April 30, 2020

Mitsui O.S.K. Lines, Ltd.

1. Financial Summary for Fiscal 2019

[Overview]

Ordinary profit for fiscal 2019 increased by ¥16.5 billion, or 43%, to ¥55.0 billion. In addition to stable profits from medium- to long-term contracts in the Dry Bulk Business and the Energy Transport Business, this increase was mainly due to higher earnings from the booming tanker market in the second half of the fiscal year and the containership business integration company ONE, which is in its second year after the business integration, achieving profitability in the Product Transport Business.

Net income attributable to owners of parent increased ¥5.7 billion, or 21%, to ¥32.6 billion. As a result, ROE was 6.3%.

Although the impact of the new coronavirus (COVID-19) has affected cargo movement and market conditions since early February depending on the ship type, it should be noted that the impact on MOL's financial results in fiscal 2019 was limited because many of the company's consolidated overseas subsidiaries closed their accounts in December, and the voyage completion method is applied to the company's non-consolidated vessels for recognizing revenues.

[By Segment]

<Dry Bulk Business>

The Capesize bulker market recovered gradually over the summer following a slump caused by the collapse of a mining dam in Brazil in early 2019. Although the market subsequently remained firm to a certain extent due to steady crude steel production in China, it fell around November due to a slowdown in shipments of iron ore caused by the cyclone in Western Australia and the beginning of the rainy season in Brazil. After the start of 2020, the impact of the Chinese New Year holiday and COVID-19 meant that the market remained sluggish as spot-chartered vessels to China decreased. In addition, freight revenue decreased due to the renewal of long-term contracts for the transportation of iron ore, which were concluded when the market soared.

The small- and medium-size bulker market rose over the summer due to firm grain shipments from South America. Since September, however, the market has been on a downward trend due to uncertainty in the U.S.-China trade negotiations and China's restrictions on coal imports. From the beginning of this year, cargo movement to China became sluggish due to the impact of COVID-19 and the market fell, as was the case with Capesize bulkers. However, our company's small- and medium-size bulkers completed structural reforms years ago and had minimal market exposure, making their impact on business results limited even during periods of weak market conditions.

As a result of the above, ordinary profit in the entire Dry Bulk Business decreased by ¥9.8 billion year-on-year to ¥12.0 billion, although it exceeded the forecast at the beginning of the fiscal year, supported by stable profit based on medium- to long-term contracts for iron ore and woodchips.

<Energy Transport Business>

■ Tankers

The VLCC market was generally sluggish in the first half of the fiscal year due to a decline in demand for crude oil in early spring and regular repairs at oil refineries in the Far East. The market soared in October and remained relatively high thereafter due to tightened supply and demand against the backdrop of the situation in the Middle East and sanctions imposed by the United States on some shipping companies. Although the number of VLCCs that we operate in the spot market is limited, profits increased due to favorable market conditions and stable profits from medium- and long-term contracts.

In the first half of the fiscal year, the product tanker market remained low due to an increase in the number of newly built vessels and regular refinery repairs. However, in the second half of the fiscal year, the market remained firm thanks to the tightening of supply and demand in shipping capacity affected by the rise in the VLCC market, and an increase in demand for diesel oil transportation related to SOx-regulation compliant oil, which resulted in profit improvement.

In addition, the methanol tankers recorded steady profits from medium- and long-term contracts, and the LPG tankers increased profits supported by favorable market conditions.

As a result, the overall Tankers division recorded a year-on-year increase.

■ LNG Carriers/Offshore Businesses

Eight new LNG carriers were delivered, including one icebreaker for the Yamal Project in Russia. As a result of stable profits, mainly from long-term contracts, earnings increased year on year.

In the Offshore Businesses, profits were maintained at the same level as in the previous fiscal year due to the steady operation of existing projects, such as the FSRU, FPSO, and subsea support vessels.

As a result, ordinary profit in the Energy Transport Business, including coal carriers with mainly medium- and long-term contracts, increased by ¥4.2 billion year-on-year, to ¥25.4 billion.

<Product Transport Business>

■ Containerships

In the fiscal year under review, the second year of the containership business integration, ONE made steady progress with the synergy effects of the integration, in addition to the increase in cargo volume resulting from the stabilization of services. Cargo movement and market conditions were lower than expected at the beginning of the fiscal year due to the impact of U.S.-China trade friction and COVID-19. However, in addition to maintaining higher utilization rates through flexible service reductions, ONE achieved profitability by optimizing routes and ship allocations and reviewing its cargo portfolio. We believe that because ONE was able to achieve profitability in fiscal 2019, despite generally unfavorable cargo movement and market conditions, it is a sign that ONE has become solid.

