July 31, 2020
Mitsui O.S.K. Lines, Ltd.

The Financial Results Briefing Meeting for Q1 of FY2020

Presentation

Thank you for joining us today. I would like to start with an explanation of the financial results for Q1. Please turn to page three.

In Q1, we posted ordinary profit of JPY7.3 billion. Although ordinary profit has declined from the previous year, we achieved a significantly higher level than the ordinary loss of JPY7 billion announced at end-April. However, as I will explain later, due to uncertainty, giving an outlook on 2H onwards can be very difficult. As such, as we announced in our timely disclosure on June 17 regarding full-year forecasts, we maintain zero profit over the full year.

First, revenue declined by over JPY30 billion YoY. This was chiefly due to a sharp drop this quarter in the number of units transported by car carriers, and a market downturn in the Dry Bulk Business.

Ordinary profit turned positive, doing an about-face from the previous outlook. This was attributable to the solid performance at ONE, favorable market conditions for tankers in the Energy Transport Business, and full contributions from eight new LNG vessels that started operating last year.

I will now explain the financial results by segment. Please look at the explanation on pages four and five of the slides.

First, in the Dry Bulk Business, capsize market has been sluggish, mainly due to seasonal factors, along with longer rainy season in Brazil, and speculations that COVID-19 may temporarily stop the Brazilian mines.
A simple comparison of the April, May, and June average rates with those of the previous year seem about the same level, but taking the timing of completion of voyages into consideration, it is more appropriate to look at the average rates for February, March, and April and they were about USD1,500 worse than last year.

As for medium- and small-sized bulkers, we saw little impact from COVID-19 on grain, but the pandemic had various impacts on other cargo movements. There was also some effect from poor capesize bulker market all along. Pulled down by these factors, the market level has continued to trend around USD5,000 to USD7,000. However, regarding medium- and small-sized vessels, we do not have much exposure, so the impact on profit and loss has been quite limited, resulting in profit and loss on par with the previous year.

Meanwhile, specialized bulk carriers struggled a lot. Our specialized bulk carriers include open hatch bulkers that mainly transport pulp, and wood chip carriers that transport wood chips. Over half of our wood chip carriers have long-term contracts, but some do not, meaning they are exposed to the market. These specialized vessel types are difficult to be diverted to other cargo, and fleet adjustments are challenging. Consequently, the profit and loss has deteriorated.

Against this backdrop, the Dry Bulk Business posted a JPY2 billion decline in profits compared to the previous fiscal year.

Next, I'll go over Energy Transport Business. Crude oil tankers, particularly VLCCs, were blessed with demand for offshore storage, setting a market price of USD200,000 per day from mid-March through end-April. Our view had been that these conditions would not last for a long time, but in fact, these conditions lasted longer than we expected. During this period while market rates were elevated, we were able to conclude some contracts, and this helped shore up earnings.

Product tankers have likewise seen a rise in the market in sympathy with crude oil tankers, and thus marked a YoY improvement.

Chemical tankers have similarly achieved a YoY improvement.

For methanol tankers, as in the past, profits are being made through medium- to long-term contracts. For tankers overall, we realized a significant increase in profits compared to the previous fiscal year.

As for LNG Carriers, one of the eight carriers that were delivered during the previous fiscal year is an ice-breaking LNG carrier that is engaged in the Yamal project. She arrived at Tokyo Bay last week, as featured in the news broadcasted on TV, which many of you may have seen. Anyway, eight vessels, including this one, have been operating at full capacity since April 1 of this fiscal year, thereby contributing to profits.

In the Offshore Business, we had sent an FSRU to Turkey for a medium-term period, but this contract had expired. The next project is, in fact, in Hong Kong, but there will be a blank period before starting this project. While this was an issue at the business, we were able to extend the contract in Turkey by slightly less than one year, which would fill in the blank period before the next project. However, the profitability of this contract is lower, thus leading to a decrease in profits.

As a result, for the Energy Transport Business overall, we posted an increase in profit of JPY2.3 billion YoY.

Next, in the Product Transport Business, we will go over the Containerships Business at ONE. ONE, on a 100% basis, achieved a sharp increase in profits from the previous year, with an after-tax profit of USD167 million.
Due to the outbreak of COVID-19 across Europe and the U.S. from mid-March through April, we were worried about various things, including how demand would fare. So far, the decline in cargo volume has been kept at a level slightly above 10%.
The spot freight depends on various conditions, including the route and time of year. But trends have been solid overall.
The largest factor was the bunker surcharge effect. Since January of this year, we have received bunker surcharges from all customers. Fuel prices dropped sharply over a short period in advance of adjustment in this bunker surcharge. This factor has contributed largely to the robust performance in Q1.

