

IR Meeting on Financial Results for FY2023 Q2: Questions and Answers

[Date]	November 6, 2023	
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<Questioner 1>

What will be done about the three pending businesses, Ambatovy, TBC, and Fyffes, whose revenues continue to be sluggish, with only six months remaining in the current medium-term management plan?

<Hyodo>

Unfortunately, none of these three businesses have reached the point of meeting ROIC above WACC, but we will certainly carry out the strategy that we have set forth.

With regard to Ambatovy, the conditions necessary to achieve stable operations in the future have improved significantly since the start of this medium-term management plan. For example, the site management system has made significant progress in sorting out the technical issues that need to be addressed in implementation. Now we just need to get the results. As one of its shareholders, Sumitomo Corporation has high expectations for this project.

TBC has sold its directly managed retail business, and after integrating its wholesale business, it has been steadily working on reorganization to improve efficiency and management fundamentals, strengthening organizational capabilities, and increasing productivity. Together with our shareholder partner Michelin, we have high expectations.

It has been almost a year since Fyffes started a completely new management team. Fyffes is now executing its plan to add value to its current business with wholesale partners, particularly in Europe. We are getting to the point where we are waiting for the next few years to see the results of this process.

<Questioner 1>

What kind of discussions are going on right now in terms of investment and shareholder return policy toward the next medium-term management plan?

<Hyodo>

The blueprint of reaching a JPY600 billion profit level has already been completed and we are currently preparing and working to present more concrete information, including specific figures, of our next medium-term management plan.

We will continue our efforts to improve our sustainability management, which has been one of our major growth strategies, to identify specific investment items to utilize new technologies for our growth, and to continue to implement the asset replacement cycle based on the four strategic categories.

However, we should change the content of our portfolio considerably. For example, we have set a buffer of JPY50 billion for this year's asset replacements, but we believe that we need to continue to take necessary measures in advance in response to the external environment.

Even if all 53 strategic business units meet ROIC above WACC, we will continue to replace them after prioritizing them and evolve our portfolio.

In the next medium-term business plan and beyond, we will maintain the same approach, and we will always be greedy for profits.

The current shareholder return policy was made because this was the best for our company's business condition at the time we set up this medium-term plan.

We are currently discussing the next medium-term management plan and will further incorporate shareholder return policy as demanded by the market. We are currently discussing this with the understanding that the necessary conditions are in place to show additional returns.

<Questioner 2>

As for Metal Products, which has now been revised downward, should we assume that the possibility of recovery will be difficult in the next fiscal year onward?

<Morooka>

We have revised the forecast downward by approximately JPY20 billion for the North American tubular products business, but we have revised upwards for markets other than North America, such as the Middle East, due to strong demand, and for Metal Products as a whole, we have revised the forecast downward by approximately JPY 15 billion. In the Middle East, demand for energy transition-related products such as CCUS is beginning to emerge. Although demand is weaker in North America and inventory adjustments in the market are taking longer than expected at the beginning of the fiscal year, crude oil prices are at a high level, the use of drilled and unused wells is almost over, and the cost of drilling, including oil country tubular goods, is decreasing. Therefore, we expect inventories to return to appropriate levels, and rig counts and OCTG prices to turn around by the end of the year. The results of efforts to strengthen resilience in the North American tubular products business are showing results. Once we get out of the current situation, we believe that the level will be maintained to some extent next fiscal year and beyond.

<Questioner 2>

Out of the businesses that were key factors to reach JPY600 billion, is there any business that the business environment has changed since the beginning of FY2023?

<Morooka>

Automotive sales & marketing business, the construction and mining systems businesses are on track.

In overseas IPP/IWPP business, the profit expands based on the existing contracts, starting from FY2023 Q4.

In overseas telecommunications business, we have not changed our plan to generate revenue by expanding telecommunications areas, mainly in Ethiopia, but we are a little behind schedule due to the ethnic conflict in the country, and the plan will be reviewed once again in light of the latest situation.

Also, there are no changes in the retail and health care businesses. We have been taking steps steadily, and we expect them to be a major revenue driver for next year and the year after.

As for the agribusiness, geographic expansion and the functions we provide, especially the business of direct sales of agricultural equipment and materials, have struggled a bit with our base functions this time due to the decline in market prices. However, we were able to confirm that we have very solid functions, and we believe that this will lead to increased revenues for FY2025

<Questioner 3>

For Transportation & Construction Systems, in particular, automobile sales & marketing business, can you tell us the background of upward revision and whether this level will continue in the next fiscal year and beyond?