In the Terminal and Logistics businesses, ordinary profit declined year on year due to a decrease in the volume of cargo handled.

As a result, ordinary profit in Containerships improved ¥18.4 billion year-on-year to ¥4.1 billion.

■ Car Carriers

The transportation volume decreased compared with the previous year due to weak cargo movement on routes to Japan and between countries other than Japan affected by U.S.-China trade friction and tighter emission regulations in China. However, in addition to the improvement of freight rates, we continued efforts to rationalize ship allocation and improve operational efficiency, resulting in a slight improvement in ordinary profit.

■ Ferries and Coastal RORO Ships

Revenue in Ferries and Coastal RoRo Ships increased year-on-year due to steady cargo transport resulting from the modal shift caused by the shortage of truck drivers and the intention to reduce the environmental impact, as well as passenger demand driven by the recent launch of new vessels on the Hokkaido and Kyushu routes.

As a result, ordinary profit for the entire Product Transport Business improved significantly by ¥18.9 billion, to ¥6.7 billion.

[Compliance with SOx Regulations]

We were able to adopt to the SOx regulations that went into effect in January 2020 without major issues by securing compliant fuels in advance and thoroughly preparing for the switch.

[Dividend]

Along with the increase in net income, we will pay a year-end dividend of ¥35. Combined with an interim dividend, which we have already paid, the full-year dividend will be ¥65 per share. The dividend payout ratio will be 23.8%.

2. Overview of Fiscal 2020 Forecast

[Overview and Approach]

First of all, I would like to explain our approach to the disclosure of our financial forecasts. As COVID-19 spreads worldwide, our company's business has been greatly affected, and it is difficult to predict when the situation will be resolved and how trends in cargo movement will evolve. Therefore, instead of the usual manner, we decided to announce our full-year and first-quarter ordinary profit and loss estimates based on the following. For the full fiscal year forecast, based on the original budget made in March (that is, the initial budget made in which the COVID-19 effect was not sufficiently incorporated), we re-adjusted it by taking into account deterioration of the cargo volume and market rates under two stress scenarios: a case in which the impact of COVID-19 converges in six months and a case in which it continues for one year. As I will explain later, although there are segments where market rebound and continuous favorable market conditions can be expected depending on the type of vessel, they are excluded. Therefore, although we have disclosed ordinary loss of ¥10 billion to ¥40 billion for the full year, it does not mean that even in the best case it will be a ¥10 billion loss. Please understand that we are not giving up on achieving a profit this fiscal year by taking a variety of measures.

On the other hand, the figures for the first quarter reflect the current situation to some extent, calculated based on the loaded cargo volume and market rates from February to May in consideration of the application of the voyage completion method for accounting purposes. This is different from the full-year forecast, which was calculated by incorporating stress scenarios into the original budget.

As you can see, the approaches for the first quarter forecast and the full-year range forecast are different, but I do not think there is a large sense of incongruity when comparing these figures.

Another important addition is that the forecast for the containership business, which I will explain again later, is our company's calculation, and it should be noted that this forecast was not made by ONE.

Based on the above assumptions, we expect an ordinary loss of ¥7 billion in the first quarter mainly due to a sharp drop in transportation volume for car carriers and in the number of ferry passengers, and an ordinary loss of ¥10 billion to ¥40 billion in the full year even under a stress scenario.

[By Segment]

<Dry Bulk Business>

For Capesize bulkers, although cargo movement to China have been steady due to Chinese government's investment strategies, impact is expected on future cargo movement of steel materials due to a decrease in consumption of final products, such as automobiles and building materials. In terms of business performance, stable profits based on medium- to long-term contracts are anticipated, while in the case of market-linked vessels and vessels with short-term contracts, a significant deterioration in profit and loss is expected, taking into account the weak market conditions that have continued since the beginning of the year.

Cargo movement of small- and medium-size bulkers is expected to remain firm based on food demand, such as grain, but movement of raw materials and materials for general industries, which are susceptible to economic trends, is expected to be affected to a certain extent. However, as a result of our efforts over the past several years to reduce market exposure, the impact of our company's small- and medium-size bulkers on our business results is limited even in an environment of market deterioration.

For specialized bulkers, which I have not had much opportunity to explain, open-hatch bulk carriers operated by Gearbulk, an equity-method affiliate, and mainly engaged in pulp transportation are significantly affected by sluggish pulp cargo movement. Together with woodchip carriers, some of which do not have long-term contracts, these vessels are insufficiently versatile and it is difficult to adjust fleet size according to fluctuations in shipments. Therefore, we anticipate a significant deterioration in earnings.

