

Q&A at Investor Meeting

Financial Results for the Six Months Ended September 2019

Presentation Date: Friday, November 8, 2019 14:30 to 16:00

Presenters: Takehiko Kakiuchi: President and Chief Executive Officer
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

Q. Midterm Corporate Strategy 2021 has set 35% as a future target dividend payout ratio, but the forecast for fiscal 2019 puts the ratio for the year higher than this figure. If performance recovers next year, do you plan to maintain that level? What is your dividend policy going forward?

A.

- We set the target payout ratio of 35% to reflect the average level of the Nikkei 225. Based on our current forecasts, the payout ratio for the current fiscal year will end up at approximately 39%. Given that the average ratio for the top 100 companies by total market cap on the Tokyo Stock Exchange is about 40%, we do not think 39% is unreasonable level. However, it does not mean we will aim to maintain this ratio, as we will maintain our policy to ensure that the per-share dividend not to decrease based on the progressive dividend scheme. The payout ratio will remain to be one of the factors for us to study whether our per-share dividend is too high or too low.

Q. This year's results show that MC's performance is still largely affected by the global economy, and it gave us an impression that management policy since Midterm Corporate Strategy 2018 and investment in growth have yet borne fruits. Could you once again explain your management policy going forward? Also, what measures are in your mind other than selling assets, if economic conditions get worsen from now ?

A.

- MC's investment policy is not to divest it in a short term period, but to take an active part in the management of our investees to encourage growth and increase consolidated profits, thus explicit changes are not always apparent within just one or two years. Sometimes our growth gets stronger and sometimes gets weakened due to cyclical elements of our businesses. Our management policy is to continue businesses in which we expect we can lead the growth through our involvement, and to reorganize or divest businesses in which we cannot. This approach is unchanged. I do

not think at all that our management is stagnating, as we are at a stage of carefully evaluating targets for investment and asset replacement. I would ask our shareholders to watch how each of our investees will be changed going forward from a longer-term perspective through our involvement in their management.

- To survive under worsening economic conditions, we must be an “insider” for each of industries on our business portfolio. And then, we analyze the mergers and alliances necessary to reinforce cooperation within the industry, as well as to shift to more robust and stable industrial structures, so that we can execute such measures at a right timing after a careful monitoring on the conditions. I believe this approach will also help us to strengthen our business foundations. Accordingly, please understand that such measures are not implemented in response to each dip in the economy, but take a certain amount of time.

Q. Stock markets remain at a high level while growth in the global economy is slowing down, thus it makes difficult to execute investments in growth under the investment discipline. Under such a circumstances, is there any change in your approach to investment and its amount expected during Midterm Corporate Strategy 2021? And what will be your countermeasure to increase ROE, if the investment amount in growth and the expected returns from it are to decrease ?

A.

- We have a long list of candidate investments, but we do not think we have to execute all of them during Midterm Corporate Strategy 2021 if it does not satisfy our investment discipline. I believe, patience is also necessary for management, thus I do not think we have to execute the investments during my period only because we drafted the plan at the initial stage, and will maintain the policy to carefully judge the execution based on the business circumstances. The total amount of investment is ultimately determined only as a result of this process.
- On the other hand, we are expecting some investments are coming up soon, thus it's not practical to anticipate no investment will be made during my period. We will move forward with projects that satisfy our investment discipline.

Q. Given the current conditions, including the revised results forecast, are there any changes to the initial plans for cash flows in Midterm Corporate Strategy 2021?

A.

- Seeing that we have revised results forecasts downward from the first year of the plan, it is not appropriate to say that underlying operating cash flows for the three

years of the plan will be unaffected, but even if they decrease in some degree, we do not expect the impact to be large enough to affect the planned investment in growth.

Q. Under the revised net income forecast for the fiscal year (¥520.0 billion), how much one-off gains are included in the net income of the second half (approximately ¥280.0 billion), which is somewhat higher than the first half? Please let us know the forecast of ordinary profit in the second half as it helps us to evaluate the performance for the next fiscal year. Also, what are your market assumptions for the remainder of the fiscal year 2019 ?

A.

- One-off gains and losses included in the plans for the second half of the fiscal year are still only forecasts, thus I cannot provide detailed figures, but capital gains due to asset replacement in accordance with Midterm Corporate Strategy 2021 have been factored in. Furthermore, results are impacted by resource markets, thus the forecasts for the second half are evaluated based on certain assumptions of resource prices without stretch.
- Additionally, rebound from the loss on trading derivatives recorded by Petro Diamond Singapore (PDS) is expected in the second half.
- As for market assumptions in the latter half of the fiscal year, while we cannot disclose our metallurgical coal price assumptions due to antitrust law constraints, one price with a significant impact is that of crude oil. In the LNG business, there is a time lag for about six months as an average between benchmark prices' trend and its impacts on our profits, thus price assumptions for the second half of the year are already fixed. As for copper prices, our plans are based on the current price level.

Q. Were there any important factors other than worsening economic conditions, such as slower than expected progress in Business Management Model, behind the downward revision to the full-year forecasts? If so, do you expect such factors to improve going forward?

