Sojitz IR Day

Business Presentation Meeting (February 25, 2019)

Condensed Transcript of Q&A Session

General

First Questioner

Q. Could you please explain the progress in the year ending March 31, 2019, toward the investment and loan target put forth by Medium-Term Management Plan 2020, the likelihood that this target will be achieved in the three-year period, and the current outlook with this regard?

A. Smooth progress was made with regard to investment plans in the Automotive Division during the year ending March 31, 2019. Looking to the year ending March 31, 2020, we anticipate that investments will proceed more or less as planned as we are approaching the final stage of pre-closing negotiations in relation to already-approved projects. Investments are projected to be executed as planned in the year ending March 31, 2021.

In the Aerospace & Transportation Project Division, the accumulation of assets is currently proceeding as planned. There has been no change to the asset portfolio projection for the final year of the medium-term management plan.

As for the Energy & Social Infrastructure Division, smooth progress is being made in investments in renewable energy and gas-fired thermal power projects in reference to our investment plan for the year ending March 31, 2019, and preparations for the year ending March 31, 2020. In addition, we have identified certain projects from which we anticipate earning contributions in the year ending March 31, 2021. We are committed to generating revenue from these projects in order to achieve the targets for the final year of Medium-Term Management Plan 2020.

Second Questioner

Q. What are the main focus areas and targets of each division? Also, what are areas of strength for Sojitz and in what areas will you pursue growth or dedicate resources based on consideration of factors such as outside growth potential?

A. In the Automotive Division, our strength does not so much lie in a particular business field as it does in our ability to effectively manage 4,900 employees. We aim to grow the business of this division through the effective utilization of human resources for managing Group companies and developing new businesses, among other applications.

The Aerospace & Transportation Project Division commenced used aircraft and part-out operations during the period of the previous medium-term management plan, and these businesses are growing rapidly under the current medium-term management plan. In addition, we plan to allocate resources to this division’s business jet operations in light of the fact that the market is in a period of growth stimulated by the upcoming 2019 Rugby World Cup and Olympic and Paralympic Games Tokyo 2020. Businesses in the aforementioned areas are more oriented toward accumulating short- to medium-term earnings. Meanwhile, airport-related operations feature business models in which earnings tend to be accumulated over the medium to long term. Projects commenced during the period of the previous medium-term management plan have been taking shape under the current medium-term management plan. We will therefore be allocating resources to these operations while increasing the number of projects we are involved with a particular focus on those areas from which we can anticipate returns or asset accumulation during the period of the next medium-term management plan.

The primary focus of the Energy & Social Infrastructure Division will be Gas-to-Power projects. Having restructured this division to integrate energy- and generation-related organizations in April 2018, we see the development of Gas-to-Power projects as being a core part of this division's mission.

Automotive Division

Second Questioner

Q. In the Automotive Division, profit for the year (attributable to the owners of the Company) of ¥5.5 billion is projected in the year ending March 31, 2019. Subtracting the gain on the sale of MMPC Auto Financial Services Corporation of the Philippines from this amount, we arrive at a situation in which annual profit growth of around 20% will be required to achieve the target of profit for the year (attributable to the owners of the Company) of ¥6.0 billion set for the final year of the medium-term management plan. This looks like a substantial performance hurdle. Could you please provide an explanation of from where this profit will be generated? For example, will it come from existing operations, new projects, or forward-looking investments?

A. We are currently in the process of formulating our forecasts for the year ending March 31, 2020, and we intend to disclose these forecasts in May 2019. Based on the preliminary calculations we have already performed, we believe that the disclosed targets for the year ending March 31, 2021, are entirely achievable. There are two earnings pillars in three main pillars to the growth strategies of the Automotive Division. The first is the upside risk in areas where we have traditionally been refining our asset portfolios. The second pillar is the formed by new assets that were accumulated during the period of the previous medium-term management plan. Support by them, the likelihood of the Automotive Division achieving the targets set when the medium-term management plan was established is increasing. With regard to figures for the year ending March 31, 2019, performance excluding gains on business sales are also relatively strong.

