Q&A at Investor Meeting

Financial Results for the Three Months Ended June 2019

Presentation Date: Thursday, August 1, 2019 17:00 to 18:00

Presenters: Kazuyuki Masu: Executive Vice President, Chief Financial Officer
Yuzo Nouchi: General Manager, Corporate Accounting Department
Hiroshi Takehisa: General Manager, Investor Relations Department

Questions and Answers

Results

Q. In the three months ended June 2019, progress in the Business-related sector toward the forecast for the full fiscal year was low. Was this a result of worsening global economic sentiment? Do you expect progress in Petroleum & Chemicals, Automotive & Mobility, and Food Industry, which particularly lagged, to improve?

A.

- Yes, results were affected by worsening economic sentiment worldwide.
- The year-over-year decrease in profit in Petroleum & Chemicals was due mainly to unrealized loss of derivatives in the overseas petroleum business as well as decreased profit from SPDC Ltd. reflecting a drop in sales prices of ethylene glycol and other products in the petrochemicals business. We are not currently planning to change the segment forecast for the fiscal year.
- The decline in profit in Automotive & Mobility was due to lower equity earnings in the Asia automotive business and from Mitsubishi Motors Corporation. The Asia automotive business was hit hard by slowing demand growth for automobile in Thailand and weakening automobile demand in Indonesia and China. However, business environment deterioration was incorporated into our plans from the start, so we are not planning to change the full-year forecast at present. As for Mitsubishi Motors, they have announced their own full-year forecasts, so please look there.
- The main factor contributing to the fall in profit in Food Industry was the impact on the salmon farming business, Cermaq, from red tides in Norway, increasing production costs in Chile, and slackening the North American market. Deemed sales volumes* are rising in Norway and Chile, which will compensate for some of these negative factors. However, we expect business environment to remain challenging for some time, as the North American

market remains lackluster, and recovery from the increase in production costs in Chile will take time.

*Volume including matured and sellable fish at farming sites

- As for whether or not the rate of progress will improve, we expect to realize gains from reversal of the derivatives in the overseas petroleum business when actual transactions are made in the second quarter and onward. We also expect to recover some of the profit lost to red tides in the salmon farming business through insurance claims.

Q. You seem to regard the slow progress in the Business-related sector with a sense of urgency, but the overall rate of progress was 27%. Do you expect to raise the forecast for the full fiscal year? Or is there a possibility that you will not reach it?

A.

- The market consensus exceeded ¥600.0 billion at the time we released our forecast for the fiscal year, but I think it may be difficult to do so. On the other hand, we do not currently feel in danger of falling short of ¥600.0 billion, either.

Q. In the Automotive & Mobility Group, while overall automobile demand in Thailand is growing, results in your business there have worsened. What factors in the competitive environment caused this, and what is your forecast going forward? Could results end up lower than your initial assumptions?

A.

- Automobile demand in Thailand saw year-over-year growth from April to June. Looking just at June, however, demand edged down year over year for the first time in 30 months. Sales of the Isuzu vehicles that we handle increased slightly year over year, but rising promotional costs due to intensifying competition led to a decrease in profit. We expect conditions to remain challenging going forward.
- Impact from tougher competition was expected in our initial forecasts, to some extent.

Q. What caused the increase in production costs in the Chilean salmon farming business, and do you expect improvement going forward?

A.

- Overall costs have increased, from farming to processing, including transportation costs. Intensifying competition is also playing a part, thus this tough situation may continue for some time, but we have already begun to take countermeasures.

Q. What caused the decrease in profit in the Australian metallurgical coal business, and what was the impact of the disposal of the Australian thermal coal business? What is your forecast for the Mineral Resources Group in the second quarter and onward?

A.

- The profit of Mitsubishi Development Pty Ltd. fell approximately ¥6.0 billion year over year. To break that down, price and royalty factors were down about ¥1.0 billion, and volume and cost factors were down about ¥11.0 billion, while foreign currency factors were up ¥5.0 billion and other factors were up ¥1.0 billion. Volume and cost factors mainly consisted of increased contractor and other production costs.
- Aforesaid year-over-year increase in production costs was incorporated into our plans, thus it did not represent an increase over initial forecasts.
- While we cannot disclose specific monetary amounts, the disposal of the thermal coal business resulted in a year-over-year volume decrease of approximately 1.0 million tons. This impact is included in "volume and cost factors."
- In the second quarter, maintenance is planned at the coal wash plants for some mines, but overall production volume is expected to increase year over year thanks to production optimization at the Peak Downs/Caval Ridge mines completed in the previous fiscal year. This is expected to help improve productivity, as well.