Next, please look at page three of the material prepared by ONE.

In this material, there is a waterfall chart that describes the factors contributing to the increase in after-tax profits to USD167 million from USD5 million in Q1 of the previous year.
In this chart, the part enclosed in the dotted line has been affected by COVID-19 mostly. First, due to the impact of COVID-19, there was a decrease in cargo volume, which was a deteriorating factor. Next to that, the operating costs was an improvement factor. Service frequencies were reduced in tandem with cargo volume, resulting in lower costs.
Next to that, fuel charges improved largely. April, May, and June were months during which low fuel prices after a drastic drop stayed for some time. Profits were pushed up thanks to this factor.

Next, page four describes the cargo volume, etc. with regards to North America and Europe routes. Although the cargo volume was reduced, the utilization rate had, in contrast, improved, as shown here.
Also, with regards to the freight rate, when looking only at Q1, the freight rate increased compared to the full year in FY2019, and it also rose compared to Q1 of FY2019. Of course, part of this increase in freight includes the increase from bunker surcharges.

We will now once again look at the company's materials. Returning to page six of the company materials, in the containerships business, our Terminals and Logistics Businesses are included. As for these two businesses, cargo volume has declined, and in this sense, profits have decreased YoY.

As a result, the Containerships Business overall posted a JPY4.1 billion increase in profits YoY.

Next is the Car Carrier Business, which is the business most affected by COVID-19. Last time, we mentioned that some cargo movement to China was favorable. In fact, cargo movement was active from Europe to China. But, an example easy to understand is Japan, where manufacturers made significant shipment adjustments. Due to the reduced production of these manufacturers, we saw a considerable decrease in cargo movement. We believe the bottom was in April and May. Although we think April was the bottom, improvement speed is slow, despite the uptrend in May and June. The units we transported fell by 40% compared to the same period last year. Please look at page 18 of our materials for details.
As you can see here, the transport volume exceeded one million units in Q1 of last year. This volume decreased to 610,000 units. By the way, this is the units transported, so the timing in which they are recorded differs from the shipment volume at manufacturers. When looking at Q2, we expect the units we transport to fall in Q2 more than Q1. This is attributable to the timing in which completion of voyages are recorded. Meanwhile, the shipment volume at domestic manufacturers is probably recovering gradually from April to May and June.

Returning to page six again, against this backdrop, we implemented fleet size adjustments by redelivering chartered ships or scrapping old owned ships, but the slump far outpaced those adjustments. Particularly around the long holidays in May, about half of our fleet had been idle, resulting from a significant fleet surplus. Unfortunately, we booked large losses.

Next, in terms of ferries and coastal RoRo ships, we saw a decline in shipments of automotive components loaded onto RoRo ships due to COVID-19. Although we saw an impact from this, above all else, a sharp drop in the number of ferry passengers had a grave impact.
Consequently, profit and loss has deteriorated compared to the previous year. Unfortunately, this business booked a loss for the first time in a long time.

As a result of the above, containerships posted a significant increase in profits, but car carriers and ferries booked a sharp decrease in profit and loss. Overall, the Product Transport Business deteriorated by JPY6 billion and booked a loss.

As for Associated Businesses, we didn't see any major impact on real estate caused by COVID-19 as we had worried, but we were forced to cancel cruises in the Cruise Ship Business. Also, our travel agency, which is considered to be strong in overseas business travel, took a huge hit. Consequently, we posted a JPY1 billion decline in profit compared to the previous year.

This concludes the summary of the financial results for Q1.

Next, we will move on to the full-year earnings forecasts.

With regard to the full-year earnings forecasts, we announced a “Rolling Plan” on June 22. Before that, on June 17, we made a timely disclosure, in which we revised our ordinary profit forecast to plus or minus zero. It has been about a month and a half since that time, and we make no revisions to that outlook.

As for revenue, operating profit or loss and net income or loss, we believe that we will be able to issue a proper figure at the time of announcing 1H results. By that time, we think we will be able to develop reasonable estimates regarding these figures. We hope to explain our outlook once again at that time.

Next, as for the breakdown by segment, we will first look at the Dry Bulk Business.

The main cargo for capesize bulkers is iron ore. Imports of iron ore to China have been very steady. The cumulative shipments from January to June have been up 9% YoY. Imports have amounted to around 550 million metric tons. Likewise, imports have increased for coal. While the market rate had been poor for a long time, during the period from late June to mid-July, it temporarily exceeded USD30,000. However, the demand for steel products has not increased except in China. Demand is reliant on China. Due to multiple factors on top of that, we do not expect a significant rise in the market rate in 2H. Thus, we only revised the assumption by a little more than USD500 in the guidance announced in June.

