29 January 2016

Mitsui O.S.K. Lines, Ltd.

Explanation by the CEO and Major Q&A

First of all, I must report that we will carry out business structural reforms entailing in an extraordinary loss of ¥180.0 billion in the fourth quarter, which I regret to say that net income/loss for the full year is projected to show a deficit of ¥175.0 million. We will explain the outline of our business structural reforms later.

1. Supplementary Explanation of FY2015 Q3 Financial Results

[Overall]

The cumulative results for nine months show ordinary income of ¥38.7 billion, a ¥9.0 billion increase in year-on-year comparison, but looking at the third quarter alone, ordinary income was ¥10.9 billion, or a decrease of ¥4.3 billion in year-on-year comparison. Both the containership and the dry bulker markets fell into the doldrums, but the financial results for the quarter were slightly better than the internal projections when we announced our second quarter results (October 30).

While the slump of the containership market increased losses in the segment since the second quarter, we originally assumed the October-December market at very low levels, and we could enjoy the advantage of a continuing decline in bunker prices. Concerning dry bulkers, most of our free vessels are operated by subsidiaries in Singapore, so the consolidated financial results for the third quarter reflect the performance of those subsidiaries for July through September. There were few factors that changed from the previous announcement, and the third quarter still recorded a slight surplus. All other segments showed results that were basically in line with previous projections. Combined with the delay of certain drydockings scheduled for the third quarter to the fourth quarter, overall results were slightly above the previous projections. Meanwhile, we recorded extraordinary profit of ¥12.8 billion in the third quarter through "sales of shares".

2. Supplementary explanation of FY2015 full-year forecasts

[Overall]

We made a downward revision of ordinary income for the full-year, from the previous forecast of ¥42.0 billion to ¥32.0 billion. We cannot avoid the impact of an unprecedented slump in the dry bulker and containerships market for the fourth quarter and were forced to make a downward revision of the full-year forecasts as a result of a projected ¥6.8 billion ordinary loss for the fourth quarter. We project a loss of ¥175.0 in net income/loss for the full year as a result of including ¥180.0 billion in the costs for business structural reforms, which I will explain later.

[By segment]

<Bulkships>

■ **Dry bulkers**

The dry bulker market remains stagnant in a double-dip decline as anxiety about the slowdown in China's economy has deepened after the beginning of this year, and we saw no sign of a market rally we originally expected due to seasonal factors in early fall. Although the number of Capesize vessels scrapped (93) exceeded the number delivered (88) in 2015, resulting in a net decrease in number, the market has been sluggish due to the impact of an increase in VALEMAX operation, inactivation of the spot market where major shippers are moving to oligopoly, and other factors in addition to a decrease in China's crude steel production. The number of mid- and small-size bulkers scrapped also increased, but this did not tighten the demand and supply balance because an even greater number of newbuildings were delivered. While we cannot expect an increase in cargo trade due to seasonal factors such as Chinese New Year and the beginning of the rainy season in Brazil, we see no indication of an end to the difficulties this market faces.

In light of this situation, we made a large downward revision in our forecast for the full-year business performance for the Dry Bulker Division, anticipating that it will slip into red ink for the first time since FY2012.

■ **Tankers**

We originally expected gradual softening of the crude oil tanker market after a boost from the winter demand at the end of the year, and forecast continued strength in the product tanker market, backed by strong demand for gasoline in the United States and low prices for crude oil. As a result, the full-year business performance will show a slight upturn from the previous projection, but unfortunately this is not enough to offset the downward movement in the dry bulker business.

■ **LNG carriers/Offshore businesses**

Long-term contracts are the main source of stable profits for the LNG carrier and offshore businesses. Four LNG carriers and one FPSO (our third), which started operation during this fiscal year, will contribute to this division's profits, and we anticipate the same level of profits as in earlier projections.

■ **Car carriers**

In the car carrier business, cargo trade for North America and Europe show strength, but trade bound for emerging nations and oil-producing countries remains in a slump. We factored a number of changes, including decreases in the number of units transported inbound and cross trade business into the previous projection, and we expect the full-year business performance will be slightly lower than the previous projection because of an increase in costs associated with moving up drydockings.