Q. You explained that the concentration of the shale gas business's profit in the first half of the fiscal year was a factor behind the Natural Gas Group's increased profit. Could you tell us what caused this and your forecast for the

business?

A.

- Due to the seasonal impact of the winter rise in gas prices as well as increased LNG production, the shale gas business recorded a net profit in the first quarter and did better than our initial forecast. However, for the full fiscal year, we once again expect a net loss. As cost carry forwards will end with the current fiscal year, we expect the business to contribute to profit from next year onward.

Q. The Consumer Industry Group and Urban Development Group appear to be doing well. What factors contributed to this, and what is your forecast for these groups going forward?

A.

- In part because profits at Lawson Inc. tend to be concentrated in the first half of the fiscal year, we do not expect the full-year results of the Consumer Industry Group to greatly exceed our initial forecast.
- In the Urban Development Group, gains on asset sales in the overseas and domestic real estate businesses proceeded faster than our expectation, resulting in a high rate of progress for the quarter, but these gains were largely incorporated into forecasts for the fiscal year.

<u>Midterm Corporate Strategy</u>

Q. It appears there were no particular capital gains in the first quarter. What kind of progress, including capital gains from asset divestment, can we expect toward the realization of the value-added cyclical growth model introduced in Midterm Corporate Strategy 2021?

A.

- The approach of Midterm Corporate Strategy 2021 is to execute asset divestment based on a three-year investment plan. It does not assume capital gains in the short term.
- However, in light of recent results, we are aware of the necessity to accelerate asset divestment going forward and will take steps to do so.

Q. Under the "business management model" , there seem to be some companies, such as Lawson and Cermaq, where business is not going entirely smoothly, due to external factors. What are your thoughts on such companies? To the extent that they are not doing well, why is that, and what steps will you take in response?

A.

- The "business management model" is that in which we not only invest capitals, but also get closely involved in management. At Lawson, Cermaq, and all our other investment, we are currently implementing specific measures toward that end. In some cases, these may not yet have yielded results, but they were always intended as long-term initiatives. We believe that the fruit of these efforts will become apparent in the medium to long term.

Capital Policy

Q. Why was the investment leverage ratio omitted from the disclosure materials? Also, underlying operating cash flows remained firm, but there was not a great deal of investment. Will your investment strategy change in light of the uncertainty in the global economy?

A.

- We intend to continue using the investment leverage ratio as an indicator of financial soundness. We previously regarded 25%–35% as the target range for this indicator, but we expect this to change due to the application of IFRS 16. We are still calculating the details, so we plan to disclose the range from the second quarter onward. Please note that we plan to disclose the investment leverage ratio at the end of fiscal 2019.
- The tone of the global economy has not majorly impacted the amount of cash flows we are devoting to investment and is not particularly affecting our approach to investment strategy at present.

Q. As share buybacks are expected to boost earnings per share, assuming consolidated net income comes to ¥600.0 billion as planned, could the per-share dividend go higher than the initial forecast of ¥125?

A.

- Bringing the payout ratio closer to 35%, the target level under Midterm Corporate Strategy 2021, is important to us. However, as we use a progressive dividend scheme, we still need to keep the next year's profit level in mind when we make decisions about dividends. We will have to consider such factors as where we expect results for the fiscal year to end up and the increase in per-share earnings as a result of decrease in shares issued and outstanding due to ongoing share buybacks.

<u>Individual Businesses</u>

Q. How do you evaluate Chiyoda Corporation's performance?

A.

- Chiyoda Corporation is making steady progress, as planned. At the end of fiscal 2018, we recorded large provisions for losses on existing EPC projects. On the other hand, as a way of supporting the company, we have been negotiating cost sharing with customers. For example, through contract renegotiation for the Cameron LNG project, we secured certain incentive bonuses, capturing additional revenue. In addition, we have agreed to revise the terms of the Tangguh LNG project, the impact of which will be reflected from the second quarter onward. The results of such efforts to support Chiyoda Corporation are beginning to appear, and we believe that we are making solid progress.