As for medium- to small-sized bulkers, we see no significant impact on earnings because the market will no longer have a large impact, as explained earlier.

Also as explained earlier, we are struggling a lot in terms of specialized bulk carriers including open hatch bulkers and wood chip carriers. We expect a sharp deterioration in earnings for this fiscal year in these areas.

In the Dry Bulk Business overall, in June, we announced our forecast of JPY3 billion in losses, and no changes have been made to it.

As for Energy Transport Business, I’ll first go over tankers. We believe the market rate for VLCCs is currently around USD20,000. Our forecast assumptions are also based on a price of USD20,000 in Q2, Q3 and Q4. Usually, crude oil tanker market tends to deteriorate in 1H and improve in 2H, but unlike normal years, we don’t expect a meaningful rebound this year during 2H. The storage demand that we saw in the spring made the VLCC market surge up to around USD200,000 per day, and this in itself is not bad. But, we expect the actual demand for oil to fall.
In fact, cargo movement has declined recently, and market rates have also been falling gradually. As we head into 2H, ships that were allocated to meet storage demand will become available again, but the underlying real demand for oil is not favorable. As such, we believe the VLCC market in the remainder of this year will not be very good.
That said, if the market level below USD20,000 were to persist for three consecutive quarters, there would naturally be an urge to scrap some old ships, which has rarely been observed this year. As long as a corresponding number of ships are scrapped, we think the market should head for recovery around late next year.

Previously, we mentioned that we had effectively captured the period in which the tanker market soared in the spring. But, when we say this, we are not just talking about a one-voyage contract based on good terms. It means that we were able to obtain contracts for three or four consecutive voyages, rather than one, during the period when the market was relatively high. Likewise, we obtained time charter contracts lasting for about a year. These are contracts that are relatively immune to future downturns in the market.

As for product tankers, rates were elevated for a while in sympathy with high rates for crude oil tankers. However, prices have normalized since then. That said, when discussing rates for product tankers, it should be noted that they are subject to more seasonality compared to crude oil tankers. In particular, the movement of heating oil in the northern hemisphere is certain during the winter period. So, we expect a rebound in market rates for product tankers during the winter more than crude oil tankers.

In addition, we expect stable profits for methanol tankers, for which we have long-term contracts.

In the LNG Carrier and Offshore Businesses, in addition to factors we explained earlier, the utilization rates were very high for FPSO during the previous fiscal year, so we received a bonus. For the full year during the current fiscal year, we do not factor in this bonus. In this sense, we project a slight decline in profits compared to last year.

As a result of the above, we keep our forecasts for the overall Energy Transport Business unchanged from the ones announced in June, and we expect ordinary profit of JPY24 billion.

Next, I'll go over the Containerships Business. Three months ago, ONE did not give its forecasts. This time, again, it did not disclose its forecasts due to uncertainties in the economic environment stemming from the lack of clarity around when the COVID-19 outbreak will be contained. Thus, ONE left its forecasts undecided. Accordingly, as was the case for announcements made in April and June, we have made our original estimates and factored them into our earnings forecasts in the Containerships Business.

As for the current business performance at ONE, cargo movement has remained brisk, thanks to ongoing demand during the summer peak season. The freight level has not dropped either. Rather, there are some routes in which peak-season surcharges have been added to the freight charge.

However, demand isn't by any means booming right now, of course, as cargo movement has fallen by around 10% compared to the previous year. That said, our current concerns have been that the cargo being transported to the US might be directly being piled up as inventory. In fact, we have heard from some shippers that inventory levels will pile up too high in the future, resulting in a considerable number of customers saying that they will be curtailing incoming cargo. Cargo movement would usually peak around June, July, and August, and then turn down in September, followed by a stoppage for the first week in October due to holidays in China. Recovery after the holidays in China will be key, as is usually the case, and we still have a question on this. On top of that, October coincides with the period before the US presidential elections. President Trump may say something that will heighten tensions with China or take other political measures.
Another point that bears mention over the short term is US economic policy. Whether the US continues to implement unemployment benefits, which are supposed to expire for the time being at end-July, and other economic policies is a factor contributing to uncertainty.

In Q1, we were able to respond to the decline in cargo volume of slightly above 10% thanks to the reduced number of alliances and the suspension of some services. However, if cargo volume were to fall 20%, as was the case around the Lehman crisis, whether the reduction of service frequencies would be sufficient in responding to the situation is a cause for serious concern.

In addition, during Q1, the bunker surcharges were high, and the actual fuel used was inexpensive. These effects would naturally fall out going forward. Given these conditions, we expect to record a loss in 2H.