Considering the above-mentioned factors, for the Dry Bulk Business, we forecast ordinary profit of ¥500 million for the first quarter and ordinary loss of ¥2 billion to ¥10 billion for the full year as a stress scenario.

<Energy Transport Business>
The VLCC market is currently soaring due to temporary demand, such as offshore storage caused by a significant drop in crude oil prices. However, under the stress scenario, we assume that the market will eventually fall due to a decline in actual demand caused by the stagnation of the global economy, and we do not take into account the rebound in the winter, which is the usual demand period.

As with the VLCC market, we expect the product tanker market to decline at some point in the year due to a fall in actual demand caused by the global economic slowdown. As for methanol tankers, long-term contracts are the main business, and stable profits are expected.

The number of new LNG carriers that will be delivered this fiscal year is limited, but we will continue to secure stable profits based on long-term contracts.

Despite steady growth in profits in the offshore business over the past few years, we have unfortunately factored in a significant decrease in profits from the previous fiscal year, regardless of COVID-19, as a medium-term contract for one FSRU currently deployed in Turkey will expire and there will be a lag until the next long-term contract starts.

As a result, in the Energy Transport Business, we expect to secure ordinary profit of ¥5 billion in the first quarter, reflecting favorable market conditions in the Tankers division, and of ¥12 billion to ¥15 billion for the full year even under a stress scenario in which the tanker market will remain sluggish.

<Product Transport Business>
Cargo movement for containerships is shifting from supply-side issues, such as a decrease in cargo movement from China during the spread of infection in China, to demand-side issues, particularly in the United States and Europe, in line with the spread of infection worldwide. ONE is responding to the recent decline in cargo movement by flexibly reducing service frequency. With concerns over a further decrease in cargo movement due to a decline in demand in Europe and the United States in the future, ONE is currently unable to develop a solid business performance forecast for fiscal 2020, and therefore, the business performance in our stress scenario is based on our company's projections by taking our past experience and other factors into account.

In addition, we expect a decrease in the volume of containers handled for the terminal business and a decline in the volume of air cargo handled for the Logistics business. Due to these factors, in the Containership business, we forecast ordinary loss of ¥13 billion to ¥24 billion under a stress scenario.

In the past, the Containership business experienced a significant decline in cargo movement following the Lehman Shock and, to a lesser extent, a decline in cargo movement due to SARS. Although the subsequent recovery in demand is expected to have a greater impact on profitability than in other segments, the stress scenario does not take into account a significant recovery in cargo movement during the current fiscal year.

Car carriers experienced a significant decline in cargo movement, particularly in April and May, due to a large reduction in production by car manufacturers. We expect cargo movement to make a moderate recovery after COVID-19 converges.

For ferries and domestic RoRo ships, we expect strong demand for cargo transportation, while passenger demand is anticipated to continue to decline substantially.

As a result, we forecast ordinary loss of ¥13 billion in the first quarter due to a significant drop in the number of car transportation and ferry passengers, and ordinary loss of ¥25 billion to ¥41 billion for the full year.

<Associated Businesses and Others>

In the real estate business, steady profits are expected under the stress scenario, while in the cruise business trips are suspended for a certain period of time. As a result, ordinary profit is expected to be ¥1 billion in the first quarter and ¥5 billion to ¥8 billion for the full year.

[Dividend]

Because it is impossible to predict the exact results at this time, we have not yet decided to announce them, however, we will maintain our policy of a dividend payout ratio of 20%.

3. Countermeasures against COVID-19 and the Management Plan

[Response to COVID-19]

On February 3, shortly after the outbreak of COVID-19, our company established a task force. We believe that our company’s most important mission is to provide transportation infrastructure through continual safe operations. Accordingly, the company is making utmost efforts to achieve the following three objectives: (1) securement of thoroughly safe and reliable operation of MOL-Group-operated vessels; (2) assurance of the safety and prevention of the spread of infection for customers, business associates, and MOL Group officers and employees; and (3) upgrade of the business continuity system to prepare for the case the current situation does not improve for an extended period.

Regarding operating vessels, the biggest issue at present is that crew changes have been hindered due to onshore travel restrictions and the suspension of flights in a variety of countries. Our company has been making efforts to gain understanding from the governments of various countries through appropriate channels, such as the Japanese Shipowners' Association and the International Maritime Organization (IMO). Prolonging the issue could have a direct impact on the physical and mental health of the crew, and in turn, on the safe operation of ships in our company, and we are working to resolve this issue. Due to a shortage of workers at shipyards and repair docks, some construction work has been delayed, but overall there has been no major disruption to ship operations.