<Containerships>

Cargo movement the in the peak season before Chinese New Year, is unfortunately not favorable as in past years. The Asia-North America route is currently operating at nearly full capacity, and we think this situation will continue until Chinese New Year, but the demand and supply balance will not be as tight as in past years. We are also nearly at full capacity on the Asia-Europe route, but we can see lower utilization for other companies. And the raise in spot rates at the beginning of the year has disappeared overnight. Some degree of recovery in cargo movement from the off-season after Chinese New Year will be the key to restoring freight rates. During the fourth quarter, we will be able to reap the benefits of lower bunker prices, but anticipate a deterioration of overall freight rates and cargo volume from the previous assumption. We also expect a decrease in cargo volume for our terminal and logistics businesses. As a result, we made a further downward revision to ¥3.0 billion in red ink for the full-year forecast, compared to a loss of ¥2.8 billion projected in the previous outlook.

Faced with situations that make it difficult to expect a recovery in cargo trade, such as deterioration of economic conditions in resource-producing countries including Russia and Brazil and a slowdown in the Chinese economy, we continued to rationalize unprofitable routes and reduce the fleet. In addition to measures we have already decided on by the second quarter, we decided to rationalize more routes: Asia-South America West Coast (December), Asia-West Africa (February), and Asia-Australia (February), and have already implemented some of the changes. Another recent development, which I would like to share with you today, is a broad agreement with current consortium members Maersk and MSC to rationalize the Asia-South America East Coast route. The route is showing our second-highest deficit following the Asia-Europe route and puts us at a severe disadvantage compared to other shipping companies. We will make a significant reduction in our capacity on this route. We still have to negotiate the details with other companies, so we cannot go into specifics, but we think we can officially announce it within February.

Looking at other issues to address in the containership business, I have explained that we must enhance our sales strength, which lags behind other companies, and improve the efficiency of our cargo collection and container allocation (in other words, yield management). It has been only a few months since we started full-scale implementation of these moves, but we are seeing concrete results, such as significantly improved utilization on the Asia-Europe backhaul leg and reduced deadhead costs for empty containers on the Asia-North America route. We will continue these measures and closely monitor the results.

3. Explanation of Business Structural Reforms

The business environment surrounding our company has deteriorated dramatically, particularly from the second half of the last year, due to a slowdown in China's economy, a double-dip decline in crude oil prices, and stagnation of resource-producing countries' economies. The resulting delay in recovery of the demand-supply balance for some ship types puts us in an extremely difficult situation. To cope with the significant changes in the business environment, we decided to carry out business structural reforms, targeting containerships and dry bulkers, which will entail an extraordinary loss of about ¥180.0 billion in the fourth quarter.

In the containership business, deterioration of profitability in MOL operations on the North-South route has worsened, putting us in a much weaker position than other shipping companies. In addition, all shipping companies, MOL included, face flagging freight rates and cargo movement on the Asia-Europe route. Against this backdrop, MOL will record deficits for five consecutive years. As I explained, we have pressed ahead with measures to rationalize each route separately, including elimination of some routes. On the other hand, we plan to reduce ship costs, centering on mid-size containerships we could not take big countermeasures, which are relatively costly to operate, and dispose of ships that become surplus due to the rationalization we have been pushing, mainly on the North-South route.

In the dry bulker business, we carried out the Business Structural Reforms in fiscal 2012 and transferred operation of some Capesize vessels on the spot market and most of our mid- and small-size bulkers to Singapore. At the same time, we lowered our vessel costs to the level of forward charter rates prevailing at the time to make the fleet competitive. However, after that, we saw cargo trade stagnated with the slowdown in China's economy, and the Baltic Dry Index marked new lows. The market remains well below our earlier assumptions. It is difficult to expect a swift recovery to FY2012 market levels in consideration of the difficult external environment. To cope with this situation, we will further reduce the number of Capesize vessels operating on the spot market. Also, as for mid- and small size bulkers, we will focus on more effectively meeting various customers' transport needs after we withdraw our excess tonnage from the free-vessel market to significantly reduce fleet scale.

We have not reached the point where we can explain details of specific measures here today. However, I think it is important to explain the target amount of the extraordinary loss we are projecting, and reflect in in our full-year forecasts. In total, we expect the extraordinary loss resulting from these business structural reforms to total up to ¥180.0 billion. As we confirm the details of each measure, we will announce them promptly, in accordance with timely disclosure rules.

In addition, regarding the current midterm management plan "STEER FOR 2020", which was slated to end with FY 2016 under normal circumstances, I regret to say that the current severe business environment has forced us into a situation in which we must make major revisions to our plan. We are developing a new business plan for FY2016, and plan to announce it at the appropriate time.

