28 April 2016

Mitsui O.S.K. Lines, Ltd.

Explanation by the CEO and Major Q&A

Three months ago, I announced here that we would implement business structural reforms and record an extraordinary loss of ¥180.0 billion in the fourth quarter of FY2015, as a result of the cost of those reforms. The backdrop for these business structural reforms included a rapidly deteriorating business climate for both dry bulkers and containerships since the second half of last year. We made the choice to take measures to swiftly prepare a structure that allows us to respond effectively to this difficult business climate. But this had a significant detrimental effect on shareholders' equity, and for that we express our sincere apologies.

We recorded approximately the projected costs for these business structural reforms. The benefits will be achieved steadily from FY2016, but I regret to say that in fact, the benefits will be offset significantly in FY2016 by further deteriorating market conditions.

1. Supplementary Explanation of FY2015 Financial Results

[Overall]

Despite favorable winds of the yen's large depreciation and lower bunker prices, ordinary income for FY2015 was ¥36.2 billion, a decrease of ¥15.0 billion or 29% in a year-on-year comparison. In particular, the results turned to negative territory in the fourth quarter, due to a major slump in the dry bulker and containership markets. On the other hand, the year ended with a slight upturn from the previous outlook (January 29). For the most part, this was due to a difference in the number of voyages completed and other factors, but this does not mean the business climate was better than anticipated.

We posted a net loss of ¥170.4 billion due to business structural reforms carried out. Speaking of dividends, we plan to pay ¥5 per share for the full year including ¥1.5 per share for the year end in addition to the interim dividend of ¥3.5 already paid, as we previously announced.

[By segment]

<Bulkships>

Looking at the bulkship business overall, the benefit of a very strong tanker market mostly offset an unprecedented deterioration of profits in the dry bulker market. As a result, ordinary income was almost the same as the previous year.

■ **Dry bulkers**

The Capesize market entered a temporary recovery phase, but it generally remained in the doldrums although the number of vessels scrapped and the delivery of newbuildings were at the same level. This was due to a downturn in sentiment in addition to China's continued trend toward an economic slowdown. The full-year average rate was at the $7,000 level, which was significantly lower than costs, resulting in a continued severe business environment. Fleet oversupply remained unresolved even with mid- and small-size bulkers, and the market remained slow.

Although we continued efforts to improve operational efficiency and reduce costs, and recorded a certain level of stable profits from long-term contracts mainly with iron ore carriers, ordinary income significantly deteriorated from a surplus in the previous year, as a result of negative margins on spot operations, and we posted a loss.

■ **Tankers**

The crude oil tanker market remained generally firm, as demand for ocean transport rose thanks to an increase in actual demand resulting from low crude oil prices and China's expansion of its strategic reserves. The petroleum product tanker market was also buoyed by low crude oil prices and expanded production at refineries in the Middle East. The full-year average was higher than the previous year despite a slight weakening from the winter season. The LPG carrier market remained at a high level until summer due to increased LPG export volume from new terminals in the U.S. and increased demand in India. Later on, it weakened due to the impact of newbuilding vessels coming into service, but overall the market remained firm.

As a result, tanker division's ordinary income increased significantly in a year-on-year comparison, and its increased margin almost offset deteriorating dry bulker profits.

■ **LNG carriers/Offshore business**

The LNG carriers and offshore business generates stable profits through long-term contracts, so the results were nearly as projected. In a year-on-year comparison, ordinary income increased as new projects started and we did not incur temporary costs

for drydocking and so on, as in the previous year.

■ **Car carriers**

While trade for the U.S. remained strong, trade to resource-exporting countries in particular slowed due to the impact of low resource prices. Cargo volume for West Africa, Russia, and other countries declined. This led to a slight decrease in profits in a year-on-year comparison despite efforts to improve operating efficiency and respond to changing trade patterns.

As a result, ordinary income for the overall bulkship business, encompassing the above four segments, rose slightly by ¥0.7 billion, to ¥54.8 billion.

<Containerships>

Cargo movement from Asia to North America remained strong, but the demand and supply balance slackened due to increased fleet supply, and spot freight rates declined significantly year-on-year. On the Asia-Europe trade, the issue was declining cargo movement as opposed to an increase in vessel supply. Despite efforts to reduce capacity by cutting sailing frequencies, we saw no resolution to the demand-and-supply gap. The freight rate market remained at a record low level through the fiscal year. Cargo movement on the Asia-South America route decreased significantly due to Brazil's economic slump, and freight rates stagnated, the same as on the Asia-Europe route.

