Questions & Answers at IR Meeting on Financial Results for FY2024 Q1

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<Questioner 1>

For overseas IPP/IWPP, compared to the initial forecast of 57.7 billion yen, Q1 results were 24.6 billion yen, showing strong performance when compared to FY23 Q1 and compared to the annual forecast. I'd like to know the background of this and its sustainability.

<Fuse>

Compared to FY23 Q1, the overseas IPP/IWPP business saw an increase in profits based on contract terms for existing projects, as well as increased revenue from the start of operations at Van Phong in Vietnam, resulting in a profit increase of approximately 10 billion yen compared to the same period last year.

Compared to the annual forecast, the progress rate is high due to cost improvements in multiple overseas power generation projects, and in offshore wind projects, profits are concentrated in Q1 due to favorable wind conditions in Europe, as seen in the previous year. We expect some of this upward trend to continue beyond Q2, leading to strong performance for the full fiscal year.

<Questioner 1>

I understand that the contract terms that contributed to the increase in profits compared to the same period last year were TJB, but since you did not mention in the explanation of the comparison with the budget, I understood that progress is in line with the budget. Regarding the cost improvements that are likely to continue beyond Q2, is that related to coal prices for TJB? I assume that TJB is benefiting more than expected from lower coal prices, and if coal prices remain at the current level, the outlook will be strong. Is that correct? Also, regarding cost improvements, when considering sustainability, please tell us what we need to monitor to predict them, such as coal prices.

<Fuse>

Regarding the contract terms, your understanding is correct. This started in FY23 Q4 and is in line with the budget. The answer to your second point, what is performing better than budget, is several overseas power generation projects performing better than budget due to cost improvements, etc.

<Takayama>
The cost improvement is not due to coal prices, but rather the overall operating costs of power generation, which was not as high as projected in the budget. It depends on the power generation operations for each fiscal year, but considering the fact that Q1 costs are not as high as we had expected in the budget, we believe that this will continue to a certain extent from Q2 onwards.

<Questioner 1>
Regarding the progress of investments, it seems that the company is on track with 1.8 trillion yen over the three-year medium-term plan, or 150 billion yen per quarter. Please explain the details of the investments, such as the scale and the level of return that can be expected.

<Morooka>
Although 150 billion yen is 1/12 of 1.8 trillion yen, there was no major investment in this quarter. The three projects listed in the highlights on page 5 of the presentation were in the 10 to 20 billion yen range, while the rest were mostly small-scale projects. Of the 150 billion yen, 70 to 80 percent will be allocated to SBUs in focus areas, such as acquiring real estate projects both in Japan and overseas and increasing assets in construction equipment rental. This also includes renewal investments.
We would like to come up with ways to explain when our investments will start contributing to profits in our Q2 disclosures. For example, the investment in a Norwegian owner and operator of offshore windfarm support vessel is expected to contribute to profits from a relatively early stage, while the investment in an Indian city gas business is expected to begin some time later.

<Questioner 2>
Regarding the Transportation and Construction Systems Group, I understand that construction & mining systems saw a decrease in profits, but leasing, ship, and SMFL saw increases in profits, and that overall are going well. I would like to know more details about what positive and negative factors that have contributed to this good performance.

<Fuse>
The Transportation and Construction Systems Group's Q1 results were 20 billion yen, an increase of 3.3 billion yen compared to the same period last year. Excluding one-off factors, the performance progress rate was 24%, and performing well overall.
The transportation business, such as aircraft leasing and shipping, is stable, with some businesses strong. On the other hand, the construction systems business saw a decline in profits due to a slowdown in growth in construction demand and increased costs such as depreciation expenses. Regarding Sunstate (a construction equipment rental business in the United States), one of our core businesses, growth in the non-residential construction business has slowed due to high interest rates and inflation, resulting in a weaker than expected start. The trend did not recover from FY23Q4, which

was weak even in the off-season, and occupancy rates declined, slowing the sales growth. Although the fleet was expanded, sales remained flat compared to the same period last year, and profits decreased compared to the previous year due to increased fixed costs and interest burdens.
Regarding the outlook for Q2 and beyond, we believe that demand will gradually recover toward the market levels expected at the beginning of the period, due in part to expectations of a predicted interest rate cut. However, we also believe that the recovery may not be enough to make up for the delays in Q1. We will implement various cost-cutting measures and work to improve business performance to a certain extent. The Trench business, which we acquired last year, is progressing as expected.

<Questioner 2>
Can we understand that SMFL's increased profits are due to improvements in aircraft leasing?

<Morooka>
The contribution is roughly half from aircraft leasing, and half from real estate business and general leasing business. The market environment is very good with strong demand from airlines.

<Questioner 2>
In Q1, the recovery is slightly slow in North American-related businesses such as construction systems, TBC, and tubular products, and it appears that demand is slowing down. U.S.-related businesses were doing well until FY23, but are there any signs that the trend is changing?