<Morooka>

In the automobile sales & marketing business, Q2 has been quite strong, and I think it will continue in H2. We are doing business in Iraq, Libya, and Ukraine, which are our priority countries in the Middle East, as well as in Central Asia, where we have been making profits since last year, although the scale of our business is not yet that large. Each of these projects has expanded considerably this fiscal year compared to the previous fiscal year. One of the drivers in particular is that demand is very strong, especially in Iraq and other countries, because of the current oil prices. In addition, we are now steadily expanding our sales network, and we expect further growth in the current fiscal year and in the next fiscal year and beyond.

As for Ukraine, we actually had to be very careful at the beginning of the period, not being able to put much in the plan, but business is booming as long as we can keep the cars in stock. Therefore, there were no special factors, but the current fiscal year was very strong. Of course, there were some large transactions, which will continue in the next fiscal year and beyond. In addition, our

earnings base is expanding very rapidly, so I think we can expect great things in the next fiscal year and beyond.

<Hyodo>

It is difficult to maintain strong performance if we remain in the same market, with the same customers, and in the same business scope. For example, the construction equipment business in North America is one of the pillars of the construction equipment business and although this business contributes greatly to our current revenues, I would still be concerned if we were to rely solely on it. We acquired a construction equipment business company called Aver Asia several years ago in the Asian market, where demand is expected to increase even more significantly in the future. While establishing these new pillars one by one, we are expanding our business and making investments while creating a system that enables us to implement specific strategies for the medium- to long-term expansion of demand for each of these businesses.

About three months ago, I, myself, went to Iraq, to see the site where the brand name Toyota Iraq is strengthening its sales structure, which has been enhanced even during the COVID-19 pandemic. They have a well-strengthened system of both after-sales service and sales, so well developed that it is on par with the sales system in Japan. Including the training of personnel, Toyota Iraq's system and preparations are very well prepared for the future market of 100,000 to 200,000 units, and we are ready to tackle the reconstruction demand in the future.

<Questioner 3>

What is your approach to investment in the next medium-term plan? I believe that your approach to investment will change after spending JPY50 billion dealing with problematic projects. What is the scale of investment and what areas do you think you should focus on in the future?

<Hyodo>

We will continue to expand invested capital in strategic business units that can produce ROIC exceeding WACC in the medium- to long-term.

I think what we need to strengthen is to add value to carbon. This is a very important point for existing businesses as well, and all businesses must change their business and their respective portfolios in a way that adds value to carbon.

For example, in the tubular products business, we not only deliver the tubular products needed for drilling on a just-in-time basis so that operations do not stop, but also further strengthen value-added services for the automation of drilling in upstream development on a global basis to create another revenue pillar. This will surely lead to decarbonization.

It is necessary to add to the business models of each of the existing businesses from this perspective. We are currently discussing this issue in concrete terms in the discussions of the next medium-term management plan.

<Questioner 4>

What is the background of the upward revision of Sumitomo Mitsui Finance and Leasing Company?

<Morooka>

The full-year forecast for FY2023 of JPY72.4 billion includes the Russian insurance claims and deposits from the aircraft leasing business. Excluding this, it is not a very large upward revision. However, based on H1 results, the business itself is doing very well. Our domestic business is strong, and the aircraft leasing business is also in a good business environment because the normal airline industry is doing very well right now. The real estate and other areas are also generating solid revenues.

FY2023 forecast is slightly lower than FY2022 results, due to upfront costs for system modifications and human resource development costs to expand our revenue base toward 2030.

<Questioner 4>

In Chemicals and electronics, are you already seeing signs of recovery? It seems that other trading companies are struggling in this area.

<Morooka>

We are certainly aware that the current situation in some markets is very difficult.

As for the trade in petrochemicals, we have to see that the petrochemical market continues to be very difficult, partly due to the sluggish Chinese economy. However, the strength of our strategic business units is in the area of supply–demand adjustment, where we earn profits by performing our trading function, and we expect to be able to conduct such business during this period of market transformation, by increasing spot transactions.

On the other hand, sulfuric acid business has been growing steadily, including the investment we made in the US this fiscal year.

As for electronics, we expect an adjustment phase in the semiconductor materials business to continue through the end of the fiscal year, but we anticipate a recovery from Q4.

Also, regarding the agribusiness, the demand period for Agro-Amaozonia is in H2, and sales increase is expected from the latter Q2 to Q3. Then, the pesticide trade is in demand from January to May. Since we will be in the demand season during this Q4, we expect to see a recovery in H2.

<Questioner 5>

Do you have any particular project in mind that will be using JPY50 billion buffer?

<Morooka>

Losses on sales, including withdrawals, that are already quite visible and concrete are included in the forecast by segment, as you can see in Infrastructure and Transportation & Construction Systems segments.

Regarding the JPY50 billion, we have several projects in mind, but it is too early to put them in the segment forecast. We have set this amount as a reserve for the asset replacements in order to strengthen the soundness of the portfolio.

<Questioner 6>

Can you tell the situation of overseas telecommunications businesses?