In light of this business climate, we pushed ahead with rationalization of more than 10 routes, mainly in the north-south trade, including withdrawal from some routes, during FY2015. Specifically, in February of this year, we rationalized the Asia-South America East Coast route, where we have historically had a major presence, reducing our capacity by half. The impact of the flagging freight rate market due to deteriorating demand-supply situation outstripped the benefits of those rationalization efforts, the depreciation of the yen, and low bunker prices, resulting in further losses compared to the previous year.

■ **Ferries & Coastal RoRo (Roll-on/Roll-off) Ships**

Profits for ferries and coastal roll-on/roll-off (RoRo) ships showed a slight downturn from the projection set at the beginning of the fiscal year due to the impact of an accidental fire that occurred aboard one of the ferries in July of last year. However, cargo movement remained firm thanks to the ongoing effects of the modal shift, and we

are expecting this business to play one of the key roles in our company's growth.

■ Adjustment

The primary factor in the ¥8.7 billion deterioration from the previous year in the "Adjustment" segment is foreign exchange gain/loss on a non-consolidated basis, which showed a gain in FY2014, but turned to a loss in FY2015.

Supplementary explanation of Business Structural Reforms

A breakdown of the extraordinary loss of about ¥180.0 billion shows about ¥120.0 billion related to dry bulkers, and about ¥60.0 billion related to containerships.

<Dry bulker business structural reforms>

We implemented business structural reforms in the dry bulker division on the assumption that we cannot expect a full-scale recovery of the spot market for the time being. The reforms can be broadly divided into two areas: first, to reduce the number of vessels in spot operation as much as possible to reduce our market exposure, and second, to reduce ship costs for the core fleet of mid- and small-size bulkers, which will remain at the company.

We will implement some dramatic changes in our business model for mid- and small-size bulkers, withdrawing from the "cruising taxi" style business of free vessel operations in markets that are not backed by specific cargo demand, in other words, hoping that a customer will come along and need one of our vessels. We will focus on cargo transport based on long-term stable relationships with cargo owners, and reduce the fleet by about 50 vessels, which will consequently become surplus. Among the mid- and small-size bulkers we currently operate, about 100 vessels in the core fleet are procured by mid- and long-term chartered-in contracts. We plan to reduce the fleet by half by means of returning those vessels through early termination of chartered-in contracts. Turning to the larger Capesize, vessels, about 80% of the 100 or so vessels in our fleet generate stable profits under mid- and long-term cargo contracts. We will dispose of about half of the remaining 20%, which operate on spot contracts, through sales of owned vessels, and early termination of chartered-in contracts as with mid- and small-size bulkers.

The second structural reform related to dry bulkers is ship cost reduction in the core

fleet of mid- and small-size bulkers that will remain with our company. After reviewing our business model for mid- and small-size bulkers, we decided to dissolve a subsidiary in Singapore, MOL Bulk Carriers, which engages in bulker business and operation, effective this coming September. Then, the Tokyo Head Office will take over the remaining core fleet along with its charter-in contracts at market value, and through that process, we will reduce ship costs to market levels.

Costs recorded for those measures totaled ¥117.4 billion in the dry bulker division — ¥50.0 billion for cancellation of chartered-in contracts, about ¥37.0 billion for losses on sales of vessels, and¥30.0 billion for losses incurred by the transfer of core fleet chartered-in contracts to Tokyo.

<Containership business structural reforms>

The performance of our containership business has lagged far behind our competitors in recent years. There are three factors behind this:

First, MOL owns relatively higher-cost mid-size containerships as its fixed fleet.

Second is, MOL has a generally stronger presence on north-south routes, typified by the Asia-South America East Coast route, on which the profit picture is especially bleak.

Third, MOL has fallen behind the competition in the quality of business and yield management.

In our business structural reforms, we will take measures for the first two factors outlined above. We claimed the high-cost mid-size containerships we owned as impaired assets, which accounted for most of the approximately ¥60.0 billion in costs for business structural reforms related to containerships. In addition, we have worked to rationalize service, especially on north-south routes, throughout the past year. And we will dispose of vessels that become surplus as a result of our rationalization efforts. We believe these measures will address our competitive disadvantages and put us on par with other companies. And of course, it is absolutely necessary to enhance the quality of business and yield management I mentioned as the third factor. It has now been about half a year since we started to address that third factor. But we see visible results such as an increase in utilization on Asia-Europe in-bound routes and reduction in empty container transport costs on the Asia-North America route, and these movements will accelerate in the future.

We project a total profit improvement of ¥36.0 billion – ¥26.0 billion for dry bulkers and ¥10.0 billion for containerships in FY2016 – thanks to the business structural reforms explained above in these divisions. On the other hand, these benefits will be offset significantly by further deterioration of the market environment. So the reality is that we cannot avoid projecting a year-on-year decrease in profits.