<Morooka>
We are closely watching our U.S. businesses to see if there is a turning point in the U.S. economic situation. Regarding North American tubular products, we have heard that due to consolidation in the shale industry, large companies are acquiring interests owned by smaller companies and investment behavior has change, focusing more on efficiency.
At TBC, inflation and high interest rates have reduced personal disposable income and stagnated demand, which is even affecting wholesale. In terms of product mix, demand has shifted towards lower-priced items, with high- and mid-range products selling less. We have also heard that in Q1, major competitor with financial issues proceeded with inventory disposals at very low prices, which had a dampening effect on the market, and we will be closely monitoring future developments.
Regarding construction machinery rental, as Mr. Fuse explained earlier, we have heard that there are some areas, such as California and Houston, where the situation is very bad, so we will continue to monitor the situation closely.
Our company has some other businesses in North America, such as steel sheets, but in terms of impact to the performance, the businesses I have just mentioned are the major businesses.

<Questioner 3>

I would like to know the situation of the projects after recording large impairment losses last fiscal year. As with Fyffes, it has gotten off to a slow start, taking into account the effects of restructuring such as reducing fixed costs. I had assumed that there would basically be no impact on business performance going forward, but I would like to confirm my view.

<Fuse>

I will explain Fyffes and Ambatovy.

First, regarding the situation at Fyffes, Q1 results were minus 600 million yen. Bananas and pineapples were strong, but melons performed poorly, resulting in an overall loss. Fyffes melons are winter melons, and the season ended in May. The market did not recover as expected, and bad weather in the producing areas at the end of the season resulted in a loss, and the impact on PAT exceeded 1 billion yen. On the other hand, bananas were strong. By narrowing down customers, sales volume decreases, but due to profit margins improvement, we plan to achieve the same level of profits as FY23, which achieved its record-high profits. At present, bananas are performing at a level even higher than planned.

The company expects to cover the loss from melons in Q1 with bananas and pineapples, and there are currently no changes to FY24 plans. The plan also takes into account a reduction in depreciation expenses for fixed assets due in part to impairment losses last year.

Regarding Ambatovy's nickel production in Q1, production volume decreased compared to the same period last year due to a utility plant issue occurred in December last year, but compared to FY23Q4, the plant's operating rate has improved, and production volume has increased. Nickel production in Q1 was approximately 8,000 tons, with operational status generally in line with plan.

The project plans to return to normal production from the second half of FY24 onwards, and expects to produce around 30,000 tons for the full year. In addition, annual production is expected to be just under 40,000 tons in FY25. With regard to accounting, the entire book value was written off as a loss at the end of FY23 in our consolidated financial statements, and currently, we are not recognizing any equity gains or losses.

<Questioner 3>

It was explained that the tubular products business is being affected by structural changes in the industry, but looking into the future, will the headwinds get stronger? While it depends on rig counts and oil prices in the long term, are you in a position to see the results of the structural reforms you have undertaken?

<Morooka>

The market conditions for tubular products in North America have been deteriorating since last year. Although the correlation between demand for OCTG and the rig count is not as strong as it was, the rig count assumption for this fiscal year was at around 600 units, while the current figure is below 600. I think it will recover slightly in the future, but I see it remaining at around 600 units on average. Given that oil companies are focusing on drilling efficiency and that technological improvements are improving productivity per well, it is likely to take some time for the rig count to recover significantly.

As for the market price of OCTG, we believe it will take some time until around the new year for the market to recover from its poor conditions.

I believe that if we had not implemented the structural reforms that we have been working on for several years, our performance would have deteriorated even further in this market environment. Even in this prolonged market downturn, we have been able to maintain a certain level of profitability and we believe that our structural reforms have been successful.

From a very strong performance in FY22, our business deteriorated in FY23 and is currently even worse, slightly behind initial forecasts.

We expect businesses in other areas to cover North America. The businesses are performing extremely strong, particularly in the Middle East. We are expecting large-scale transactions as well as aggressively capturing demand for CCUS. We would like to cover the decline in North America as much as possible.

<Questioner 4>

Regarding the full-year forecast for the overseas IPP/IWPP business of 57.7 billion yen, the FY23 actual result of 53.5 billion yen plus one-off losses (*) comes to 67.5 billion yen, resulting in a decrease in profits. If we compare the results for just Q1, it was 14.3 billion yen in FY23 and 24.6 billion yen this fiscal year, which is a dramatic improvement as there is no one-off. Compared to FY23 Q1, in what order have the following factors contributed to improvement: improved wind conditions, cost reductions, increased profits based on contract terms, and the start of Van Phong operations? Given the huge improvement in Q1 compared to the same period last year, what is the reason for the decline in profits in the full-year forecasts?

(*) Of the approximately -22 billion yen one-off losses in FY23 in the Infrastructure Business Unit, excluding the impairment loss of approximately -8 billion yen associated with the sale of the UK water business, the questioner estimated that the one-off loss associated with overseas IPP/IWPP business was approximately -14 billion yen.

