Question & Answer at IR Meeting on Financial Results for FY2023 Q1

[Date]	**August 3, 2023**	
[Presenters]	**Reiji Morooka**	**Representative Director, Senior Managing Executive Officer, Chief Financial Officer**
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<Questioner 1>
Regarding the progress of tubular products business and outlook after Q2 (supply and demand environment, etc.), is it likely that the timing of the market recovery will be delayed compared to the initial plan?

<Fuse>
The main North American tubular products business is in an adjustment phase, and rig count is currently at the 600 level. Although it will be slightly delayed from the initial plan, the market is expected to recover from the second half, and the rig count is expected to return to 700 to 800 units’ level.
Outside of North America, we recognize that investment in the upstream energy sector is increasing, and that demand is growing steadily, especially for high-end products for the Middle East. In addition, there is a recent demand for energy transition including CCS/CCUS. In terms of individual businesses, Eryngium (HOWCO) has improved due to the recovery in demand and business performance of service companies, which are its main customers, as well as the structural reforms implemented by the company and the shift to high-margin products. This steady performance is likely to continue after Q2.

<Morooka>
The overall progress rate for Metal Products is 26%, and it is almost at a normal pace. Trade in non-U.S. areas and performance of group companies have been extremely strong, and overall tubular products achieved Q1 performance at normal speed. In addition, steel sheets also showed a progress rate of 26%, and we evaluate it as a good start.

<Questioner 1>
Do you have any evidence to back up the recovery in the North American tubular products market from the second half?

<Morooka>
We understand that we are currently in an adjustment phase of supply and demand, but overall gas production activity itself has not changed significantly, and we believe that this adjustment phase will dissipate. In addition, gas inventories are planned to increase in Europe and other countries from the beginning of autumn, so a recovery from the second half is highly likely.

<Questioner 1>
Do you intend to proceed with asset replacement more than your initial plan?

<Morooka>
We plan to recover 220 billion yen this fiscal year from asset replacement, and the Q1 result was 50 billion yen. We are confident that the initial plan of 220 billion yen will be achieved, and we are currently discussing to accelerate asset replacement. We cannot mention specific projects, but we would like to generate cash flow through proactive asset replacement and make investments for growth.

<Questioner 1>
If the asset replacement is accelerated, is there a possibility that the gain on sale of the replacement will also exceed the initial plan?

<Morooka>
Asset replacement depends largely on the negotiation with the other party, so we cannot anticipate the outcome. However, at this point, we do not anticipate large one-off gains outside of our plans.

<Questioner 1>
ITOCHU announced TOB of ITOCHU Techno-Solutions, but what is your stance on SCSK's parent-subsidiary listing?

<Morooka>
In case of SCSK, we have judged that the current form is the best. We will continue to discuss and pursue even better forms. Considering the competitive environment, market environment, etc. in SCSK's business areas, we believe that continuation of listing is better to improve the corporate value of SCSK alone or the Group as a whole. For example, it is extremely important not only to ensure the transparency of corporate management and to establish a financial base, but also to improve creditworthiness, name recognition, reliability, brand power, securing human resources, and relationships with customers.

<Questioner 2>
About Ambatovy, please explain why you were not able to achieve production as planned in Q1, and what are the solutions to stabilize production?

<Fuse>
An overview of Ambatovy's business performance is shown in the materials. There was trouble with the auxiliary plant in Q1, and production volume was just under 10,000 tons. Although it is somewhat behind the full-year production plan of over 40,000 tons, the problem with the auxiliary plant has already been resolved. We are currently reviewing our production plan or working on a cost optimization project to achieve our initial forecast of above 40,000 tons. We are making steady progress on-site to stabilize operations. For example, we used to respond to problems after they occurred, but in order to prevent them from happening, we have strengthened the monitoring of our main equipment and introduced a mechanism to detect problems early. In order to improve the quality of maintenance, we are promoting human resource development, including locally hired managers.

<Takayama>
In the past, problems occurred repeatedly in the PAL and refinery processes, which are the core of the entire plant. Currently, we are managing PAL and refinery processes well, and the problems are in peripheral areas, such as drop in the utilization rate of the heavy equipment used to process the ore or the malfunction of the auxiliary plant seen in Q1. We can evaluate these changes as a positive progress toward stable production.