Third Questioner

Q. Is there any risk that operations, such as Sojitz's Hyundai automobile businesses, may suffer sudden declines in profitability or need to be sold due to changes in transactions trends, as was the case in the Mitsubishi automobile business sold in the Philippines?

A. In addition to the Hyundai automobile management businesses started in Thailand, Puerto Rico, and Pakistan, we are also in the process of examining new business fields with the potential for growth, which Hyundai Motor Company Limited has not fully explore, and determining the extent to which we will allocate resources to develop operations in these fields through discussions with managers of the company. From a medium-term perspective, we believe the risk of cases such as the Mitsubishi automobile business in the Philippines emerging to be low.

Fourth Questioner

Q. In the process of expanding the automotive part quality assurance business, how will Sojitz leverage its strategies to grow profits?

A. The automotive part quality assurance business is conducted by Stratosphere Quality, LLC, a company that currently boasts the No. 1 share in the U.S. market along with high levels of customers satisfaction. While rival companies are specializing in the dispatch of inspectors and engaging in price competition, Stratosphere has fostered strength in its ability to acquire contracts for quality assurance procedures by accumulating inspection data to improve traceability as it pertains to quality. Looking at cases of airbag inspections performed by other companies, we will see that the demand for quality assurance inspections is incredibly strong. In addition, cross-border transactions are on the rise, and automobile production levels in Mexico continue to increase as manufacturers eye the U.S. market. We therefore intend to broaden the scope of this business in growing Mexico while expanding our operations in the United States in light of the ongoing production increases.

Fifth Questioner

Q. I understand that certain areas of operations that previously generated earnings in the Automotive Division are being withdrawn from. Could you please explain where the division is in the process of creating new revenue sources and laying the groundwork for future business development? Also, have these efforts been effectively linked to initiatives for improving return on assets (ROA). For example, given that the number of dealership businesses is rising, meaning that these businesses will have increased weight in Sojitz's profit mix, will these businesses contribute to higher earnings capacity or improved profit margins? Or, will Sojitz be instituting measures to enhance value and boost profit margins in existing dealership businesses?

A. The greatest asset for pursuing future growth is our human resources. The business model of the Automotive Division draws its strength from the accumulation of assets in the form of consolidated subsidiaries, which are sometimes even joint ventures, controlled by the Company. Sojitz dispatches managers to these companies to support them in growing and improving their profitability. It is relatively difficult to improve ROA with consolidated subsidiaries as the balance sheet of these subsidiaries must be recognized in its entirety. For this reason, we have chosen to use gross profit to gauge growth potential that cannot be measured in ROA.

Aerospace & Transportation Project Division

Second Questioner

Q. The slide on the used aircraft and part-out businesses features a flowchart detailing the value chain for the part-out business spanning from procurement to sales. In what part of this value chain does Sojitz add the most value?

A. Sojitz's greatest strength in used aircraft and part-out businesses is its insight pertaining to aircraft. This insight represents the portion of business models in which we are most able to add value. Based on our insight, we are currently positioning narrow-bodied aircraft as core products. Moreover, we have been working together with The Boeing Company for a number of years. Through this relationship, we are able to obtain early access to information such as the sales records of a given aircraft model or its market longevity. This information helps us choose high-quality aircraft, and we are thus generally able to completely sell our stock in cycles of about three years.

Third Questioner

Q. Sojitz stated its intent to grow the part-out business during the period of the previous medium-term management plan. However, there has been no disclosure of the profitability of this business. Could you please offer some details on the current scale of profits in this business, the amount of inventories to be accumulated leading up to the final year of the medium-term management plan, and the levels of profitability to be realized as a result? Also, are there any obstacles that are being faced in this business?

A. We cannot disclose details on the scales of profits or assets in the part-out business. However, we can say that, as of December 31, 2018, we handled 28 aircrafts in this business, and we are making smooth progress toward our target of 45 aircrafts under the current medium-term management plan. As for obstacles, aircraft can only be purchased in small numbers due to the procedures associated with these purchases, making it difficult to procure several aircraft at once. In addition, if we were to order several aircraft without sufficient thought, we would risk being saddled with low-quality assets. Based on these considerations, we aim to expand the scale of this business going forward while conducting M&A activities.

