is about JPY40 billion, we felt your confidence for the response in the explanation.

Considering the fact that basic profit cash flow is recovering more than expected, excluding external environmental effect, how do you think about reviewing minimum dividends of JPY70 or aiming to improve capital efficiency through share buybacks? Please explain your current thoughts.

Hyodo: I believe that it is our top priority to complete the structural reforms that we have been working on. Our management base generated JPY198 billion excluding one-off profits/losses in the last fiscal year even under the sever business environment. In addition, we have been able to improve our net profit by JPY40 billion, excluding tailwind part of the current environment, as of the end of Q2 as a result of structural reforms. By the end of this fiscal year, we expect that we will be able to accumulate about JPY20 billion more and we believe that we will be able to return to the level of about JPY260 billion as our earning capability. On top of that, during three years in this medium-term management plan, we will raise our net profit by JPY130 billion by Divestment, Value Creation, and Steady Business Growth as shown in the page 12. This includes the JPY70 billion that is expected for profit improvement through structural reforms. If we achieve these goals, we will be able to see the profit level of more than JPY300 billion.

Then, we will be able to show the results of our continuous efforts for improving our financial condition since the downgrade by S&P last fiscal year which has not been upgraded. At that point, we can review our overall cash flow plan and make improvements in shareholder return. We are currently holding such discussions internally. In this Q2 results announcement this time, in addition to the minimum dividend of JPY70 which we announced at the beginning of this fiscal year, we also presented an additional JPY20 dividend considering payout ratio and based on the annual forecast of JPY380 billion for this fiscal year.

Shiomi: First of all, you asked if we are going to revise the minimum dividend, but in the current medium-term management plan, we would like to maintain the dividend at JPY70 or more and maintain a payout ratio of 30%. However, if we are able to achieve our goals in medium-term management plan earlier, which means if we stabilize our financial performance and improve our financial condition ahead of schedule, then we can review our measures in shareholder return including share buyback. The market including rating agencies has pointed out that we still have high financial leverage. We will be able to think about shareholder return after improving such indicator and increasing our capital. It has only been 6 months since the start of the medium-term management plan, and we do not have any specific plans at this point. We will do our best to get as close as possible to these stages where we can consider additional shareholder return in the 3 years in this medium-term management plan.

Questioner 1: It looks that there is about JPY30 billion of structural reform cost is included in the forecast of Corporate and Eliminations in H2. Please explain the detail. And can we expect that this will have an effect on earnings improvement in the next fiscal year?

Yoshida: I would like to explain about Corporate and Eliminations referring to page 7. In H1, as one-off profits/losses, partially there were some positive effects came from the foreign exchange adjustment account borne by the head office as part of the asset replacements. Also, in terms of excluding one-off profits/losses, tax costs decreased due to improvement in earnings under recovery in business environment.

On the other hand, H2 forecast includes a certain amount of costs that are weighted toward H2, and other than that, the structural reform costs are also included as one-off losses. Also, the structural reform cost of the initiative launched this time, EII, Energy Innovation Initiative, are included. We will build strong resilience to downturns through the structural reform.

Yamane: In fact, there were some exits in H1 which have come earlier than initially planned. If this happens in H2 as well, we believe that this will lead to improvements in the next fiscal year and beyond.

<Q2>

Questioner 2: I think Metal Products and Transportation & Construction Systems segments were performing well in H1. On the other hand, H2 is expected to be quite weak in those segments. In the Transportation & Construction Systems segment, structural reform costs are included. Is it assumed to be conservative? Other companies don't seem to have been affected by automobile production cut. Is there any possibility that they will keep good performance in H2?

Shiomi: We expect the steel sheets prices are likely to remain high. So the margin that has been rising until H1 will be reduced. We also see that the bottleneck in semiconductors is very serious, and we are assuming there will be an impact of production cut in automotive related business.

In terms of mineral resources prices, coking coal and iron ore have already fallen. I believe that these high prices are temporary and tailwind effect from external environment was around JPY60 billion in H1, but this will fall to JPY30 billion in H2. We believe that this is not so conservative.

Questioner 2: The costs for structural reform in Transportation & Construction Systems will be contained within the JPY10 billion one-off loss in this segment's annual forecast?

