

MOL's Transformation:

What will MOL look like after the Business Structural Reforms?



Junichiro Ikeda

President & CEO



Masato Sakaguchi

Analyst, Asset Management Division
Mitsubishi UFJ Trust and Banking Corporation



Hajime Hitotsuyanagi

Senior Analyst, Equity Research Dept.
Daiwa Securities Co. Ltd.

Question

1

What rationale lies behind launching this new round of Business Structural Reforms so closely on the heels of the fiscal 2012 reforms?

Hitotsuyanagi: First, I would like to ask about the reason and background behind launching the current round of Business Structural Reforms not even five years after the Business Structural Reforms conducted in fiscal 2012.

Ikeda: MOL conducted Business Structural Reforms for the dry bulker division in fiscal 2012 and recorded a large loss. Afterward, in this short time frame, we again had to implement the current round of Business Structural Reforms and record another loss. For this, I would like to sincerely apologize to our shareholders.

The main point of the previous set of Business Structural Reforms was to reshape our business model by moving our base for spot operations of dry bulkers to the main hub of Singapore and securing cargo contracts to reduce market exposure. In that sense, the current round of Business Structural Reforms aims to accelerate that move to thoroughly minimize market exposure.

This time, however, the outlook for the market is strikingly different. During the previous round of

reforms we thought the dry bulker market would recover in two to three years. However as seen in fiscal 2015, we faced a steep market downturn that defied our initial predictions. Ultimately, I believe the cause of this downturn is the broader, structural problem posed by the end of resource driven economies. We realized that the dramatic growth in transport demand that had been supporting the dry bulker market—that is to say the demand growth coinciding with the integration of China into the global economy—is over and that there will now instead be persistently low growth. We determined that it will be extremely difficult for the market to fully recover for the time being.

Since structural factors were at the root of the market stagnation, we absolutely needed to reform our business structure once again. We couldn't rely on the same business model as five years ago when we maintained fleet size in anticipation of a certain degree of market recovery. That is why this time we decided to be more thorough and vastly shrink our fleet size. We will again transform our business model, focusing on the core area where we have



Underlined words are explained in the Glossary on page 18.

expertise and maintain stable business based on long-term relationships with customers. This is how we arrived at this round of Business Structural Reforms.

H: I see. So you've considerably revised the fleet portfolio. When this current fiscal year is over, to what extent will MOL resemble the company you envision?

I: How rapidly we can reduce the size of our fleet depends on talks concerning redelivering the vessels with the ship owners of chartered vessels. Right now, we are committed to achieving our goals in the current fiscal year and are in the midst of earnest negotiations. If we can reach an agreement on redelivering vessels, the market exposure of our dry bulkers will be reduced. In addition, the vessel costs associated with MOL's remaining core

fleet will be reduced to current market levels, so even if current market conditions persist, the core fleet will not generate a loss.

On the other hand, some issues remain in the composition of our containership fleet. In the current round of Business Structural Reforms, we disposed of surplus containerships, recording impairment losses mainly related to owned vessels. Unlike dry bulkers, however, we were unable to completely transform the fleet. But I do feel that we have now come significantly closer to the industry average in terms of cost competitiveness. Unfortunately, we are not yet at a level where we can outperform all of our competitors so I cannot say that we have attained our ideal position. Going forward, we will continue to comprehensively restructure the containership business, focusing especially on strengthening our sales capabilities.

Question 2

What is the basic strategy for the containership business after the Business Structural Reforms?

Sakaguchi: Can I take this to mean that even after the Business Structural Reforms have been carried out, there will be no change in the basic strategy for containerships.

I: The basic strategy remains largely unchanged. There is no change in our goal of ranking in the top third of the industry in terms of cost competitiveness, and we are working hard to reach that goal. However, one issue in terms of earnings is our sales capabilities. In fiscal 2012, we felt that our sales capabilities simply couldn't be beat by our competi-

tors. Entering fiscal 2015, it became apparent that our performance, even among the three largest shipping companies in Japan, was inferior. We came to the conclusion that one of the causes behind this was our sales capabilities. For example, our slot utilization rates have continued to slide in comparison with our competitors, and this situation has become more pronounced. During the previous year, we seriously analyzed this. Based on what we learned, we are currently about midway in our efforts to reinforce our sales capabilities.

