July 29, 2016

Mitsui O.S.K. Lines, Ltd.

Explanation by the CEO and Major Q&A

[Overall View]

The first quarter of FY2016 ended almost in line with the initial outlook. However, I regret to say that we made downward revisions of the outlooks for both the first half and full year due to factors such as a review of the containership market, higher bunker prices, and the appreciation of the yen. On the other hand, we steadily see the effects of the Business Structural Reforms, for which we recorded related expenses of about ¥180.0 billion, as planned.

1. Supplementary Explanation of Q1 FY2016 Financial Results

[Overall]

Ordinary income was ¥0.7 billion, and we secured a low level of profitability. This was a slight upturn in comparison with the internal initial outlook. The business environment has not improved compared to the outlook. I think it is fair to say that the results were mostly in line with the outlook. Speaking of Business Structural Reforms, we continued to see steady progress in Q1, and we turned to profitability from deficits in Q4 of FY2015.

On the other hand, turning to a year-on-year comparison, results showed a significant decrease despite the effects of the Business Structural Reforms, because the markets for almost all divisions deteriorated.

[By segment]

<Bulkships>

■ **Dry bulkers**

The dry bulker market, which has continued to fall since last summer, marked a historic record low from January through February of this year, but after that it hit bottom and then got back on track for recovery, albeit mildly. However, I’m sorry to say the recovery is not strong.

The Capesize market saw tightened supply and demand in the short term and improved from April, when major Australian customers increased orders for shipping. However, the Q1 average was $6,700/day, so upward mobility was limited, although it was at a slightly higher level than the initial outlook.

Most of our Panamax and other mid- and small-size vessels were still operated by our Singapore subsidiary in Q1, and the market from January to March, which marked a historic record low, is reflected in this quarter's financial results. Since March, the market turned upward, backed by strong grain shipments from South America and firm coal demand, but the fleet surplus is still strong.

The dry bulker market has not entered a full-scale recovery, but we are seeing steady benefits from the effects of the Business Structural Reforms in addition to a certain level of stable profits from long-term contracts, mainly for Capesize vessels, and income turned into the black during this quarter, in contrast to the deficits in Q4 of FY2015. It also improved in a year-on-year comparison, closing slightly upward from the internal initial outlook.

■ **Tankers**

The crude oil tanker market entered the slack demand season and showed a downward trend from January of this year, but from April to June, remained generally at the level of the initial outlook. In the petroleum product tanker market, the middle distillate trade from Middle Eastern refineries to Europe and naphtha and other trades for the Far East were firm, but as a whole, the demand and supply balance slackened due to slowing trade of vegetable oil, etc., and the delivery of newbuilding vessels. As for LPG tankers, the spot market rate declined due to a slowdown in trade from the U.S. to Asia resulting from sluggish LPG prices, in addition to initially anticipated increased supply pressure from newbuilding vessels. However, we concluded mid- and long-term contracts while the market was booming, so currently we have only three free vessels. The chemical tanker market remains stable because we concluded annual COA contracts for 70-80% of the cargo.

As a result, ordinary income of the tanker division decreased in a year-on-year comparison, but we recorded the level of profits that we initially projected.

■ **LNG carriers/Offshore businesses**

This segment was nearly in line with the outlook, since these businesses recorded stable profits due to long-term contracts.

■ **Car Carriers**

While trade for the U.S. and Europe remained strong, trade volume for resource-producing regions such as the Middle East and West Africa weakened due to the impact of lower oil prices. This impact was included in the initial outlook and we forecasted a significant decrease in profits for this fiscal year in a year on-year comparison. But these trades are much weaker than the outlook. Income for Q1 fell further below the initial outlook.

As a result, ordinary income for the four bulkship divisions was ¥8.4 billion, a decrease in a year-on-year compassion. The quarter ended slightly above the initial outlook.

<Containerships>

Outbound trade on the Asia-North America route remained relatively firm, but the spot freight rate market stayed stagnant, which was already included in our initial outlook, because the demand and supply balance was loosened by an increase in the fleet supply. Annual contract rates, after renewal in May, fell significantly compared to the previous year's contracts.