Shiomi: There are several costs, including a slightly larger one, are included in the forecast.

Questioner 2: I understood that the dividend of JPY70 this time is minimum dividend in this medium-term management plan. Meanwhile, for the next fiscal year, is it correct to understand that if downturn is due to a one-off non-cash loss, you may be able to maintain JPY90, but if profit excluding one-off losses decreases, is there a possibility that the dividend will be reduced from JPY90?

Shiomi: We will maintain JPY70 per share in this medium-term management plan. JPY90 is in accordance with the payout ratio of 30%. These dividend amounts are in accordance with the policy announced in this medium-term management plan. We will maintain this dividend policy in this medium-term management plan unless it is revised. Therefore, if the next fiscal year's performance level does not reach JPY380 billion, for example, we will multiply that amount by the payout ratio of 30%, and if it is more than JPY70, that will be the dividend amount. It is unlikely, but if it is less than JPY70, the dividend amount will be JPY70.

In any case, our policy is to provide stable dividends to our shareholders. Although we will make decisions based on the environment and business outlook time to time, we would appreciate it if you could understand that we will comply with the dividend policy of the current medium-term management plan.

<Q3>

Questioner 3: On page 6, the annual forecast excluding one-off profits/losses for FY2021 is written as JPY360 billion, of which about JPY100 billion is due to external environmental effect. So I understand that you are seeing the earning capability of JPY260 billion. The improvement effort excluding external environmental effect is about JPY60 billion compared to the previous fiscal year. What kind of businesses are actually responsible for the improvement? And it has been specified from the initial announcement that the profit level for next fiscal year will be JPY260 billion, but is there any possibility that this will be exceeded?

Shiomi: Please refer to page 12 where the earnings excluding one-off profits/losses are shown. The improvement for H1 of FY2021 was JPY150 billion in total, and JPY30 billion is from Divestment, JPY90 billion is from Value Creation, and JPY30 billion is from Steady Business Growth. And the improvement by Full Potential Plan, JPY60 billion, is also contained.

Yoshida: This JPY60 billion is made up of multiple elements, so it is not made up of specific projects. In terms of mineral resources businesses, the nickel mining and refining business in Madagascar has recommenced production and there is an improvement effect. In addition, Metal Products and Transportation & Construction Systems have their own KAI/KPI for each issue, and are working to make improvements through PDCA cycle. Other than nickel mining and refining business in Madagascar, TBC and Fyffes are improving as well. As overall, including those, we will steadily accumulate the results.

Hyodo: As for the specific projects that have actually achieved solid reforms, on page 12, we have listed the progress and examination status as of H1 FY2021. In tubular products business, we have been able to reduce the marginal cost and improved the efficiency by devising ways to hold inventory, after impacted by inventory valuation losses in the last fiscal year including tubular products business in North America. As to nickel mining and refining business in Madagascar, after recommencement of production, it steadily ramped up and production is progressing in accordance with the plan. In addition, there are contribution through the continuous effort to stabilize the operation and also through the debt restructuring. In other business, we are also working to reduce costs and improve operations one by one, and these efforts are contributing to the actual improvement of our business performance.

Questioner 3: Will the businesses listed on page 12 continue to improve in the next fiscal year?

Hyodo: Exactly. This is not a positive effect only for this fiscal year, but will continue to appear in the next fiscal year as well. In addition, there are some projects to exit next fiscal year, and some cost improvement effects that have not yet been appeared this fiscal year will come into effect next fiscal year. I have explained the progress of JPY70 billion which was initially announced as an improvement effect of Full Potential Plan during this medium-term management plan. But what is also important is to generate more than JPY80 billion through Value Creation businesses. Among the Steady Business Growth category, we are making additional investments, for example, in the construction equipment business in anticipation of future progress in infrastructure construction in the North American market, which is expected under the policies of the Biden administration. Based on the above, we believe that we will be able to raise the basic profit further in the next fiscal year and beyond.

Questioner 3: I think the profit for next fiscal year will be higher than the JPY260 billion which was initially forecasted. However, considering the profit of JPY380 billion for this fiscal year, I think it will have to fall substantially to some extent. In that case, as to shareholder return, for shareholders of trading companies, if they want to hold their shares for a long time with a certain degree of stability, they may not want to see a large dividend cut. Although the payout ratio is 30%, the next fiscal year after it has achieved good results, would you consider making the dividends fluctuation mild?

