Q&A at Fiscal 2021 Business Segment IR Meeting (Power Solution Group)

Date	June 3, 2021 (Thu.) 13:30 to 15:00	
Presenters	Katsuya Nakanishi	Group CEO
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Questions and Answers

Q. In relation to the earnings breakdown in the mid-to-long term profit plans (FY2024, FY2030), on page 9 of the material, please give a comparison with the current figures. What is your assumption on cashflow in relation to this profit target?

A.

- We cannot comment on the details of the mid-to-long term profit plans.
- As of today, thermal power generation assets serve as the main driver of Group earnings, excluding Eneco. We will divest from the thermal power generation assets, while concurrently growing the earnings of the renewable energy business.
- We plan to double the owned generation capacity (net equity base) of renewable energy towards FY2030, compared to FY2019. However, due to the current popularity of renewable energy, a big premium is required when acquiring brown field projects, so we intend to steadily develop and build up green field projects first.
- In building up our assets, we will maintain financial discipline, and will generate funding to cover the investments by replacing existing assets. We will divest from thermal power generation assets at the right timing and generate profits from the divestments.
- Therefore, in terms of the earnings breakdown, the current earnings from thermal power generation assets will shift to gains from the divestments, as well as earnings from the new renewable energy businesses. The cashflow needed to make new investments will be generated by the divestments of existing assets.

Q. Please explain your policy on domestic offshore wind power generation. I understand Mitsubishi Corporation is participating in bids for projects in 3 locations in Japan. As competition intensifies for domestic green field projects, can you secure sufficient profitability? Or, will you focus more on building a track record in terms of the number of projects rather than profitability, at least in the early stages of the business?

A.

- First, as for our strategy in relation to the regions in which the Group conducts business, we have positioned Japan, Europe and the U.S. as the 3 focus geographies. I will explain the current situation in Europe and the U.S. before I move on to Japan.
- In Europe, we are achieving profitability through our subsidiary Eneco and the offshore transmission businesses, and in the U.S. through our subsidiary Nexamp which is engaged in the distributed solar power generation business*.
- On the other hand, in Japan, although we have begun initiatives such as solar power generation, the size of the business is still smaller than that in Europe and the U.S.
- Therefore, we are promoting the domestic offshore wind power generation business with the aim of reaching a size that leads to good balance between the 3 core geographies; Europe, the U.S. and Japan.
- The first offshore wind power generation project we participated in was the 2011 project in the Netherlands. We have spent around a decade since then, building up expertise and experience on the business, and we expect to generate sufficient returns that is in line with the firm's investment principle.
- We expect the domestic wind power generation projects to begin in the late 2020's. Until then, we plan to grow our earnings mainly through the gains from the divestments of thermal power generation assets, as well as business expansion in Europe and the U.S.

  * A distributed solar power generation business is a business that realizes local power production and consumption, and it also realizes selling electricity to customers directly.

Q. Please explain the recent business status of Eneco. I recall the CAGR expected at the time of acquisition was 10%. Any changes in your assumptions?

If all of your projects under development are completed, how much will the renewable energy-based generation capacity increase?

A.

- In FY2020, we booked the impact from changes in the Dutch tax scheme due to COVID-19 (cancellation of the corporate tax cut) as a one-off loss. Although profit from the BtoB business declined due to the lockdown in Europe, this was offset by profit growth in the BtoC business as well as cost reductions, and if we take aside the impact from changes in the tax scheme, we were able to secure the originally expected level of profit.
- In terms of future earnings, we should be able to achieve the 10% CAGR target, with the COVID-19 situation in Europe improving.
- The current renewable energy-based power generation capacity of the Group is 3.3 GW, out of which Eneco accounts for 1.5 GW.
- There is 0.6 GW of additional capacity that is already certain, including the power generation facility for Amazon announced last July. By the year 2025, Eneco alone should have around 2.2-2.3 GW of power generation capacity.
- Aside from Eneco, we are adding solar power generation assets at a pace of around 0.3 GW per year in the U.S.
- On top of the projects already mentioned, there are 2 offshore wind power generation projects coming up in the U.S., although it is too early to say whether operations will start in 2030. Moreover, we expect to be adding a number of domestic offshore wind projects as mentioned earlier, although we have not included them in the pipeline because we still have not won the bid.
- Based on all these factors, we believe we can double the current renewable energy-based power generation capacity of 3.3 GW to 6.6 GW by 2030.

Q. In terms of shrinking the thermal power generation business, will it not be difficult for trading companies to drive the process forward, considering the intentions of the host countries, as well as the existence of long-term PPA's (power purchase agreements)?