S: Looking at containerships from a medium-term perspective, if we assume that the external environment remains unchanged, how long do you think it will take for MOL to return to the black through its own efforts?

I: The current market conditions are such that the entire industry is bleeding red ink. At this rate, the industry itself may be at an unsustainable level, so I think this trend will reverse in some way. However, MOL is not just anticipating a market recovery; it is also still advancing initiatives to enhance its cost competitiveness. Fully leveraging the 20,000 TEU vessels slated for delivery from 2017 onwards will also play a part.



Question 3

How do debates with outside directors improve outcomes?

S: MOL is seen as one of the pioneering companies in Japan for corporate governance, due in part to its introduction of an outside director system in 2000. Nevertheless, the Company was again forced to implement Business Structural Reforms resulting in a large loss in fiscal 2015. Can you tell me what kind of discussions took place with outside directors at the Board of Directors meetings leading to the implementation of Business Structural Reforms this time?



I: As you point out, we introduced outside directors at a relatively early stage. I feel we have also been leaders in fostering an open atmosphere conducive to earnest discussion. At Board of Directors meetings, we welcome frank comments and questions from outside directors based on their backgrounds and experiences. These include questions spanning a range of previously unconsidered angles, often addressing the basics of whether a business decision was indeed fundamentally sound. They have a broad, comprehensive view of the global economy, trade structures, and the future investment climate. When we decide on an investment, we have received truly eye-opening remarks from outside directors in areas previously overlooked despite incisive deliberation, such as the outlook for crude oil

new customers. Moreover, we can expect our terminal in Cai Mep, Vietnam and other locations to also accumulate profits. Add to this the steadily growing logistics business, and we expect to return to the black in around two to three years if we forecast a moderate market recovery.

and energy demand going forward or how environmental issues will pan out.

MOL's Board of Directors typically meets for three hours, with one hour of each meeting set aside for the Deliberation on Corporate Strategy and Vision. This is not a deliberation on individual agenda items but rather a free-form discussion with a set theme about our business strategies going forward. Here, too, the outside director's remarks serve as an invaluable resource. Specifically, when we discussed the expansion of offshore businesses, we received a comment that went to the core of the issue, asking how we felt about the fact that this is a large investment and would mean making a bold entry into a very different field from our existing marine transport business model. This comment made a lasting impression.

And in regard to containerships, we have also received comments about whether this segment can even survive as a business. There was a consistently harsh exchange when we were coming up with ideas about how to improve the situation in relation to the Business Structural Reforms. The outside directors would always talk about relative inferiority. They'd ask where the problem is, if we had done a careful analysis and, if not, insist one be done. The matter that was the most difficult to perceive was the problem surrounding our sales capabilities. Admitting to ourselves that we were lacking in our sales capabilities was a tall mental hurdle to overcome. To a large degree, I think it was an outside director's strict admonition in fiscal 2015 that brought us to the point where we could make this realization. In determining the current round of Business Structural Reforms, we have also benefited from the counsel of the outside directors.

Underlined words are explained in the Glossary on page 18.

S: In last year's annual report, you said, "we are currently working to reinforce total risk control." If everything turns out as hoped, I believe MOL will be able to minimize losses even if the market experiences a downswing again in the near future. Please tell us about whether MOL has established a system capable of dealing with future market troubles and the status of these efforts.

I: Total risk control involves comparing the largest possible loss we could incur against our risk-free assets. There are both market risks and asset risks. We periodically assess whether we have an appropriate level of market exposure, looking at market risks in terms of how the market has historically evolved over the long term past and asset risks in terms of how asset prices of vessels have fluctuated. While monitoring our present position, we decide whether we can or cannot take on more risk. On the other hand, timing is also an important factor in making investments. We can't just say shy



away from all investment in a particular year because we don't want to assume any additional risk at all. These competing demands are weighed and decided by the Board of Directors through vigorous debate. In the past, there were situations where we had to make investments intuitively based on experience as we did not have any kind of formal system in place. Now, however, we make extensive use of quantitative analysis and I feel the process has become more transparent.