Shiomi: Our basic policy for shareholder returns is to paying shareholders a stable dividend over long term, and return profits to shareholders by increasing dividends through profit growth. Therefore, if business performance declines once, it is certain that it will rise again in the following year, and we can consider to adopt a dividend policy that does not fluctuate. However, in the current medium-term management our dividend policy is to maintain at least JPY70 and payout ratio is about 30% as guideline. So we will make a decision taking into account the movement of dividends over the next 3 years. We are not yet in a position to review the plan for FY2022, which are still JPY260 billion, so we will consider and present the dividend level after H2 when FY2022 plan becomes more visible.

<Q4>

Questioner 4: As to the efforts in Value Creation, I think it is a major achievement of making allowances for major impairments in the last fiscal year and greatly lowered fixed costs to increase profitability. I would like to know more about the path for the Value Creation category to raise the level of earnings to the level aimed for FY2023. For example, as to Ambatovy, although the nickel market is at a high price, the cost of subsidiary materials has also risen in some areas. In cases market price settle down from the next fiscal year onward, it would be good if costs also settle down, but I think the key is whether you can continue your efforts to further lower the break-even point. First of all, I think you will aim to maintain stable operations at a pace of 40 KMTs per year, but it will not be enough if profits are just above the waterline. I think the efforts that can be made in remained 2 years till FY2023 will be led to a significant increase in the Value Creation category. At the same time, I would like to know if the similar improvement can be expected in TBC and Fyffes which are the larger projects.

Shiomi: As to Ambatovy, the operation was suspended for a year last year, and only costs were occurring. But it has been recommenced and running smoothly since March of this year and as Q2 individually we could operate at a level that exceeds our costs. However, as you pointed out, the prices of sulfur and coal, which we call subsidiary materials, have risen, and the break-even point has risen. Although we are currently struggling with the price of subsidiary materials, we will continue to work on stabilizing the operation as planned and reduce unit costs on site. if the market price settles down, we expect to make a good profit in the near future.

Similarly, at TBC, our people on the ground and the management of TBC are working together based on the management policy. As to Fyffes, with the market tailwind, the melon was good, and the company is changing its structure every day to be able to make a profit steadily.

Regarding these initiatives of each business, we have grouped the businesses by strategies so called Strategic Business Unit, SBU, under the current medium-term management plan. Within each SBU they have 3-year medium-term plan, and progress is reviewed in Management strategy meeting every 6 months. On the other hand, at each SBU, the KPI/KAI is updated every month to check the status of achievement to ensure that the progress is in line with the plan of each business. We recently held the first Management strategy meeting in this medium-term management plan, and we reviewed the progress of the KPI/KAI of each of the 69 SBUs, and confirmed the progress towards the completion and achievement of each plan. PDCA cycle is established, and we will continue to move forward with the plan by carrying it out in an honest manner.

Yamane: Ambatovy is explained on page 29. Nickel production is forecasted 40 KMTs this fiscal year and we produced 19 KMTs almost in line with the plan in H1. By achieving 21 KMTs of production in H2, that will result in a 10% increase in production volume. The reduction of fixed costs is closely related to the stability of production, we would like to focus on maintaining our operations stable.

Questioner 4: As to the graph showing the fundamentals of Metal Products on page 35, the tubular products business has returned to normal operations after experiencing negative factors such as valuation losses, and the business environment is improving. While the energy market is raising the bottom, the rig count is still low but has bottomed out and is recovering. With this trend, I am aware that you are working on changing the business model itself, but please explain how much contribution can be expected from tubular products business in the future?

Yoshida: The rig count in North America is a very important indicator in our tubular products business, and as shown in page 35, the market is now recovering. Some of this return is directly reflected in our business performance, but while experiencing the sluggish business performance, our tubular products team has been steadily reduced the number of distribution companies and integrated operations and improved cost efficiency, and strong resilience has been built against downturns. On the other hand, the oil industry is in a very difficult environment, and our customers are also looking for a way to transform their business in the future. Our tubular products team will closely align with customers, based on existing relationship built through tubular related business, and will lead to the next step to establish new business. In addition to ensuring stable earnings contribution through existing tubular products business, we are now focusing on building new businesses derived from there in long term with our partners.

