Question & Answer at IR Meeting on Financial Results for FY2022 Q1

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[Presenters]

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< Questionnaire 1 >
As to tubular products business in North America, the market conditions has been favorable and continues to reached record high. How long do you think this market conditions to continue?

< Morooka >
Currently, the oil and gas industry are in a trend of production increase, but it has not led to rapid increase due to rising global material costs and labor availability, and so on. Against this backdrop, although the U.S. rig counts is slowly rising to over 750 at present, we see it will reach the peak at some point. We expect the current strong market conditions to continue until the beginning of 2023, but after that, there is a possibility that demand may decline due to changes in monetary policy and other factors, which we are watching closely.

< Questionnaire 1 >
Considering your Q1 results, which businesses do you expect to continue to perform well, and which businesses are expected to be weakened?

< Morooka >
Regarding Metals Products segment, we expect strong market conditions to continue in the tubular products business for a while. The steel sheets business performed well in Q1, but we do not expect it to continue as the tubular products business does, as the market conditions are weakening recently. In the Transportation & Construction Systems segment, although the automotive related business and construction equipment related business in North America have been currently performing well, we are concerned about a decline in demand resulting from a slowdown in the U.S. economy. On the other hand, among the businesses that are already suffering, the automotive manufacturing business in Transportation & Construction Systems segment is struggling due to the semiconductor shortage and the lockdown in China. The shortage of semiconductors seems to be resolved a little, but costs including electricity are rising, and we expect the situation to remain difficult. Infrastructure Business segment's domestic electricity retail business is also in a difficult situation, affected by the soaring wholesale electricity procurement prices. We will do our best to minimize impact, reducing proportion of purchases in the trading market as much as possible for instance, but I assume the difficult environment will continue. In the mineral resource business, mineral resources prices are recently declining, and we will continue to look closely.

< Questionnaire 2 >
As to Transportation & Construction Systems segment, I think the deficit caused by the suspension of operations in Russia and Ukraine was factored in initial forecast. What was the situation in Q1?

< Morooka >
The automotive, construction equipment and other businesses in Russia and Ukraine have effectively suspended operations or have significantly downsized business. These are budgeted at a loss because we don't expect revenues while fixed costs remain. The Russian business is almost in line with our initial assumption, but especially in the construction equipment business, we have many bases in Russia and fairly number of employees, so we need to keep a close eye on the situation and how to respond to it as the crisis drags on. The necessary impairment losses and provisions were recognized at the end of last fiscal year, but our exposure to that country remains about 60 billion yen as we still have cash and other assets in each group company. Therefore, there is a potential risk, depending on how our business goes. In Q1, the Ukraine business has not made a loss as much as it was budgeted.

< Questionnaire 2 >
Regarding breakeven costs in the nickel mining and refining business in Madagascar, I'm not familiar with sulfur among the main subsidiary materials, so please tell us the background of price increase and the outlook. Also, please provide a supplementary explanation on the breakeven cost if the price of coal and sulfur, the main subsidiary materials, decreases, as I do not know the extent of impact.

< Takayama >
The current spot price for coal is roughly around USD400 per ton, while the price for sulfur has fallen to around USD90 per ton. In terms of the impact of each subsidiary material, the change of USD1 per ton for both coal and sulfur has an impact of approximately 30 million yen each on equity earnings. Therefore, coal price is rising, and sulfur price is falling compared to the initial forecasts, which offsetting each other. On the other hand, the higher price of subsidiary materials in Q1 compared to the initial forecasts was a factor in worsening the breakeven cost for the full year.

< Questionnaire 3 >
Please update the situation of Fyffes, fresh produce business in Europe and the Americas, which is in the red. Although the level of earnings has improved with the measures for value up, we feel that issue remains because we cannot see the next move. Please explain if there are any updates in your efforts.

< Fuse >
Fyffes posted a loss of 0.6 billion yen in Q1 due to soaring ocean freight and material costs, decreased production by unfavorable weather conditions, and lost revenue from its Russian operations. In particular, the surge in ocean freight and material costs has exceeded our assumptions. We are aiming to achieve our initial forecast by reflecting the increase to sales prices. In addition, various measures for value up are being implemented under the new management. We believe that the structural reform of operations is progressing well, and we intend to continue it.

< Questionnaire 3 >
There were acquisition of domestic real estate and asset increase in construction equipment rental business as major investments and loans in Q1, and I believe these projects can be expected to contribute to earnings in a relatively short time frame. In terms of company-wide asset replacement and investments and loans,

can you give us an idea of the time frame in which these projects have led to the accumulation of assets that will contribute to earnings growth within the next five years?

< Morooka >
As to investments and loans, we will actively invest in areas where we have strengths as it is desirable to further expand in areas where our company already has strengths in terms of building a portfolio with resiliency. While the projects shown in Q1 results are businesses that can be expected to contribute to profits in the short term, we will also invest in projects that we will take up with a medium-term perspective. We are discussing various projects within the company and would like to realize them. In addition, as a seeding field in response to changes in the social structure, we are actively discussing how to build a business in EII, and we would like to present you with excellent projects that we can expect contribution to earnings in the future.