<Questioner 2>
I would like to ask about the background behind SMFL's high progress. Also, I would like to hear your perspective on the impact of the interest rate changes in Japan and overseas on your major businesses such as leasing and real estate.

<Morooka>
SMFL's major businesses such as aircraft leasing, domestic leasing, and real estate are doing well, and there are no special factors. In SMFL's initial plan, we anticipated a year-on-year decline in profit due to upfront investment cost of strengthening the quality and quantity of human resources and replacing systems, etc., to leap forward in FY25, the final year of the medium-term plan.
If interest rates rise in the future, although there will be a problem of funding costs in the short term, the finance leasing business, including SMFL and auto leasing in Japan, and automotive finance business in abroad, will be able to earn higher profit margins along with demand increase.

<Questioner 2>
Do you foresee a negative impact on your business performance due to the interest rate changes? In general, real estate business is a matter of concern, but are you managing it well?

<Morooka>
Yes. There are currently no major concerns in our real estate business.

<Questioner 3>
Are there any factors that supported the high progress in Q1 and are likely to fall off after Q2?

<Morooka>
There is nothing like that at the moment. In Transportation and Construction Systems, which showed high progress in Q1, the progress rate was 29%, even excluding one-off factors. Demand in non-housing and infrastructure-related fields, as well as mining equipment, is expected to remain strong. Leasing, aerospace, and automotive sales &marketing businesses also started strong and are expected to continue after Q2. In terms of infrastructure, the domestic electricity retail business is firmly in the black, and we expect it to continue to grow steadily. In addition, the overseas power generation business is also steady. In addition, recovery is expected in Media & Digital, Living Related &Real Estate, and Mineral Resources, Energy, Chemical & Electronics, where progress is currently slow. In Media & Digital, although SCSK performed well in Q1, many of the major domestic group companies, including SCSK, are tend to make profit in the second half, and we expect overall results to be in line with the initial plan. In Living Related &Real Estate, gains on sales of real estate assets are included in the budget, and the delivery of assets are expected after Q2. In Mineral Resources, Energy, Chemical & Electronics, profits from iron ore business in South Africa will be recognized in Q2 and Q4, and in Agribusiness, recovery from seasonal factors are expected in Q2 and Q3.

<Questioner 3>
I would like to hear your thoughts on the advantages and disadvantages of delisting SCSK. Generally, I think there are benefits to delisting, such as quick management decisions, appropriate allocation of management resources, and acceleration of DX within the company.

<Morooka>
The disadvantage of delisting is the flip side of the advantage of maintaining the listing that I explained earlier. As a listed company, its brand power and credibility attract excellent talents and motivate its employees, even in the intensifying competition to acquire human resources. In general, one of the issues in maintaining the listing is conflicts of interest. In case of SCSK, there are variety of systems to ensure independent decision-making by appointing independent outside directors and setting an advisory body to the board of directors, and at present, the benefit of delisting is not that big. Even in the current situation where SCSK is listed, we have been able to cooperate with the company in promoting various DX of the whole Sumitomo Corporation while avoiding conflicts of interest. Therefore, the benefit of TOB is not big in terms of accelerating DX.

<Questioner 4>
You said that Transportation and Construction Systems was performing well, with a progress rate of 29%, excluding one-off factors, but could you explain its Q1 results and forecasts after Q2?

<Morooka>
In terms of the overall mobility, the progress rate, excluding one-off factors, is 26%, normal speed. As for the manufacturing business, Kiriu and Asama Giken's auto parts manufacturing businesses continue to be in a difficult situation. Insufficient pass-on of rising costs to prices, and recovery of OEM production by our customers is still in progress, resulting in low progress. However, in addition to improving profitability through cost reductions on its own and passing on costs to customers, there are signs of recovery in OEM production at customers in the Americas, and a recovery is expected from Q2. On the other hand, in terms of the sales & marketing business, sales in the Middle East, Ukraine, Central Asia, and other markets were extremely strong, and is expected to continue to perform well from Q2. The construction machinery business made good progress, especially in Sunstate, the rental business in North America. In the United States, although the housing market continued to be weak, rentals to various customers, including non-housing and infrastructure-related sectors, were strong. In addition, transactions for mines, especially for oil sands drilling in Western Canada, are strong and are expected to continue to perform well. Both Sunstate in the United States and SMS in Canada had difficulties in procuring construction machinery, but those issues are improving considerably and are expected to continue to perform well.