A.

- As you point out, it is hard to withdraw from thermal power assets in Asia, for which there are long-term PPA's.
- However, the thermal power assets totaling more than 7 GW in coal-fired and gas-fired, most of them(gas-fired) is in the U.S., where the power business is liberalized. The market is fluid, and we believe it is not difficult to divest the assets.
- Moreover, the simple sale of assets is not the only way of withdrawing from the business. For example, Eneco owns some thermal power facilities that are used to generate steam, which could be replaced with heat pumps. Technology conversions such as this is another way to shrink the portion of thermal power.

Q. How do you view the market environment in relation to the divestment of / withdrawal from the thermal power generation assets? Is it becoming harder to justify the economic rationale of thermal projects, with increased focus on ESG?

A.

- Gas-fired thermal power generation assets will continue to be economically viable.
- On the other hand, for coal-fired thermal power generation assets, there was sufficient economic rationale 2 years ago when we sold the project in Chile, but the future outlook is uncertain, as you pointed out.
- The last remaining coal-fired asset is the Vung Ang 2 power station in Vietnam. We assume to continue this business by maturity of the PPA rather than a divestment, and we will work toward achieving a low-carbon thermal power generation business by ammonia or hydrogen co-combustion.

Q. In relation to the 1.8 trillion yen of Group assets, if the assets are to be replaced through the asset replacement model, the ROE could decline. For the renewable energy business, which you will double your capacity, will you be able to secure earnings by applying the asset recycling model?

A.

- Currently, total assets of the Group is 1.8 trillion yen, out of which 1.2 trillion yen is investments assets.

- In terms of renewable energy-based power generation, which we plan to double, we will maintain returns by focusing on the development of green field projects, rather than brown field projects which have a high premium. Moreover, by replacing renewable energy-related assets through the asset replacement model, we also expect to secure capital gains.

Q. With expected returns falling due to the renewable energy boom, is it correct to assume that there is a substantial valuation gain on the assets owned?

A.

- That is correct, although we cannot disclose the actual amounts.

Q. How high is the possibility of achieving the FY2024 profit projection on page 9? In which businesses and regions is growth expected?

A.

- We cannot discuss the details of the FY2024 profit projection, but we are assuming two main drivers of profit growth.
- The first is the earnings expected from Nexamp, which is engaged in distributed solar power generation in the U.S. Since becoming a subsidiary in 2016, Nexamp has been expanding its business, and we will be entering the collection phase of our investment.
- The second driver is the expansion of renewable energy, centered around Eneco. Eneco may be regarded as a company focusing on large offshore wind power generation facilities, but its true strength lies in the comprehensive renewable energy business, such as onshore wind and solar power projects rooted in the local areas. We will continue to leverage on these strengths, and pursue continuous earnings growth.

- To add some details on the first driver Nexamp, as shown on page 13 of the material, Nexamp is a distributed solar power generation company in the U.S., based in Boston.
- Since our investment in 2016, the size of the business has grown approximately 26 times, and Nexamp has become the leading company in distributed solar power generation in the U.S.

- Since investing in Nexamp in 2016, the company's management policy has been to make the scale of businesses growth over the mid-to- long term. As a consolidated subsidiary, MC has provided financial support.
- The company plans to gain the unrealized profits from Nexamp going forward.

Q. One of your strategies is to strengthen the retail business. Please quantify the size of the retail business in 2030 in terms of earnings as well as the breakdown by region.

A.

- Eneco has diverse functions including power generation, trading and retail, and its customer base reaches 6 million customers.
- Going forward, with the growth of the renewable energy business, one of Eneco's challenges will be the intermittency of power supply, due to the impact from changes in the weather. Therefore, in order to strengthen its retail business, Eneco will also need to strengthen its trading operations, in order to overcome the intermittency of supply.
- For example, if the trading side can provide functions to adjust the demand and supply, using digital technologies, it will allow the retail side to provide high value-add services. Moreover, by bringing together Eneco's strong customer base rooted in the local areas with Mitsubishi Corporation's strength as a trading company, we would like to expand services other than power-related services.

  In terms of domestic initiatives, as shown on page 14, we established Chubu Electric Power Miraiz Connect this April together with Chubu Electric Power Miraiz. We will improve the levels of existing services for Chubu Electric's customers, while developing a diverse range of services including non-power related services, through customer analysis using digital technologies. We expect the business to turn profitable in around 2025.