< Questionnaire 4 >
You mentioned the decline in sulfur prices. Please tell us about the impact on the agricultural input business such as agrochemicals and fertilizers.

< Takayama >
The agricultural input business is mainly operated in overseas, and raw material costs are reflected on to sales prices. Agricultural input as a whole, including fertilizers, have been performing well, and we do not expect that decline in sulfur prices will affect our agricultural input & service business and others, so we expect strong performance to continue.

< Questionnaire 4 >
I think there was some hoarding of fertilizer, and does that mean that the agricultural input business continues to be strong globally?

< Takayama >
Your understanding is correct. Demand for agricultural materials is robust and prices are rising against the backdrop of rising grain prices. In addition, this is a business that we have been focusing our efforts over several years, including regional expansion, and it has been contributing to the revenue over the past one or two years, and I believe it will boost our performance.

< Questionnaire 5 >
The profit from the coal business have increased considerably in Q1. I believe it is mainly spot trading, but does it include fixed-price trading? Please tell us the situation after Q2.

< Takayama >
We will check and answer later.

(*) Comment added after the IR Meeting

> We will refrain from disclosing information from the standpoint of confidentiality, as we are negotiating separately with each of our business partners, based on current market conditions and prospects in accordance with their policies.

< Questionnaire 5 >
As to the production of coking coal and thermal coal shown on page 10 of the material, Q1 was slightly lower, which may have been affected by heavy rain, but do you expect to achieve the initial forecast for the full year?

< Takayama >
We do not expect any significant change from our initial forecast at this time, although we have not reviewed in detail.

< Questionnaire 5 >
What is your view on the future portfolio of mineral resources, including thermal coal mining interests? In terms of thermal coal mining interest, it is subject to a withdrawal policy, and I think you can sell it if you lower the price, but it would be a great regret to sell the interest that generates so much cash flow with a low price. Please tell us if there is any review on the policy including other mineral resources interests.

< Takayama >
There is no change in our Policy on Climate Change Issues which was previously announced. We are optimizing our product portfolio for the upstream business in mineral resources and energy business, and we are working on fossil energy concession business based on our aim of being carbon neutral in 2050. In addition, based on demand for battery metals, we will shift our management resources to copper and nickel, which we have been working on for some time, and to lithium in the future. With regards to thermal coal mining interest, we will not make any further investment, and aim to achieve zero production in equity share from thermal coal mines by 2030. Currently, we have no plans to sell our interests ahead of schedule.

< Questionnaire 6 >
On page 21 of the material, it states that nickel production in the nickel mining and refining business in Madagascar is expected to remain at just under 40,000 tons. Was the large-scale repair planned for Q3 factored into the initial production forecast? Also, please let us know if there are any production issues.

< Takayama >
Large-scale repairs are regularly incorporated into production plans and have been factored into the initial plan of just over 40,000 tons. It was originally planned to be carried out in Q1, but it has been rescheduled to Q3 due to restrictions on the travel in and out of Madagascar due to the COVID-19, as well as the impact of global supply chain issues, which caused difficulties in arranging the necessary contractors, materials and equipment. On the other hand, we expect annual production to remain just under 40,000 tons due to repairs on some facilities in Q1, though not critical.

< Questionnaire 6 >
Many of the major copper mining companies have seen their costs rise more than expected. Is it the same for the copper mines in which your company invested? Also, please tell us about the cost increase in the zinc mine.

< Takayama >
In terms of copper mines, we have seen a certain cost increase compared to the same period of last year, but we do not think this is a significant impact. It is the same for zinc mines.

< Questionnaire 7 >
On page 5 of the material, it shows that the progress is strong against the forecast by 50 to 60 billion yen of increase. Please tell us whether this increase is due to Q1 result alone or whether one-off profits are included, and what the breakdown of mineral resources and non-mineral resources are.

< Fuse >
This is because our Q1 results, excluding one-off profits/losses, was stronger than we expected. The breakdown is roughly half between mineral resources and non-mineral resources.

< Questionnaire 7 >
In this fiscal year, if higher results are achieved compared to the initial forecast, will a dividend per share be determined in increments of 5 yen, applying a payout ratio of 30% to net income?

< Morooka >
Our shareholder policy is to return with a dividend payout ratio of 30% within a DOE range of 3.5 to 4.5% based on approximately 3.2 trillion yen of shareholders' equity at the beginning of the fiscal year. Also, as you understand, we determine the dividend per share in increments of 5 yen. The net income equivalent to the DOE of 4.5%, which is the upper limit, is approximately 480 billion yen. So basically, if we revise our forecast upward within that range, the dividend forecast to be reviewed accordingly. It will be reviewed and determined considering factors such as the progress of structural reforms, improvements in financial soundness and stock prices.

[END]