Fourth Questioner

Q. It would appear as though profit growth in the Aerospace & Transportation Project Division is being driven by the growth of Sojitz Aerospace Corporation. I understand that defense systems are part of this company's business. Specifically, what businesses do you expect to see grow over the next three years and how confident are you in this outlook?

A. Sojitz Aerospace generates its earnings through the defense business and the commercial business. Based on Japan's medium-term national defense plan, which was established in December 2018, Sojitz Aerospace can be expected to achieve a certain degree of earnings in the defense business, and it is unlikely that actual performance will deviate significantly from this forecast. The commercial business of Sojitz Aerospace, meanwhile, can be divided into three categories: materials, airline seats, and engine part-out operations. Sales of airline seats are linked to the aircraft introduction plans of airlines, and we can therefore anticipate earnings of a certain amount. Earnings from engine part-out operations, however, can fluctuate a little. Overall, we project that growth at Sojitz Aerospace will be relatively strong under the current medium-term management plan.

Fifth Questioner
Q. Sojitz has been advertising its approach toward asset replacement in the Energy & Social Infrastructure Division, which entails reducing resource assets and increasing assets in other areas. Is it possible that, in a similar manner, an expanded scope of operations in the Aerospace & Transportation Project Division will contribute to overall ROA growth? Also, do you see asset replacement as necessary for boosting ROA?

A. We anticipate that growth in part-out, used aircraft trading, and business jet operations will contribute to higher ROA. These operations employ business models that do not depend on assets to the same degree as other models, which will also help heighten ROA. As for asset replacement, we possessed six ships on December 31, 2018. We have no intention of greatly expanding our fleet, and we will look to sell aged vessels to the extent that we can do so without incurring losses.

Sixth Questioner
Q. Could you offer an explanation of projected profit growth leading up to the year ending March 31, 2021, from operations other than those of Sojitz Aerospace including details on factors behind this growth and the likelihood of these factors coming to fruition, as was provided for Sojitz Aerospace?

A. Aside from Sojitz Aerospace, the Aerospace & Transportation Project Division develops transportation and airport infrastructure and aircraft operations as well as the operations of Sojitz Marine & Engineering Corporation. Transportation and airport infrastructure operations include the Indian freight railway project, the business of Cad Railway Industries Limited, and the airport operation business. The Indian freight railway project is expected to proceed more or less on schedule, though this outlook is contingent on the progress of construction. Performance from new railroad projects and other engineering, procurement, and construction projects may diverge from projections as participation in these projects will be decided through bids. Our involvement in Cad Railway Industries takes the form of a business investment. Freight railway demand is growing steadily in North America, and performance at this company will not likely deviate much from our forecast. As for airport operations, Sojitz has currently approved investments in three airports. Airport infrastructure projects to tend to require time in order to realize profitability. Accordingly, earnings contributions from these projects will be limited during the period of the current medium-term management plan.

Aircraft operations can largely be divided into three categories. One of these categories is defense systems. The Company acts as a defense system sales agent in a similar capacity to Sojitz Aerospace. Some transactions in these operations are included in Japan’s medium-term national defense plan, and steady earnings should therefore be generated. In commercial aircrafts, we have already received orders in our conventional sales agent operations and we are also pursing orders for which competitions will be held going forward. For this reason, we anticipate that performance may climb slightly above our forecasts. As for business jet operations, we plan to increase the number of aircraft we manage and address new demand while conducting additional investments and loans. Business jet demand is growing in Japan, and we feel highly confident in our ability to generate profits.

Turning to Sojitz Marine & Engineering, this company develops marine-related and marine equipment-related operations. Overall, the markets for these operations seem to have bottomed out, and albeit slow, recovery trend has emerged. In marine-related operations, we aim to generate consistent earnings through past orders for new ships, used ship transactions, and chartering. As for marine equipment-related operations, shipbuilders in Japan and overseas are currently undergoing headcount optimizations. Against this backdrop, we will look to invest in fittings and peripheral engine components that are relatively free from volatility. At the same time, we will develop structures that ensure consistent earnings while limiting exposure in the marine transportation market.