<Morooka>

Myanmar is facing currency depreciation problem. Since we are engaged in the cell phone business in Myanmar, our income is in the local currency, but some of our investments and facilities are denominated in foreign currencies. In other words, the depreciation of the currency will increase our foreign currency denominated payments. In addition, we have been facing increased competition with some of our competitors, and the cost of inflation has been increasing.

Our Ethiopian operations are in the start-up phase, but we are having a bit of trouble getting them up and running, and there have been some delays in development due to ethnic conflicts and other issues. They're trying to rethink their business plan a little bit at this point. The current plan is to return to profitability in terms of EBITDA in the next fiscal year, which is the plan shared among shareholders and with the management of local operating companies, but there is a possibility that this may be delayed a little.

<Questioner 6>

What is the reason of Ambatovy's downward revision? In addition, what is your outlook for the next fiscal year and beyond?

<Morooka>

The major reason is the decline in nickel and cobalt prices. The production volume for H1 was slightly down due to some equipment malfunctions and other factors. However, we are currently undergoing periodic repairs, and we expect to produce 40,000 tons of nickel for the full fiscal year, after thorough repairs to the entire plant. Our main goal for this business has been to stabilize operations at a high level. By doing so, the cost per unit will also go down. It is difficult to predict market conditions for nickel and cobalt, but our view is that prices will remain firm over the medium to long term. At any rate, what we can do is to stabilize operations and ensure high production output.

<Questioner 7>

You mentioned that you would like to invest in areas that add value to carbon in the next medium-term management plan. Market expansion in this field is unlikely to occur unless customers are willing to pay for and recognize the added value. Please tell us what areas are currently available where your company can leverage its strengths and where you can expect to generate revenue at scale with ROIC above WACC.

<Hyodo>

Let me begin by saying that our specific strengths are all 53 strategic business units and our points of contact with our customers. Naturally, our customers are also working on the issue of reducing their carbon footprint as a business challenge from the perspective of Scope 1, 2, and 3, respectively.

The very basic concept is that customers in the business value chain with high cost-bearing capacity will recognize the carbon value of the product and purchase it.

The key is to build a new value chain while leveraging the relationships and trust we have with our customers, and we are now trying to sell this value with our commercial products and customer network.

For example, there is a movement to achieve 10% SAF utilization as a goal for the entire aircraft industry on a global basis. This is where the value chain for SAF demand is emerging.

The key point is whether we can differentiate ourselves from other companies by leveraging our strengths, network and trust built through our leasing business, in this new SAF value chain including SAF manufacturing.

From this perspective, we are now delving into each of these opportunities, taking advantage of the strengths that our company has in each business. We will work to include as many of these items as possible in the menu of the next medium-term management plan. This is the specific strategizing for the advancement of sustainability management.

<Questioner 7>

Could you tell us what discussion are you having right now in terms of the B/S size and the appropriate leverage to achieve net profit of JPY600 billion?

<Morooka>

To be honest, I am not able to give you a definite answer at this time since our discussions are rather focused on business strategies and how to increase profits, rather than B/S aspects.

This may be my personal viewpoint, but I believe that the structure of allocating cash to investments and shareholder returns within the cash inflows from revenues and asset replacements will remain the same in the future.

One thing that may be different from the past is working capital. Since this is a short-term inflow and outflow of funds, I am wondering if this area could be addressed with debt.

Although we are in the very primitive stage of our discussion, we do not intend to increase leverage significantly.

<Questioner 8>

I believe that there are businesses that require in-depth judgment based not only on increasing value, but also on exit strategies, by utilizing buffers to improve the quality of assets.

Please tell your thoughts on what you should do during this fiscal year.

<Hyodo>

We will not postpone asset replacement and will continue to relentlessly pursue ways to strengthen the portfolio's downside resilience and earning power, and to improve efficiency.

From that perspective, we will accomplish what we have determined to do this fiscal year with a buffer of JPY50 billion. There are some things that we can decide on our own and others that we have negotiating partners with, but we will work hard on them.

<Questioner 8>

Are you properly building up assets and order backlogs that will lead to future profits in your business in order to reach a profit level of JPY600 billion?

<Hyodo>

During the current medium-term plan, we have been able to formulate a strategy to further strengthen 53 SBUs, identify investment opportunities, create a long list for investment decisions, create a short list, and execute investments.

I believe that we have developed strategies and investment execution plans that are sufficient to increase profits beyond JPY600 billion.

<Morooka>

Investment and loans amounted to JPY240 billion in the H1 against the initial plan of JPY500 billion, which is about 50% progress. When we updated the list of investment and loan projects, we found that there are projects approximately 40-50% higher than the JPY500 billion plan. We have been making investments around our strong businesses, and in the H2, we are seeing quite a few deals centering on our focus businesses, which we disclosed as drivers towards JPY600 billion.

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