As for our terminal and logistics business other than ONE, the volume handled has not grown. In that sense, we anticipate a deterioration in profit and loss over the full year.

As a result, we expect zero ordinary profit over the full year in the overall Containerships Business, which adds our Terminals and Logistics Businesses to the equity method profit and loss at ONE.

We are also struggling a lot in the Car Carriers Business. As explained earlier on page 18, we expect the number of vehicles transported on the basis of completed voyages to decline even further in Q2 from the level in Q1. In 2H, we, of course, expect a gradual recovery, but even still, it's hard to tell what would happen. Over the full year, as described in the scenario in the Rolling Plan, we project that vehicle shipment would decline by 25% to 35%. Our forecasts are premised on this level of cargo movement.
As stated earlier, we are, of course, proceeding with reducing the fleet size and scrapping old ships in response to the reduced demand. We already disposed of four vessels during Q1, and we are planning to dispose of an additional eight vessels during Q2.

However, in terms of car carriers, if we were to downsize the fleet size to match the cargo movement, then there is a possibility that we would miss business opportunities when demand starts to recover unless we possess these special vessels. It is a very difficult matter to strike the right balance in terms of how much we reduce the fleet. We are at a stage of deciding on how much we would reduce the fleet going forward, while carefully observing the movement in cargo and the impact of COVID-19.

For ferries and coastal RoRo ships, profits will basically increase in tandem with an uptick in passengers, as explained earlier. Thus, results hinge largely on passengers, and we don't place too much expectation here.

Based on the above, our outlook for full-year earnings in the overall Product Transport Business is a loss of JPY26 billion, although in the Rolling Plan, we forecasted a loss of JPY28 billion.

For the Associated Businesses, Others, and Adjustment combined, we previously forecasted a profit of JPY7 billion. This time, we revise that to JPY5 billion. Regarding whether profit and loss for the business would deteriorate by JPY2 billion, it is, of course, reflective of factors such as the uncertainty around the resumption of passenger cruise ships and losses booked at our business travel agency.

However, the biggest factor is the method by which general and administrative expenses are allocated, which probably isn't worth a lot in explaining. But it's basically how these expenses are allocated to each business division or recorded as companywide costs in case it cannot be allocated. And part of the deterioration in the segment is a result of expenses that were categorized as companywide costs, which is included here.
Earlier, I mentioned that the Product Transport Business had improved slightly by JPY2 billion. Some of you may think that we raised our forecast for the Product Transport Business by reducing the general and administrative expenses of JPY2 billion, and put such expenses instead on Associated Businesses, Others, and Adjustment. But that's not the case. Of course, there would naturally be some expenses, which are spread across many business divisions that have been taken out of the Product Transport Business. But the JPY2 billion in the Product Transport Business and the JPY2 billion explained here is completely unrelated.

Lastly, we have not given an explanation of dividends yet. We have left our dividend forecast undecided, given that we are still unable to forecast net income at this point. That said, over the last 10-plus years, we have continued to state that our dividend payout ratio is 20%, and we will, of course, continue to stick to this policy of paying out 20% of net income as dividends. Thus, we hope you will understand that leaving the dividend forecast undecided does not equate to paying no dividends.

Lastly, I would like to explain the current status of the impact of COVID-19 on our business.

During the previous financial results briefing meeting, we mentioned that we were experiencing constraints on crews changes. To update you on this situation, if we were to assume that normal operations are 100, then operations recovered to around 70 in June, and to around 90 in July. That said, operations haven't returned to normal. There are still crews that have been on board for a long time. We are continuing to work with the parties concerned to handle this situation.

As for operations on land, at the headquarters office, we temporarily raised the ratio of workers commuting to the office to 50%, but due to the increase in COVID-19 cases once again, we lowered this to 30%, meaning that the majority of our employees are now working from home.

We will continue to work to prevent the spread of infections to business partners, related parties, as well as executives and employees, and take measures to ensure their safety while striving to run business operations smoothly. We ask for your understanding.

This concludes my explanation.

Question & Answer

Q: The full-year forecast for the Product Transport Business is a loss of JPY26 billion, but what is the balance for Car Carriers? Also, for the Product Transport Business overall, the forecast has been revised upwards by JPY2 billion compared to the previous forecast. What is the breakdown of this upward revision?

A: I think our disclosure is relatively easy to understand. Ferries are included in the business, but the disclosure almost exposes how much losses will be booked in car carriers. The forecast for containerships is plus or minus zero, then most of the remainder is attributable to the Car Carriers Business.