<Fuse>

The largest factor in the profit increase compared to FY23 Q1 was due to factors based on contract terms, followed by the start of operations at Van Phong. The smallest factor is an improvement in wind conditions.

<Takayama>

Regarding the reason why the overseas IPP/IWPP business's FY24 forecast of 57.7 billion yen is a decrease, based on an estimated figure that adds back one-off losses to the FY23 actual results, one reason is that it was assumed that wind conditions, which were favorable last year, would not be as good this year. Another reason is that last year, a number of existing projects saw a combination of favorable factors, but that is not expected this year. These factors have accumulated to result in a decline in forecasts.

However, there have been some changes from our initial assumption, for example, the wind conditions in offshore wind power projects have actually been quite good this year.

<Questioner 4>

For Chemical Solutions, progress appears to be low, with Q1 profits of 5 billion yen compared to the full-year forecast of 40 billion yen excluding one-off items. How do you evaluate the Q1 performance of the basic chemicals, electronics, and agribusinesses? I would like to know how you feel about the probability of achieving your full-year forecast.

<Morooka>

Basic chemicals, electronics, and life sciences were stable compared to the same period last year and also performing well towards the annual forecast. On the other hand, the agribusiness decreased compared to the same period last year. For example, Agro Amazonia is usually weak in Q1 to begin with, but the current minus 2.6 billion yen figure was due to several special factors. The first reason is that last season, El Niño caused soybean and corn plantings to be postponed or canceled, resulting in reduced profits for farmers. As a result, provision for doubtful receivables were incurred in Q1. The second reason is the negative impact due to technical accounting procedures. Since the terms of accounts receivable and accounts payable are long, interest is calculated based on the period, and discounted profits and losses are booked when receivables and payables are booked. Currently, as we are trying to keep our payables under control, we are not discounting our payables, which means we are not generating profits. This is something that will come back later if we see this in the longer term. The third reason, also a technical one, is due to the change in the fiscal year end of Nativa, which we acquired in FY22, from December to March. In FY23, we consolidated the peak demand period from January to March, and this year we consolidated the off-peak period from April to June. In addition, the crop protection distribution business was sluggish due to the effects of drought in Europe and the impact of generic products.

Although Q1 was weak, overall, the businesses usually generate profits from the second half of the year due to seasonal factors, and we believe that the agribusiness will be able to recover over the full fiscal year.

<Questioner 5>

Regarding the Lifestyle Business Group, compared to the initial forecast of 12 billion yen, this Q1 was zero, although this may be due to seasonality. In Healthcare, you have stated that business expansion will occur both in Japan and overseas from Q2 onwards. What is the background to the profit increase from Q2 onwards, and the probability that the initial plan will be achieved?

<Fuse>

There are two reasons for the Lifestyle Business Group's low progress. One is the global fresh produce business, known as Fyffes and Highline, and the other is healthcare. Other businesses, such as retail and food, are doing well.

As I mentioned earlier, the low progress of Fyffes in Q1 will be offset from Q2 onwards by Banana's profitability exceeding the plan. In the healthcare business, for example, the profits of drugstore Tomod’s have decreased compared to the same period last year, but this is mainly due to the revision of dispensing fees applied to large-scale pharmacy chains. The drugstore and pharmacy businesses are generally progressing well against their monthly budgets.

As for how things will recover from Q2 onwards, some factors are seasonal, as well as growth due to expansion in scale through the roll-up strategy for dispensing and a recovery in earnings in overseas businesses, which have lagged behind in some areas. As a result, we expect the overall healthcare and lifestyle businesses to perform as planned.

<Questioner 5>

Cash flow earnings in Q1 were 195.7 billion yen, which, if multiplied by 12, come to about 2.35 trillion yen, which I think will exceed the 2 trillion yen target for the three-year medium-term management plan. Profits are expected to be 650 billion yen in FY26, and while you are planning to increase profits gradually, how do you view the fact that cash generation is somewhat favorable compared to profits, and do you think this will be sustainable going forward?

<Morooka>

Unlike profits, cash flow earnings of Q1 are usually greater than Q2-4. The reason is that dividends, not profits, are counted from equity method investments, and these dividends are paid out in large amounts in Q1. For reference, the cash flow earnings results by quarter in FY23 were, 178 billion yen in Q1, 150 billion yen in Q2 and 3, and just under 160 billion yen in Q4, with Q1 being the largest. Those of FY24 Q1 were 196 billion yen, which were about 18 billion yen increase from FY23 Q1. This is due to increased dividends from equity method investments and increased profits at stand-alone and subsidiaries.

<Questioner 6>

Regarding the real estate business, I believe construction costs have risen significantly. Has this had any negative impact?

<Morooka>

The plan is being made with cost increase to some degree. Regarding property deliveries, there has been no change in the number of properties or buyer’s interest. I believe that things will basically proceed according to plan.

[END]