Energy & Social Infrastructure Division

Second Questioner

Q. What are your policies for downsizing upstream exploration and production assets in the Energy & Social Infrastructure Division? I believe that Sojitz possesses certain interests in the North Sea. Meanwhile, the investment and loans and distribution by business chart on slide 5 of today's presentation materials showed that capital expenditures under Medium-Term Management Plan 2020 are only projected to represent 4% of total investments and loans, a decrease from 20% under Medium-Term Management Plan 2017. Is this decrease associated with exploration and production assets? I wanted to confirm this matter as such a decrease will free up funds for other investments. Furthermore, it would appear that resource businesses will still account for 19% of total assets in the year ending March 31, 2021. What does this situation represent? Finally, what is the greatest factor influencing whether or not orders are received for LNG terminals and for floating storage and regasification units?

A. In regard to exploration and production assets, Sojitz still holds its interests in the North Sea Gryphon Field, as you mentioned. We are engaged in the development of both crude oil and gas field projects, and it is our basic policy to sell upstream interests. As for the timing of these sales, we aim to avoid losses and to turn a profit if possible. The possibility of taking part in additional gas field projects will be examined based on the conditions seen as we move ahead.

A challenge going forward will be finding ways to rapidly reduce the remaining 19% worth of resource business assets and to redirect these funds to other investments.

LNG receiving terminals have become widely recognized as representing Gas-to-Power projects. Sojitz was able to secure participation in one such project in Indonesia. This accomplishment was no doubt a result of our relationship with our partner PT Pertamina. Our relationship with this company has continued since the 1970s, when Nissho Iwai Corporation, Sojitz's predecessor, assisted Pertamina in what would become its LNG development operations of today. LNG Japan Corporation, meanwhile, has bases positioned in Indonesia, through which it has formed a close relationship with Sri Lanka. In this country, LNG Japan has been engaged in power generation operations for much longer than its competitors. We have also built solid relations with partners in Bangladesh through past textile-related machinery and real estate transactions. In this manner, Sojitz's competitiveness is a product of its relationships with partners. This is particularly true when it comes to Gas-to-Power projects, which can be of massive scale. We are receiving substantial amounts of support from the Japanese government as we develop such projects in countries like Indonesia and Sri Lanka.

Third Questioner

Q. I suspect that gains on sales from replacing Sojitz's stakes in solar power generation projects are included among regular earnings as they are a part of the Company's main business. How should we look at this situation? Is it just that the large amounts of asset replacement are generating gains on sales that exceed earnings from existing generation projects, making asset replacement a main source of earnings? Also, will Sojitz be increasing the scale of its power generation stakes or maintaining the current level?

A. Our solar power portfolio currently consists of 12 projects in Japan with a gross generation capacity of approximately 280 MW. Spearheaded by Sojitz, development has begun at all of these projects, and we have already sold our interests in the majority of these projects. Our basic policy with regard to these interests is to generate a balanced mix of earnings from development, businesses, and sales while also quickly recovering invested capital by securing gains on sales through the sales of certain interests. The Energy & Social Infrastructure Division boasts an infrastructure asset portfolio of the scale of ¥110.0 billion, and project financing has been used for almost all of these assets. The application of the equity method is ideal from the perspectives of ROA and capital efficiency. As for whether or not Sojitz will increase the scale of its power generation stakes, this matter will need to be discussed by management, and I therefore cannot offer a definitive statement with this regard. However, I can say that we intend to expand our infrastructure asset portfolio from the current scale of ¥110.0 billion and to target ROA of 4% or 5%. Our future goal is to have around half of all of the earnings of the Energy & Social Infrastructure Division produced through power generation projects.

Fourth Questioner

Q. I saw the distribution of investment in the LNG receiving terminal in Spain. I believe that other trading companies are targeting projects of this manner. What was Sojitz's reason for participating in this project? Also, at what pace will the Company be expanding its receiving terminal and other LNG businesses?