Explanation of FY2016 Full-year Forecast

[Overall]

We project ¥20.0 billion in ordinary income for FY2016, a 45% decrease from the previous year despite the positive impact of our business structural reforms. Our foreign exchange assumption is ¥108 to the U.S. dollar, and we assume an annual average bunker price of $230/MT. Foreign exchange is a negative factor compared to the previous year, but bunker prices will be an advantage, so overall these assumptions will offset each other.

[By segment]

Bulkships

■ **Dry bulkers**

We anticipate that iron ore trade will continue to stagnate due to decreasing steel production in Japan, Korea, and the EU, thanks to increased exports of surplus materials from China on the back of its economic slowdown. We expect some improvement in the market toward the end of the year as scrapping progresses in the wake of a slow market, but we cannot foresee a drastic improvement in the demand and supply balance. Demand for mid- and small-size bulkers is weakening too, as India's coal imports decrease, so we don't see fundamental improvements. The market assumptions for this fiscal year are $7,000 for Capesize and $4,000~5,000 for mid- and small-size bulkers, which means we project that these markets will remain at the same level as the previous year, or slightly lower.

The division showed a slight deficit in the previous year, but will break into black ink this year as a result of our business structural reforms. However, we realize that some of the benefits of the ¥26.0 billion improvement will be offset by a decrease in earnings due to renewal of contracts of affreightment (COA) and maturity of long-term cargo transport contracts under the current spot market, as well as the appreciation of the yen.

■ **Tankers**

We expect demand for crude oil transport to remain firm due to China's increasing strategic reserve, as well as growth in actual demand in Asian countries, but on the other hand, we see the number of newbuilding VLCCs increasing from 23 vessels in 2015 to 55 in 2016. There is a certain level of impact because of only about 650 VLCCs in the world, so we have no other choice to anticipate that the market will soften from the previous year when it was escalating. Similarly, demand for petroleum product tankers and LPG carriers will remain high but supply pressure will become stronger, so we don't think we can expect as strong a market as last year. In addition, the number of our crude oil tankers operated on the spot market , which are currently enjoying favorable conditions, will decrease in the short term as we take advantage of last year's advantageous situation to secure stable profits for the future by signing mid- and long-term contracts. As a result, we expect the profit margin to decline slightly in a year-on-year comparison, although this business will continue to record profits and remain our biggest earner.

■ **LNG carriers/Offshore business**

These operations mainly generate stable profits from long-term contracts a total of 14 new projects – six LNG carriers, two FPSOs, and six ethane carriers – will start operation in this fiscal year, making major contributions to this segment's profitability.

■ **Car carriers**

This segment will show relatively stable profits, but we project a decrease in earnings from the previous year due to the impact of the strong yen in addition to stagnating trade to resource-dependent markets and emerging countries, where declining resource prices are hampering economic growth. Trade to North America, where demand for automobiles is strong, will remain brisk.

Containerships

Due to the ongoing market deterioration, which will offset all benefits of route rationalization already carried out, enhancement of profitability due to business structural reforms, and the positive impact of low bunker prices, we cannot anticipate an improvement in profits. A considerable portion of the market deterioration is due to our anticipation of great difficulties in negotiating a favorable annual freight rate contract on the Asia-North America route.

We will improve profits by launching large-size vessels on the Asia-North America East Coast route via Panama, in line with the expansion of the Panama Canal, which is slated for completion in June. If we cannot see an improvement in cargo movement on the Asia-Europe route, we will negotiate within the alliance to improve the demand-supply balance by reducing space through further rationalization.

Current market levels for both Asia-North America and Asia-Europe routes are absolutely unsustainable for any of the players. Shipping companies will work to reduce capacity by cutting frequencies and rationalizing routes, while larger-scale vessels will continue to be delivered in the foreseeable future. In some cases, we are already seeing the effects of these trends. On the Asia-South America East Coast route, where major players including MOL have reduced capacity through rationalization since February of this year, freight rates have bottomed out and are moving toward recovery despite a difficult situation in which cargo movement declined by nearly 30%. On such routes, we can expect even the slightest sign of a recovery in cargo traffic will spur a recovery of rates to appropriate levels.

Loading/unloading operations at our TraPac terminal in Los Angeles have been smoothly automated, and we expect the resulting cost reductions to contribute to a major improvement in our terminal business profits.

Other segments

We expect ordinary income in the ferry business to increase as conditions return to normal following the accidental fire last year, and forecast that this segment will grow into one of the main pillars of our domestic logistics businesses. In the real estate business, overseas projects are performing steadily, and a new office building completed in Osaka last year will bring recurring profit growth. These are some of the segments that will contribute to stable profits.