<Questioner 4>
Regarding chemicals and electronics, it seems that progress is low at 7 billion yen, excluding one-off factors, compared to the initial plan of 46 billion yen. Could you explain your outlook for Q2 and beyond?

<Fuse>
Regarding agribusiness, we acquired Nativa in Brazil last year and it has become one of our pillars. In Q1, sales volume declined both in agrochemicals and fertilizers, due to a rebound from the sharp rise in prices in Q1 of the previous year, or a rebound from demand ahead of schedule. From Q2, the southern hemisphere will enter a demand period, and although the market is expected to remain at the level of Q1, demand will recover as

soon as inventory adjustments are completed. In addition, we plan to expand our shares capturing the demand recovery and expect our performance to be in line with the initial plan.

As for basic chemicals business, the overall market has deteriorated year-on-year due to factors such as increased production of basic raw materials and products in China. In the second half, we expect a market recovery in line with the recovery in China, and as well as our performance recovery, demonstrating strength of the Basic Chemicals SBU, which is the trading function utilizing our business foundation. Regarding electronics business, we are involved in trading of semiconductor materials and EMS business. Our major customers are currently reducing production as a reaction to last year's production increase, but we expect this change will return to a normal level soon. With that, we expect our recovery in the second half of the year through increased profit margins on existing and new projects and expansion of new projects by demonstrating our capabilities while paying close attention to the production plans of our customers.

<Questioner 4>
In Australian coal business, the progress in Q1 looks good. Please explain the background and outlook.

<Fuse>
Q1 results of Australian coal business include one-off profits, although the amount is not that large. In addition, the price applied in the contract was higher than the current market conditions, so the progress is high. From Q2, the impact of the current market price decline is expected to be in line with the initial full year plan.

<Questioner 4>
In Transportation and Construction Systems, I understand that factors that supported strong performance in Q1 will continue to some extent after Q2, and automotive manufacturing field will also recover from Q2 as the utilization rate of automakers will rise. If so, is it safe to assume that the pace will exceed the initial plan?

<Morooka>
As you understand. In the manufacturing business, we hear that negotiations with customers are going well, and we expect to finish as planned for the full year. Whether it's automobiles or construction machinery, there is maintenance demand from customers in the normal business, and sometimes there are large contracts. Considering the demand forecast, our business is likely to continue to show strong performance to some extent this fiscal year.

<Questioner 5>
I would like to ask about the certainty of recovery in the tubular products business in the second half. While the rig count continues to peak out, you mentioned that sales are expected to recover due to inventory adjustments, etc., but as a major trend, can we understand that you are able to build a business that is not affected by demand fluctuations?

<Fuse>
In the tubular products business in North America, we are operating with a high ratio of bridging sales, and we do not anticipate any major ups and downs, including inventory valuation losses.

<Questioner 5>
In your material, it says that you are capturing new demand such as those related to carbon neutrality in the tubular products business, but could you tell me whether the effort is actually becoming your strong business?

<Fuse>
Although we cannot give details about the number of orders received at this stage, orders for tubular products are on the rise as development of CCS increases. Demand growth is expected mainly in Europe and North America.

<Questioner 5>
Regarding TBC, could you explain about the purpose and impact of the sale of the retail business, and how you plan to increase the earnings to increase value of the business?

<Morooka>
TBC has three business segments: wholesale, company-owned retail, and franchise. We have been struggling to improve the profitability of company-owned retail store, and with the overall industry environment changing, we have been discussing how to focus our management resources, including discussions within TBC and with the two shareholders.
In this industry, division of labor is progressing, and the functions required for wholesalers are becoming more sophisticated and retailers are pursuing scale. This is due to the increasing variety and decreasing number of tires, size of tires becoming larger, as well as the growing number of different types of fleets.
In response to high-mix low-volume tire demand, we believe that we can provide customers with high added value by leveraging TBC's strong product lineup and large-scale warehouse network. For this reason, we will sell the retail business to a company specializing in this business, and we will allocate the management resources that we had been putting into the retail business to the wholesale business, as well as to franchises that have a network of stores throughout the United States. From the perspective of improving profitability, the company aims to improve supply chain sophistication and business efficiency using DX, etc. toward turnaround.

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