A. This project is a being advanced through a joint venture established together with a major Spanish financial group and the government of Galicia. Sojitz's reason for participating in this project was our desire to work with these partners in projects in Asia, where there are several opportunities to take part in Gas-to-Power and LNG receiving terminal projects, and in projects in Central and South America, all areas in which these partners lack the necessary marketing capabilities. Sojitz is in need of expertise pertaining to LNG receiving terminals and to regulated industries that are difficult to enter. This need was shared by our partners, which led to our participation in this project. In regard to the timetable for our entering into new projects, we are currently focused on four or five projects. However, the outlook for Asian emerging countries is opaque at the moment due to various factors, including changes in government administrations, and we therefore cannot offer concrete details on the schedules of these projects.

Sixth Questioner
Q. It was stated that the Energy & Social Infrastructure Division contains an ICT business. It would seem as though the future growth path for this business involves coordination with the Social Infrastructure Development Office. Are there any concrete projects that are highly like to come to fruition to speak of at the moment?

A. The ICT business was introduced into the Energy & Social Infrastructure Division as part of the reorganization that took place in April 2018. Concentrated initiatives in this business have been moving forward centered on the Social Infrastructure Development Office for 10 months, although we have yet to realize any concrete projects. However, we have identified three fields that we will target. The first area pertains to the projected spread of 5G communications technologies in Japan leading up to 2020 and the large quantities of communications antenna this spread will require. Antenna sharing businesses are growing in Europe and the United States, and a trend toward these businesses can also be seen in Asia. Sojitz is therefore focusing on various trial communications tower sharing operations in Vietnam, Myanmar, and Indonesia with the aim of capitalizing on this trend. In addition, we are looking to receive contracts for data processing in light of the massive increases in data processing demand in the datacenter business, an area of strength for SAKURA Internet Corporation and Nissho Electronics Corporation. Data processing is often performed in regions with low electricity costs, such as Europe and North America. Data transmissions are possible so long as optical fiber infrastructure is in place, and we are therefore advancing several projects at the moment with goal of processing data with the lowest possible electricity prices. Another initiative was the small investment Sojitz made in DIGITAL GRID Corporation in January 2019. This company combines blockchain technologies with renewable energy to increase traceability and accelerate transactions. This business capitalizes on the push to source 100% of the power used for business purposes from renewable energy. In addition, the upcoming conclusion of the period for the feed-in tariff scheme for residential solar power systems and other systems will create a post-feed-in tariff market in which companies institute various initiatives exploring new means of handling power sources. Sojitz is targeting this market.

Seventh Questioner
Q. You offered explanations of a few LNG and gas-fired thermal power generation projects in the Energy & Social Infrastructure Division. I suspect that future cash flows from these projects will come in the form of dividend income. What investment return or cash-based standards are used when deciding whether or not to make investments? Also, it was stated that the project in Spain will serve as a foundation for future expansion. Does this mean that this, Sojitz's first project in this field, is aimed more at

creating footholds than at generating returns?

A. We consider two indicators when evaluating returns from power generation projects: internal rate of return (IRR) and ROA. In regard to IRR, we have set clear internal hurdle rates with standards pertaining to the nature of projects and countries. While I cannot disclose these rates, I can say that we conduct investments while assessing the extent to which projects can surpass these hurdle rates. Under the medium-term management plan, we are targeting consolidated ROA of 3%. Given factors such as non-consolidated selling, general and administration expenses, it will not be sufficient if we merely generate business earnings of 3%. Rather, we must target a higher level of earnings. Guideline figures, such as 4%, are set mainly by the Planning & Administration Office to account for differences that may arise from the business model or timing of involvement, or whether we choose to participate in project from the development phase or purchase a project that is already under operation. In terms of dividends, infrastructure projects tend to employ project financing to a significant degree, accounting for 60% to 80% of financing, and returns to sponsors are often not paid until a relatively late date. Based on these characteristics, we operate projects while incorporating measures for securing earnings upfront, such as through partial sales or through the exercise of our capabilities at the development phase. Meanwhile, we are in the process of identifying and moving forward with specific Gas-to-Power projects that we wish to take part in Indonesia as well as in Bangladesh, Vietnam, Sri Lanka, and Myanmar. However, the deals have not yet been closed, and we therefore cannot name projects.