The trend toward decreasing cargo volume due to inventory adjustments on the European side of the Asia-Europe route was contained, showing a moderate recovery. Efforts to raise freight rates were met with some success. So we don't see rates such as "$200 per TEU," which we saw a little while ago, but the SCFI from April to June was around $540 on average. So it is still at low levels.

On the other hand, the routes bound for the South America East Coast showed a drastic change. In February, we conducted a major rationalization on these routes, on which cargo trade decreased by about 30% and showed a significant deficit last fiscal year, and reduced our owned space by half. Other companies followed our rationalization and overall trade space was reduced by 40%. Currently, we can operate vessels with over 100% utilization. The spot freight rate marked a record low of slightly over $100 per TEU from January to February this year, but showed a mostly consistent increase starting in spring, and the current level is over $2,000. We will be able to fully benefit from the effects of rate increases during and after Q2, but these routes are currently raising profitability on a weekly basis. This is a good example of freight rate conditions being normalized by controlling the supply on the shipping company side to address the decline in demand.

Thus, despite differences in routes, the ordinary income/loss for Q1in the containership business was -¥11.6 billion, mostly in line with the initial outlook, and significant deficits remain. But this division closed slightly upward from the internal initial outlook.

2. Explanation of FY2016 Full-year Forecast

[Overall]

I regret to say that we revised our full-year forecast for ordinary income from ¥20.0 billion in the previous forecast to ¥10.00 billion this time. Major factors behind this include changes in our assumption for bunker prices, which was previously US$230/MT, to $260 for Q2 and $280 for 2H, and a slight appreciation of the yen in the foreign exchange market, in addition to a weak containership freight rate market.

Let me explain at a glance, that the downward revision of -¥10.0 billion includes ¥5.0 billion for the impact of increased bunker prices, ¥2.0 billion for foreign exchange, and ¥3.0 billion in market changes and other factors.

We made a downward revision for net income/loss from ¥20.00 billion in the previous outlook to ¥15.0 billion. On the other hand, we forecast no change in the dividend payment from the previous announcement, and plan to pay ¥2 per share for the interim and ¥2.0 for the year-end, or ¥4.0 for the full year.

[By segment]

<Bulkships>

- **Dry bulkers**

We have not made significant changes in our market assumption since the beginning of the fiscal year, though we made a small-margin upward revision, reflecting the current moderate recovery trend centering on mid- and small-size vessels.

Deceleration of the Chinese economy became clear despite favorable factors such as the halt in the decline of China’s coal imports, a trend that began in 2014. In addition, we still don’t see a significant increase in demand in India and Southeast Asia, where we anticipate future growth. The market will move up toward the year end due to seasonal demand, but we don’t think the fundamentals will improve significantly in the immediate future.

On the other hand, we can expect steady improvements resulting from the Business Structural Reforms, so we are almost certain to return from deficits in the previous year to profitability, even on the assumption that the severe market environment will continue.

■ **Tankers**

We have not revised our outlook for the crude oil tanker business—the market will remain firm thanks to factors such as China’s increasing oil imports, even though it will be soften somewhat due to the increased number of newbuilding vessels slated for delivery this fiscal year. We expect the market to recover toward the winter demand season. On the other hand, we made a slight downturn in our forecast for World Scale (WS) for H2, considering that the current market is at a rather low level of around $20,000/day.

The product tanker market currently remains weak. But we expect the margin of the refineries to return and believe cargo trade will recover from its current weakness, if crude oil production is restored after disruptions by violence in Nigeria and a wildfire in Canada.

■ **LNG carriers/Offshore businesses**

In the LNG carriers/offshore businesses, a total of 14 projects — six LNG carriers, two FPSOs, and six ethane carriers — will start operation this year, and contribute to this division’s profits. We think this will increase profits in line with the initial outlook.