Explanation of FY2016 single-year management plan

This year was originally the last year of the midterm management plan STEER FOR 2020, which started in FY2014. We set “three innovations” as the overall strategy of the plan. Among them, in “innovation of our business portfolio,” we have been accumulating long-term contracts steadily following our policy of focusing investment

on LNG carriers and offshore business, and the fleet is currently expanded to 98 vessels including those under construction and ethane carriers. And we are positioned for a steady increase in profits from FY2017 through FY2019 from the contracts we have already concluded, though we are anticipating a delay in the progress of new projects (not yet concluded) due to the outlook for continued low crude oil prices.

We could say that the "innovation of business models" will show significant progressed as we drastically scale down our market exposure through the business structural reforms we are implementing, and efforts to strengthen our business structure to meet customers' transport needs.

In addition, we will further speed up our progress toward the "innovation of business domains," starting with the allocation of management resources to our domestic logistics business including ferry operations in Japan.

Thus, we have made great progress on this overall strategy, called "three innovations," and we are continuing to move in this direction in the future. On the other hand, it is already obvious we are far behind in our efforts to achieve the financial and profit goals set out in the plan, due to much greater than anticipated deterioration in the dry bulker and containership markets. And considering that we have made "accomplishment of business structural reforms" our top priority in the current situation, we decided to formulate and implement a single-year management plan instead of continuing with the midterm plan.

The major pillar of the single-year management plan is "accomplishment of business structural reforms," specifically in the dry bulker and containership businesses as I explained earlier.

Furthermore, we restructured the dry bulker, tanker, LNG carrier, and offshore businesses into business units. The new Energy Transport Business Unit, in particular, will be able to respond swiftly to changes in customer needs resulting from liberalized electricity and gas markets in Japan and diversified needs of overseas customers.

In addition, led by Chief Executive Representatives and Chief Country Representatives allocated to each overseas area and country, we will enhance division-cross sectional and global cooperation under the watchwords "One MOL."

Current conditions in the dry bulker and containership markets make it difficult to project a full-scale recovery in the near future. While moving quickly to address

structural issues to overcome those obstacles, we believe this presents the opportunity to realize an "excellent and resilient MOL Group" by further solidifying the trusting relationships we have developed with our customers and strengthening business fields that are less susceptible to market fluctuations.

In terms of business performance, we regret that given current conditions, we will be unable to meet your expectations for the time being, but I hope you understand the efforts we are making to address this difficult business environment, and I ask for your continued patience and support.

2. Questions and Answers

Q1) Can you explain why both ordinary income and net income for this fiscal term are ¥20.0 billion"

A1) This is because the plan includes anticipated profit on the disposal and sale of assets in the extraordinary gain/loss.

Q2) Concerning the impact of foreign exchange, the materials show that every ¥1 appreciation or depreciation against the U.S. dollar has an impact of approximately ¥1 billion on the company's ordinary income. This seems like a great decrease compared to the previous year's foreign exchange sensitivity. What are the factors behind this?

A2) Foreign exchange sensitivity for the past fiscal year was initially projected at plus or minus ¥1.8 billion per yen to the dollar. But that was based on the assumption that we would gain significant profits. For this fiscal year, we project ¥20.0 billion for the full year, which is much lower than the initial projection for the previous year, and in particular, we face a large deficit in the containership business. There are some other factors, but this is the main reason behind this year's reduced sensitivity.

Q3) You project a decrease in interest-bearing debt on average for fiscal years 2015 and 2016, but will debts increase again after the following year? Or does this mean you have changed your stance on investment?

A3) The business structural reforms are generating losses from impairment, sale of vessels, and cancellation of chartered-in vessel contracts. But the impairment is not related to cash, and the sale of vessels is posted as a loss in the profit and loss (P/L) statement, but actually it is cash in. In contrast, we have to pay cancellation fees to terminate chartered-in vessel contracts, so this is cash out. These cash movements are greatly different from P/L movement, and will occur over the course of FY2015 through FY2016. Hence, cash flow from investment activities will be smaller than the actual investment amount because of the sale of vessels, resulting in positive free cash flow (FCF) despite the structural reforms. This cash surplus will be used to reduce interest-bearing debt. This is the movement we will see from FY2015 through 2016. We will continue investing in strategic fields to accumulate stable profits, our goal in the STEER FOR 2020 management plan. We are not abandoning our plan to invest in LNG carriers and so on. We will show our cash flow for FY2017 and the outlook for interest-bearing debt in next year's management plan, but we are not changing our stance on investment.

Q4) Please share with us to what extent profits for the tanker and car carrier businesses will decrease this fiscal year. We understand that the bulkship segment as a whole, including the aforementioned two segments, shows a decrease of ¥19.8 billion in a year-on-year comparison.

A4) For tanker business we used a conservative assumption in comparison with the previous year, which was very strong, and the degree of profit decrease was significant. In the car carrier business, the significant impact of the strong yen and weak trade to resource-dependent countries resulted in the worse-than-expected outlook.