[Dividends]
Finally, speaking of the year-end dividend plan, the payment will remain unchanged at ¥1.5 per share, as we previously announced, in light of the positive turn in ordinary income, although we will generate a large net loss by carrying out the business structural reforms. As a result, the full-year dividend will be ¥5 including a ¥3.5 per share interim dividend already paid.

[In Conclusion]
Our entire management team accepts responsibility. Regrettably, the extraordinary loss damaged shareholders' equity. We hope the shareholders will accept our apologies and continue to offer their support. This difficult business environment, the likes of which we have never experienced, may continue for a while, but the business structural reforms announced today will lead to an optimized fleet that is stronger and more resilient than ever.

All of us at MOL, from management to rank-and-file employees, have renewed our determination to show steady profits starting with the next fiscal year. We will rebuild shareholders' equity and return profits to you, our shareholders, through dividends. We ask for your continued understanding.

4. Questions and Answers

Q1) How will the ¥180 billion in business structural reform costs be split between containerships and dry bulkers?

A1) We are still working on the details, but we anticipate that the dry bulker business will have a slightly higher proportion.

Q2) Please tell us what improvements in profit I can expect in the next fiscal year as a result of the business structural reforms?

A2) We expect significant improvements, but we are now closely examining specific figures, so please understand that we can't give you a concrete answer at this time.

Q3) You plan to record ¥180.0 billion in an extraordinary loss for this fourth quarter, but if you will not be able to record the entire loss in the fourth quarter, is it possible that you will post an extraordinary loss in the next fiscal year?

A3) Some of it will be put into action through next year, but we intend to record a ¥180.0 billion loss in the fourth quarter and have no plan to postpone part of that to next year and after.

Q4) How many vessels of each—dry bulkers and containerships— will you dispose of?

A4) We will significantly reduce the number of mid- and small-size dry bulkers, and also free Capesize vessels. In the containership business, our plan is basically to reduce the number of ships on the North-South route.

Q5) How many vessels are subject to market exposure in the dry bulker market? And can I understand that you will completely eliminate the market exposure?

A5) The number of dry bulkers subject to market exposure is 23 Capesize vessels and 90 mid- and small-size vessels. Our definition of "market exposure" is "vessels that do not have cargo contracts for more than two years." The definition is not the same as "excess tonnage in the free-vessel market", which are the target vessels in the business structural reforms, and we will not eliminate all market exposure vessels. We will make the final reduction plan based on the idea of concluding cargo transport contracts directly with customers to meet their actual demands as our future business model. We will implement the reduction plan with strength and determination.

Q6) What impact do you expect on the company's future financial strength and on the investments you will need to make in order to accumulate stable profits?

A6) We cannot avoid the deterioration of shareholders' equity and equity ratio at the end of FY2015, but we are committed to implementing a management plan that ensures a recovery in FY2016 after we bottom out in FY2015. Concerning interest-bearing debt, we project a surplus in Free Cash Flow (FCF) even after we complete the business structural reforms because originally our cash flow from investment activities was low in this term. Also because we have scheduled payments of equipment loans, we do not foresee an increase in our interest-bearing debt in FY2015. We do not have an investment plan for free vessels, but we will continually make strategic investments by looking ahead toward growth beyond FY2016 and 2017.

Q7) You explained measures for the North-South route in the containership business, but the Asia-Europe route remains in a tough situation, so it will be difficult for you to turn a profit in the next year even if you implement countermeasures, won't it?

A7) We will reduce the cost of our existing fleet and boldly address the issue of vessels that become surplus after route rationalization—these two measures are specific structural reforms. We will push ahead with those measures in combination with tactics to raise our yield ratio by strengthening our business. We think our prospects for next year will be significantly improved, but we will separately announce full-year forecasts for FY2016 after carefully examining the freight rate picture. And of course we will maximize our efforts to return to profitability.

Q8) I think recording ¥180.0 billion in an extraordinary loss is a big decision. Can I assume that you will remove all the past negative assets, that is, all fixed, comparatively high costs that remain from investments made about a decade ago?

A8) This will remove all unrealized losses. The business structural reforms allow us to adapt to the new business environment in a timely manner, and create a fleet that is realistic in consideration of today's business environment and cost structures. We don't intend to address the losses piece by piece.

[END]