

Condensed Transcript of Q&A Session from Sojitz IR Day (November 28, 2022)
Section 1: Sojitz's Value Creation Story—Energy Solutions Strategies

Presenter

Takefumi Nishikawa

Executive Officer, COO

Infrastructure & Healthcare Division

First Questioner

- Q. Could you please offer some details on the scale and sales of McClure Company?
Do you expect this company to see earnings growth in the year ending March 31, 2024, and beyond?
- A. I cannot offer an exact figure for the income of McClure, but I can say that it is generating a respectable level of profit. This company is showing growth rates of around 10%, due in part to the decarbonization trend and government subsidies, as stated earlier, and we expect this level of growth to continue in the year ending March 31, 2024, and beyond.
We also mentioned that Sojitz's involvement with McClure will expand its solar power generation business pipeline to encompass a capacity of around 75 MW. Our plan is to invest an additional ¥5.0 billion in this pipeline. We anticipate that we can create a more-efficient business model by producing ongoing earnings from these projects or by developing them to be sold to investors. These are some of these approaches we will take toward generating returns. Meanwhile, our previously mentioned electric bus business will require a bit more time to grow sufficiently. However, we do see a variety of other cross-selling opportunities through which to boost earnings.
- Q. Through what businesses has McClure achieved its share in Pennsylvania? Also, does this company employ a scheme of annually renewed contracts for services like maintenance?
- A. McClure's share in Pennsylvania is primarily attributable to its air-conditioning and LED equipment businesses. Schools replace their air-conditioning facilities around once every 15 or so years, and McClure supplies ongoing maintenance services over this period. However, if this company is unable to secure orders for new air conditioners, its only real source of revenue is maintenance services. Accordingly, how best to take advantage of the opportunities presented by these once-in-15-years replacements has long been a major point of concern for McClure.
- A. Toshinori Kawahara, Chief Development Officer, McClure Company:
I would like to add one point with regard to McClure's funds. As McClure has historically had good profit margins, this company is relatively proficient at generating cash. However, McClure uses the U.S. pass-through scheme, With involvement of Sojitz who has capital flexibility, the company can now offer new service to customers, which uses balance sheet.

Second Questioner

- Q. How will the Infrastructure & Healthcare Division create value in the future? I

do not fully understand the approaches the division will be taking in its projects. I recognize that the division's business contributes to the transition to new energy sources. When considering growth potential, profitability, and Sojitz's strengths, what areas do you view as promising targets for investing management resources?

A. There are two main areas we are envisioning. The first is reliable, conventional infrastructure businesses. This is an area in which we intend to continue developing our operations. For example, we are looking at renewable energy and thermal power generation, though we may face some restrictions in relation to decarbonization with this regard. If we can secure exclusivity for projects in this area over periods of 20 to 30 years, we should be able to recover our investment. We will seek to ensure stable cashflows from such projects.

The second area is growth businesses, healthcare for example. We didn't talk about the healthcare business today, as it does not fall under the umbrella of this presentation's theme. Nevertheless, healthcare is a core business of the Infrastructure & Healthcare Division and one we will continue to develop. We also expect to be able to take part in new businesses in this field.

In the healthcare field, we are branching out from the public-private-partnership projects we have engaged in previously, of which the hospital project in Turkey is one example. Specifically, we look to develop business models that contribute to the growing areas of pre-symptomatic and preventative medicine. Such models could include private-sector healthcare and clinic chains. Population growth is likely to spawn an increased range of initiatives for helping people live longer healthy lives. We also see potential for Sojitz to contribute to health in developing nations, where the middle class is growing.

Meanwhile, the U.S. energy service company (ESCO) business we spoke of early is built on the assumption that the market for energy conservation services will grow. We will continue to grow our business in this area, which we believe is rich with potential for us to utilize the network and business insight we have developed through our prior involvement in independent power producer businesses. We will do this while exploring digital technologies and innovations that we cannot fully utilize with only our conventional businesses.

Q. I suspect that reliable, conventional infrastructure businesses and growth businesses will come to represent a large portion of the investments made by Infrastructure & Healthcare Division over the next five to ten years. In specific terms, what sort of investment distributions are you envisioning? In addition, the business of the Infrastructure & Healthcare Division has a cash return on invested capital (CROIC) of only around 3%, which is low in comparison to other divisions. Is it safe to assume that the division will be increasing its emphasis on growth businesses to reach the value creation guideline figure of 3% for CROIC? What are your thoughts with this regard?

A. Businesses we have been involved in for a large number of years, like those of Nissho Electronics Corporation and LNG Japan Corporation, account for around 20% of the total assets of the Infrastructure & Healthcare Division.

The remainder of our portfolio is comprised of the renewable energy and other new businesses that we have been investing in over the past decade.

As I mentioned, our growth businesses are still incredibly small, but we anticipate that they will grow rapidly in the future. Investments are becoming more expensive due to the weak yen. Nevertheless, we expect to be able to improve CROIC by increasing the representation of growth businesses in our portfolio.

Improvements in CROIC have been slow. Regardless, we anticipate that CROIC will improve when we begin to see earnings from the numerous projects currently under construction at the moment. If a project fails to contribute to higher CROIC, we will likely withdraw in the end. In fact, we have already pulled out of the majority of our upstream interest projects, though this was no easy task. As we withdraw from the remaining projects, we should be able to recover greater amounts of cash.

Third Questioner

Q. You mentioned that the Infrastructure & Healthcare Division will be shifting from conventional businesses to growth businesses. It is my understanding that Sojitz is broadening its operations to include downstream areas. However, I have doubts regarding the potential scalability of businesses in these areas. Infrastructure investments tend to be large, and thus are effective at producing returns. For example, it seems that the U.S. ESCO business displays potential for the expansion of solar power and stock-type operations as a value-adding business. Meanwhile, the small scale of the projects Sojitz is engaged in suggests low growth potential. Do you think there are opportunities for developing scalable businesses outside of Pennsylvania?

A. Including indirect investments, our investment in McClure was around the same size as those in other independent power producer infrastructure businesses.

Earlier, we mentioned that an additional investment of between ¥4.0 billion and ¥5.0 billion might be needed to raise the value of the U.S. ESCO business. This investment amount is indicative of the scale of the business we will be developing going forward.

As for our prospects outside of Pennsylvania, we might not be able to immediately get involved in projects as there is a need to form relationships with local companies. Looking ahead, we do have the intent to integrate similar businesses in the surrounding states. We also see opportunities for developing energy conservation service and ESCO businesses outside of the United States.

In developing such businesses, we will seek a significant scale in each project while being rigorous in our screening of potential projects. For example, we will not invest ¥1.0 billion in a project that only has the potential to generate ¥100 million in returns.