Q. In relation to your focus on the downstream areas in the current Midterm Corporate Strategy 2021, how will you allocate management resources in the power business among the different regions and businesses?

A.

- In the recent business environment, there are fewer projects that use the long-term PPA or long-term feed-in tariff scheme, and you need the ability to sell electric power yourself (retail). In order to sell, the ability to integrate (trading) is also required. One of the key features of electric power is that it is produced and used locally. Therefore, under "power generation through retail strategy" (the Strategy) which requires the ability to both sell and integrate electric power in the local area, it is not possible to promote projects in all regions.
- Our plan is to apply the Eneco model of the Strategy in the U.S. and Japan.
- In the U.S., we have already been laying the groundwork for applying the Eneco model, and have completed the acquisitions of companies such as Nexamp, which is engaged in power generation, and Boston Energy which is involved in trading. All we now need is retail, and we will have the same model as we have in Europe.
- In Japan, we have participated in bids for offshore wind power generation, with the aim of strengthening renewable energy-based power generation. We set up Chubu Electric Power Miraiz Connect, and have just begun working on the retail side. We are continuing our efforts to build a model similar to what we have in Europe.

Q. Due to the nature of electric power and how it is generated and used locally, there must be new business opportunities in the electricity wheeling market between different regions, using the grid. Please share your outlook and views on the electric power grid business in Japan and Asia.

A.

- In Japan, as power sources become more distributed, the shift to renewable energy will continue. And with the shift to renewable energy, we are interested in the business potential of community-based small-sized distributed grids, and will assess the potential.
- Meanwhile, in Asia excluding Japan, thermal power generation is still mainstream, and the privatization & liberalization of the power generation business will take some more time. It takes long time to contribute the Strategy which the Group will focus on for the time being.

Q. What impact will the rise in electricity prices in Europe have on Eneco's earnings?

A.

- Out of the total amount of electricity sourced by Eneco, it generates one third using its own power generation assets, while the remaining two thirds comes from the electric power market.
- As for the portion sourced from the market, in principle the sourcing price is linked to the sales price, and Eneco conduct hedge transaction in order not to take price fluctuation risk. Therefore, even if incidents such as the sharp rise in electric power prices in Japan this January, or the price hike due to the cold wave hitting Texas in the U.S., take place in Europe, the impact on Eneco's earnings will be limited.
- In the future, by building up renewable energy-based power generation assets, we plan to raise the inhouse power generation ratio, and better balance it with electric power sourced from the market.

Q. Is it correct to assume that at least in the short-term, the rise in electric power prices has a positive effect on the power generation side, so it works positively for Eneco?

A.

- Yes, that is correct.

Q. As you seek to expand the renewable energy business, what will be the ratio of your business in which profitability is guaranteed through the FIT (feed-in tariff) system, and what is the portion of your business that will be based on market pricing?

A.

- First of all, in Europe, there basically is no FIT. Therefore, we will secure stable earnings through long-term PPA's with large customers, such as the Amazon data center project announced last year.
- Moreover, for the distributed power supply businesses in other regions, we already have a customer base. As long as we have both the power source and the customer base, through the Strategy, the balance between demand and supply should be achieved.
- In the U.S., there are government subsidies equivalent to FIT, and Nexamp is making use of these subsidies.

- Lastly, for Japan, there has been a significant decline in the pricing of solar power, and a similar decline can be expected for offshore wind power generation going forward. However, we should be able to maintain a certain level of profitability, because the FIT scheme is still in place.

Q. Please explain your strategies and positioning of the offshore transmission businesses.

A.

- We have strengths in the offshore transmission business in Europe, and have around half of the market share in the UK. This dominant market share is due to the high barrier to entry in bids, with strict requirements on the track record of operating offshore transmission lines.
- Although there is not much upside, earnings are guaranteed as long as utilization of contract is maintained. Once the asset is up and running, we sell our stake to pension funds etc. to collect our investments or generate capital gains.
- We are looking into how the positioning of the offshore wind and the power transmission line business could change in the future, if changes in the business environment for offshore wind power generation result in green hydrogen or green ammonia being produced, and we could be actively involved if there is upside available.

Q. Does that mean that even with a shift to green hydrogen, the business model of offshore transmission businesses itself will not change, and there could be more business opportunities?

A.

- The key is whether unbundling ownership (regulations that legally separate power generation and transmission, including the ownership rights) will continue or not.
- If offshore wind power generation and power transmission assets are deemed to be part of the equipment dedicated to produce hydrogen, rather than a power generation asset, its positioning could change from what it is today.