<Q5>

Questioner 5: I would like to ask you about the strategy for mineral resources in terms of nonferrous metals, and please explain the strategy of the copper business. Also, in silver-zinc-lead mining project in Bolivia, the mine life is gradually getting shorter. What is your strategy for this project in the future?

Hyodo: We are planning to exit from Sierra Gorda, but we have newly invested in Quebrada Blanca since the year before last, and we are now in the process of starting operations. We consider copper to be a very strategically important nonferrous resource. With the policy of carrying out asset replacement with good assets, nonferrous resources is one of that we would like to accumulate more if good opportunities arise. Other than that, the nickel mining and refining business in Madagascar, we have had a difficult time, but we will turn them as a source of revenue by stabilizing the operation after the recommencement. In the future, as the shift to EV progresses, and as many battery technologies will be developed, nickel is expected to be a very important material for collecting electrodes and poles. In particular, it is one of the mines where there are no alternatives for Class One Nickel, a high quality nickel, so we are determined to work on the project.

Shiomi: Regarding silver-zinc-lead mining project in Bolivia, as it becomes closer to the end of mine life, we will continue to examine whether we operate till we finally abandon the mine, or whether we sell the stake. We do not have any particular plan at this moment.

Questioner 5: There is a mention of a JPY6 billion improvement for Fyffes, but I don't think your company is satisfied with the profit level yet. Do you have a profit level that you are aiming for in your medium-term management plan for these 3 years?

Yoshida: At the time we acquired Fyffes, we had 3 major businesses: bananas/pineapples, melons, and mushrooms. After having impairment loss and other factors last fiscal year, we decided to allocate our management resources in our mainstream business: bananas/pineapples and melons, and we have transferred the mushroom business to Sumitomo Corporation of America and handling the business there. Also, Fyffes has a new management team. We are working to build solid earnings base and rebuild the business by reviewing our sales methods and transportation methods from the production area. For melons, such an effect has already appeared. As for the profit level that we aim, we are working on based on the quantitative target we have internally for return on invested capital.

Yamane: For Fyffes, a growth plan is set for the next fiscal year compared to this fiscal year, and the same for the year after next compared to the next fiscal year. As for Quebrada Blanca, although it depends on prevention measures for COVID-19, the production is expected to start in later half of 2022. We are now firmly in the process of constructing and preparing for production, based on the policy to replace the asset, that one day be depleted as the nature of mining business, with new one.

<Q6>

Questioner 6: For next fiscal year, if we assume the net profit to be JPY330 billion, dividend will be decreased to JPY80 per share based on payout ratio of 30%. On the other hand, in the dividend policy of this medium-term management plan, it states that it will be decided “taking into consideration the status of fundamental earnings capacity, cash flows, and other factors.” In fact, the fundamental earnings capacity has been improved and the cash flow forecast has been revised upward, as a result that Full Potential Plan is progressing well in this fiscal year. If the fundamental earnings capacity does not decrease so much in the next fiscal year, it could be considered that it is not necessary to mechanically lower it to JPY80 based on this wording. How should we interpret it?

Shiomi: We do not simply multiply the payout ratio by 30% based on profit level alone, but we also consider the shareholder return based on fundamental earnings capacity and cash flow. Therefore, our shareholder return policy has been set to be adjusted in a direction that does not disappoint our shareholders. We would like to continue to pay stable dividends while taking into account the earnings environment at that time and the earnings situation in the following fiscal year and beyond. Therefore, we may decide to pay JPY80, or we may decide to continue to pay stable dividends if the annual forecast is estimated to increase a lot in the next fiscal year and beyond. We would like to take some time and make a decision based on the situation at that time. As stated in our basic policy, we will consider and adopt a policy that our thoughts remain consistent.

Hyodo: Thank you all for joining us today. As I have explained, we will continue to make efforts to build up results as planned in our medium-term management plan, SHIFT 2023, so that our stakeholders can evaluate us in both quantitatively and qualitatively as a company that is doing exactly what it says. We would like to ask for your continued support. Thank you very much for your time today.

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