Although we also mentioned that a loss would be made in the Ferries Business, the amount of that loss from the Ferries Business is limited. We hope you will understand this in this way.

As for the breakdown of the upward revision, we consider the Containerships Business to perform better than we expected previously.

Q: While it appears that the deterioration in the profit and loss in the Car Carriers Business will continue, do you think that the losses in Q2 will be larger than Q1?

A: I mentioned that we expect the number of units transported will be smaller in Q2 than in Q1 in the Car Carriers Business. Meanwhile, reducing the number of ships also means that fixed expenses will be curtailed.

Additionally, a considerable number of ships were stopped as of the end of June in Q1. Normally, vessel costs are only booked when the voyage is completed. But when certain vessels have clearly been idled, as is the case at present, expenses that have transpired through the end of June, for instance, the hire for chartered ships, must be booked in Q1.

Thus, part of the costs that would usually be booked in Q2, when the voyage is completed, are actually booked in advance in Q1. Considering these and other factors, we expect the losses to slightly decrease in Q2 compared to Q1.

Q: Given that the 1H forecasts have not been disclosed this time, what is the general direction in which you view results in Q2, that is July to September?

A: As for the direction from Q1 to Q2, I think the results would worsen. A reason for this firstly is ONE. As I've stated before, the bunker adjustment factor, BAF, will be revised, and this will push down profits. Meanwhile, even though fuel costs have not risen significantly, they are still higher compared to a while back, so that is another factor that would clearly worsen the results.

On top of that, the Dry Bulk Business booked a slight profit in this quarter. Even though it booked a profit, we expect a full-year loss of JPY3 billion. In other words, we project results to gradually worsen.

I believe I already answered the status of the Car Carriers Business earlier.

As for the Tankers Business, we believe results will be flat or slightly deteriorate, given that items that would normally be booked in Q2 were recorded in Q1 due to a difference in the voyage completion date.

Q: How much do you expect will be booked as extraordinary losses if you were to proceed with the disposal or return of ships, such as in the case of car carriers?

A: We've been delving into how car carrier fleet should be formed since the past. As a result, a certain portion of our fleet can be returned without any particular cancellation fees. Also, we have many ships that have been held for a very long period of time, and even if we were to scrap these ships, they wouldn't result in any large losses.

Thus, even though we are currently working to reduce our car carrier fleet, the way in which these reductions are carried out is still not one that would result in booking an extraordinary loss.

Q: Could you update us on resolving the issue of listing parent company and subsidiary?

A: Answering this question is difficult, because we aren't able to give the details, but it is being studied.

Q: We understood that the deterioration in profit and loss at the Car Carriers Business would continue on a full-year basis. How long do you think the deterioration will last?

A: We think the level of cargo movement will not return to the level in 2019 even after two years in 2022. For now, we are continuing to reduce the fleet size. That said, we think looking merely at the current cargo movement or the number of cargoes loaded could lead to faulty judgment.

Q: The 10% decline in cargo volume at ONE appears slightly better than the market average. Could you give us the background to this?

A: For instance, when looking at the cargo movement in containers from Asia to North America, based on the cumulative data from January to June, which I have on hand right now, it shows that cargo volume has declined by 8.8%. As for the backhaul trip, I only have the data from January to April, but cargo volume was down by 8.1%.

At ONE, cargo volume has decreased by slightly more than 10%. As for your question regarding whether this was much better than the market average, sorry, that's not something I can judge, so I will refrain from commenting.

That said, with regards to backhaul trip, a relatively large percentage of ONE's containers headed for Asia comes to Japan, as I may have explained before. As you know, ONE originates from three Japanese companies, so in terms of backhaul trips, I think cargo volume has been in line with or exceeded the market average since its inception.

Q: Tell us how you view specialized bulk carriers, open hatch bulk carriers and wood chip carriers, from Q2 onwards?

A: Open hatch bulk carriers, which are carriers that carry pulp, have a contract of affreightment, or COA, that can last two to five or six years, or various other numbers of years, and there is a specified cargo that serves as the basis of the contract. When looking at the contract's profitability, which can be referred to as a charter base, the results are not bad at all compared to general bulk carriers.

If, for instance, the pulp is carried from Brazil to China, then that carrier is once again returned to Brazil. But there isn't much cargo on the return trip. This is a part of the business that is susceptible to swings in the market condition. We expect that this area won't recover much, so we think the results will not be so good.

As for wood chip carriers, there are not that many other cargoes than wood chips that can be loaded. We also carry a lot of soybean meal, but this is also something that's linked to market conditions for general bulk carriers and small-sized bulk carriers. In that sense, we are not optimistic about performance from Q2 onwards.

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