Question 4

Are there benefits to being a full-line marine transport group?

H: Based on our talk so far, I really want to ask about how the board members feel about MOL being a full-line marine transport group. Do they feel MOL should stay this course? Can you tell me about the debate regarding the issue?



I: Quite frankly, the debate did not begin with the assumption that MOL should remain a full-line marine transport group. Nobody thinks MOL has to be a full-line marine transport group so therefore it must retain the containership business. We have always tried to ascertain how meaningful a contribution each business will make to the Group. By doing this, we were in the end, able to accumulate enough businesses to constitute a full-line marine transport group. However, I do think that our portfolio management has been a clear strength in the current market, enabling us to hedge our risks.

Anyway, there was no assumption that MOL must remain a full-line marine transport group. Instead, debate obviously focused on whether or not we saw a path forward in the containership business. I feel that there undoubtedly is enduring value in the business and industry, as well as growth potential. Even now, though, we continue to regularly debate MOL's current strengths, namely whether it can achieve solid returns on its business assets and competitive strengths.

Question 5

What will MOL look like in a few years time?

S: What do you think will be different about MOL in three or five years from now?

I: Looking beyond the next three or five years, MOL's unchanging challenge is laid out in the Company's long-term vision "To make the MOL Group an excellent and resilient organization that leads the world shipping industry."

I'd like to explain the specific changes of our business metaphorically, borrowing from baseball. As MOL entered the 2000s, the Capesize bulkier business was a homerun slugger. Capesize bulkers consistently hit the ball out of the park, driving up our score.

Though the glory days of Capesize bulkers have passed, they continue to hold the key place in our batting order due to their long-term contracts. But you probably want to know who our up and coming new players are. They are the LNG carriers and offshore businesses, which are growing and after two or three years, will be solid batters in our central lineup.

However, these solid batters are not homerun sluggers or power hitters at the height of their glory days like Capesize bulkers, but rather reliable batters with stable batting averages. In the long term, we would like to find another star batter to replace Capesize bulkers, but I think it will be a while before this new star enters the lineup. Basically, I think we should assume that the business environment will not be like it had been before.

On the other hand, MOL already has many businesses that are hitting respectably, in the range of average hitters. Several fields that we had relegated somewhat to the periphery—such as terminals, logistics, ferries, domestic transport and real estate—have already grown to the point of each pulling in several billion yen annually. In addition, several niche businesses have also started making steady contributions to earnings. One example is specialized methanol tankers, for which MOL has the No. 1 market share globally. We should continue to invest resources in these businesses and work to add polish to their competitive strengths. Then

we might achieve a strong baseball team unified through great teamwork and reliable batting.

Moreover, we have opportunities in new fields, while planting a pivot foot in the marine transport industry. Our options include M&A when we see an opportunity to utilize our core competence and break into new fields. Furthermore, in regard to environmental regulations, which control the fate of the marine transport industry, I believe we must showcase our strengths to our customers and adopt a proactive stance toward environmental measures. In the IT field, we will continue to invest human resources as we need to achieve breakthroughs in these fields using AI and other technologies. I think this basically covers our game plan for the next three or five years.

S: Since becoming President, I'm sure you've met with many shareholders and investors. What stands out most from these conversations?

I: That would have to be the advice to be brutally honest, to provide the unembellished truth. Given a certain topic, how can you speak most objectively about it? You need to earn trust and show how you're responsive. When asked during a conversation, most people cannot help but to try to emphasize the positive. At this point, I think it is necessary to provide information to shareholders and investors while being very careful about not misleading them. I have been asked very pointed questions, but these turned out to be great opportunities to discipline myself for which I am very grateful.

H & S: We are also glad to hear that. Thank you for your time today.

I: Thank you.