A.

- Other than the loss on trading derivatives recorded by PDS in Singapore, the decrease in net income in the first half of the year was mainly affected by worsening market conditions. As we expand the businesses globally, it is difficult to avoid the indirect impact of such changes.
- We will draw up our forecasts for the fiscal year 2020 based on our careful observation

of the global economy, however we do expect some of our existing businesses that will contribute to increase profits. For example, revenues from the Canadian Shale Gas business are expected to increase due to the end of costs carry. In the Cameron LNG Project, the first liquefaction train is already completed, and the second and third trains are scheduled to complete in the next year, thus we can expect the increase in our equity share of production volume. In the Metallurgical Coal business, production optimization is expected to increase production volume. In the Thailand Automotive business, a new pickup truck model was released in October, and we expect sales to increase compared with the first half of the year, which was the end of the previous model. Daily sales at Lawson are also picking up and expected to contribute to the profit.

Q. Why did you decide to liquidate PDS in Singapore? Were there any governance issues behind the decision?

A.

- Upon the review on our business policy from the ground up, we decided to move the overseas petroleum business that had been handled by PDS under the control of the Head Office in Tokyo to re-construct its framework.
- We need to reflect on ourselves that we failed to detect the unauthorized actions of the former employee.

Q. You have said that you will maintain the progressive dividend scheme going forward. Does that mean you will continue it beyond the period of Midterm Corporate Strategy 2021?

A.

- We intend to continue it at least for the duration of Midterm Corporate Strategy 2021. We would like to maintain the basic framework going forward and be open to any better approaches.

Q. As a result of worsening economic conditions, the manufacturing industry as a whole is facing particularly challenging conditions due to decreased demand. Could you tell us about current conditions and forecasts for MC's operating companies in manufacturing industries?

A.

- Metallurgical coal, LNG, copper, and salmon farming for example, we do not expect the business environment to further deteriorate in the second half of the fiscal year

and onward. We formulated the revised forecasts for the fiscal year based on the results for the second quarter, which is thought to have been the worst business conditions. As such, we are not worried so much that performance will get significantly worsen in the latter half of the fiscal year.

Q. We have a positive impression with increased dividends, which reflected shareholder-focused management policy, however at the same time profit result indicated MC is vulnerable to fluctuations in the external environment. Can you give us anything to look forward to, other than recovery due to improvement in the economy?

A.

- We are currently studying industrial restructuring and investment in growth in detail. Please understand, however, that we cannot disclose the details prior to their implementation.

Q. Looking just at the three months from July to September, operating income came to about ¥100 billion and underlying cash flows to about ¥140 billion. The market has been taken aback by the speed at which performance has declined. Following the net losses of the fiscal year 2015, MC has revised its business portfolio and rebalanced its risk assets in the business-related sector and market-related sector at a ratio of 7:3. In light of the recent downturn in results, however, has there been any discussion about reexamining the optimal balance of the business portfolio, or do you believe that MC's earnings power is not declining?

A.

- We do not think that earnings power is declining. In both of the business-related sector and market-related sector, it is true that a large portion of our business portfolio is affected by the global economy. However, just as the prices of different resources—say, metallurgical coal and iron ore—move separately, our businesses do not always all move in the same direction. We are constantly analyzing what our business portfolio should be, but at present, we do not see a need for major revisions to our current policy.

Q. I understand that the reason that performance in the LNG business does not always correspond to market sensitivity to crude oil prices is because of the impact of spot trading that is not linked to crude oil prices. Could you tell us more about MC's LNG sales contracts and the portion of sales accounted for by spot trading?

A.

- As a rule, we set up long-term sale agreements linked to crude oil prices before finalizing LNG investments, but any excess volume resulting from increases in production capacity is sold at spot prices. It will not be resulted in losses as these are sales of excess and associated costs are low, but the decrease in LNG spot prices in Asia has narrowed the profit margin.
- We cannot disclose the proportion of spot trading in detail, but the large majority of sales is through long-term contracts. While the portion of sales through spot trading is limited, such sales have a high profit margin, which amplifies the effect of price fluctuations.

Q. You explained that earnings power is not declining, but, excluding the metallurgical coal business, ROA is below 2%, so in that extent earnings power is at a low level to begin with. Other than industrial restructuring, are you looking to increase profitability though, for example, internal reinforcement or organic growth?

A.

- Efforts within the Group include plans to transform business models via digitization and modify business structures through coordination among the Digital Strategy Department, Business Creation Office, and the Groups. We will explain the details of specific projects when they reach the appropriate stage.

Q. You explained how sales work in the LNG business, but what are the terms of the sales agreements for the newly developed Cameron LNG Project?

A.

- As with the other existing LNG projects, our basic policy for the Cameron LNG Project is to setup long-term sales agreements for our equity share of production before the final investment decision.

Q. Lawson's results have not been showing pronounced growth. What is your strategy going forward?

A.

- We are taking numerous measures including tie-ups with other industries in an effort to increase daily sales. Lawson will announce them when they reach the appropriate stage.