■ **Car carriers**

Cargo trade for resource-producing regions is very sluggish. This puts more downward pressure on profits than we assumed in our initial outlook. We expect some improvement in profitability for the second half as our fleet rationalization continues — we are returning and scrapping vessels that became surplus after more effective allocation of ships to address shifting trade patterns. However, we believe a significant decrease in profits from the previous term is unavoidable.

As a result, for the entire bulkship segment, we project ¥34.5 billion in ordinary income, almost the same level as the previous outlook.

<Containerships>

We projected a ¥32.0 billion loss for the full year in our previous announcement, but have now made a downward revision to a ¥40.5 billion loss, largely because the rate increase we expected during the summer peak season on the Asia-Europe route could not be achieved in July and carried over to August. We also saw a decline in freight rates on routes bound for West Asia and West Africa. An increase in bunker prices is another factor. In addition, we made a slight downward revision for the terminal and logistics businesses, due mainly to a decrease in cargo volume.

We have not changed the previous outlook for second-half freight rate levels on routes bound for the South America East Coast, which are currently strong. If the current rate level continues for a long time, we can expect a slight upturn.

Meanwhile, we are seeing the positive effects of our work to enhance sales capabilities and yield management, which we have addressed since H2 FY2015. We anticipate more than ¥5.0 billion in improved profitability during this fiscal year thanks to the increase in inbound utilization and decreased costs for forwarding empty containers. We will move ahead with these efforts and closely monitor our progress.

3. Questions and Answers

Q1) Can you give us a breakdown of the downward revision in the FY2016 full-year forecast —¥8.5 billion in the containership business by route and ¥0.5 billion in the bulkship segment by division?

A1) Looking at the downward revision in the containership segment, the negative impact of higher bunker prices is ¥4.0~5.0 billion, and the other factors are foreign exchange and market conditions. Looking at specific routes, the overall trend is lower, but the Asia-Europe route is the main factor for the downward revision. In the bulkship segment, the poor performance of the car carrier division is the major factor behind the downward revision.

We see little variance in the dry bulker division because we have taken a conservative approach with the initial outlook and the Business Structural Reforms are yielding the results that we expected.

Q2) Please explain the progress of the Business Structural Reforms in the dry bulker division. Is it likely that you will implement additional reforms?

A2) The dry bulker division's Business Structural Reforms are mainly cancellation of charter contracts with shipowners. This is under negotiation now, so we cannot say everything is progressing in line with the initial schedule, but they are gradually accepting the cancellations. Targeting the end of September, we will scale down our spot market exposure. In addition, the worst seems to be over and the market is in recovery, so negotiations on contract cancellations are going more smoothly compared to when we started.

Q3) Can you explain the financial impact of the Business Structural Reforms for Q1 and the full year?

A3) We recognized an improvements totaling ¥9.8 billion for Q1—about ¥6.7 billion in the dry bulker segment and about ¥3.2 billion in the containership business. For the full year, we expect the results to be in line with our initial outlook despite a slight impact from the appreciation of the yen.

Q4) You say deteriorating cargo trade for emerging markets was behind the decline in car carrier business performance. But it does not seem like trade for the resource-producing countries would account for such a high percentage of the entire trade, so can you explain any other negative factors, including trade to North America and Europe?

A4) While unit transport volume for North America and Europe increases in a year-on-year comparison, trade to resource-producing countries is declining. The freight rate per unit for the resource-producing countries is higher in comparison with North America and Europe. So overall profitability decreased even though overall unit transport volume increased. In addition, the yield ratio deteriorated because we have had more return voyages with empty space from North America and Europe, due to decreasing cargo trade from those regions for the resource-producing countries. We made our full-year forecast expecting that situation to continue during this fiscal year.

Q5) Please explain whether the containership route bound for the South America East Coast turned to profitability in Q1, and whether the numerical figures from Q2 in the full-year forecast are based on the assumption of profitability.

A5) This route is breaking into profitability on a weekly basis, but we cannot say it has completely turned to profitability for Q1. However, our efforts to trim the deficit have had a significant effect in a year-on-year comparison. We are taking a conservative approach in our future outlook, but we still expect to eliminate most of the deficits on this route.

[END]