As for the onshore offices, our company promptly shifted to work from home from March 9. As of last week, the percentage of commuters was approximately 6%. Efforts have been made to ensure the safety of customers, business partners, and officers and employees of our company, as well as to prevent the spread of infection.

I will also explain the financial aspects described in the financial highlights (*kessan tanshin*). Freight revenues are expected to decrease due to a decline in cargo movement caused by COVID-19. As a response, we will strive to secure funds by reducing operating costs through slow steaming and taking measures such as lay-up, the redelivery of short-term chartered vessels, and the disposal of assets. Even in the event of greater-than-anticipated demand for funds, we can secure the necessary funds, because we have commitment line agreements with leading commercial banks for approximately ¥140 billion with a remaining period of approximately three to four years.

[Management Plan]

At the start of fiscal 2020, usually we would set out a new management plan “Rolling Plan 2020.” However, with the recognition that the spread of COVID-19 and the recent sharp fall in crude oil prices will have a material impact on our company's medium- and long-term management strategy, we are currently working on shaping the best plan.

We established the “Rolling Plan Special Committee” for quickly establishing defensive measures to reduce market exposure and to review investment plans for ensuring business continuity even in emergency situations, fully understanding the impact of COVID-19 on our company business, and formulating and implementing the aggressive strategy to realize a quick turnaround and growth in the post-COVID-19 world. The committee is working to compile “Rolling Plan 2020” around the end of May, focusing on defense and medium- to long-term growth.

Finally, the true strength of our company is being tested at a time when storms are at hand, such as the spread of COVID-19 and a sharp drop in crude oil prices. We will do our utmost to run our business in the hope that after overcoming this difficult situation, our shareholders, investors and other stakeholders will recognize our company's value once again.

We look forward to your continued understanding and support.

4. Questions and Answers

Q1) Describe the breakdown for the full-year forecast of - ¥13 to - ¥24 billion for the Containership business into ONE and others.

A1) The loss from others than ONE will be in the middle of the range of several billion yen. Our company's Logistics and air forwarding businesses do not have huge exposure, but we expect them to be impacted. In addition, we believe that a decline in profit and loss in the terminal business must be expected to some extent in relation to ONE.

Additional Q) Is the middle of the several billion yen range for the base case of - ¥13 billion?

A) It is for both cases of - ¥13 billion and - ¥24 billion.

Q2) Are there any policies or strategies for procuring oil compliant with IMO regulations in the face of falling crude oil prices?

A2) With regard to the slump in crude oil prices, at first it was caused by supply side factors, such as the end of coordinated oil production cuts and the announcement of increased production by OPEC Plus led by Saudi Arabia. However, due to the influence of COVID-19, we believe that demand will continue to stagnate in the future. As a result, we expect prices to continue to remain low, but we intend to hedge to a certain extent as we carefully assess futures prices.

Q3) Your explanation of the management plan was to develop and implement strategies for quick turnaround and growth. Describe some examples.

A3) I believe that we must carefully assess how the world will change after COVID-19 in order to formulate a strategy. Among the opinions of different intellectuals, we can agree, for example, that a review of globalization or a change in sourcing policy is likely. If that occurs, there will be a change in the movement of cargo, which we will have to carefully examine.
In addition, digitization and the use of ICT are expected to progress at an accelerated pace, as we have seen in telecommuting. We need to see how this will affect our business.
Furthermore, there are a variety of views on environmental issues. Some say that people's awareness of the environment is weakening due to the recent decrease in GHG emissions, while others say that people's awareness of health and hygiene has increased, and demand for environmental care has become more severe. We believe it is necessary to develop an environmental strategy that is ahead of other companies while carefully assessing the views of our customers.
As disparities in corporate strength widen, fair value of some companies may change, creating investment opportunities for our company.
We will create a strategy while keeping an eye on these factors. In any case, the importance of the logistics infrastructure has been reassessed and we will continue to firmly engage in maritime transport.

Q4) The forecast for the Dry Bulk Business is an ordinary loss of ¥2 billion to ¥10 billion, but will the market alone deteriorate the results this much?

A4) Although our general bulk carriers are not as affected by market conditions, there is a significant drop in the market for specialized bulk carriers. Specifically, open hatch bulk carriers, a niche business in which cargo that is too large to be carried by containers and too small to be carried by bulkers is carried by box-type ships, are similar to product transport in terms of cargo movement and are heavily impacted. In addition, the impact of COVID-19 is taking a further toll on woodchip carriers, as demand for paper is already declining. Because it is difficult to adjust the fleet capacities of these specialized bulkers, the earnings are damaging.

Q5) Describe how the suspension of production by automobile manufacturers will affect the profits of the Car Carriers segment.

A5) The production rate of cars by automobile manufacturers is lower than usual, but has not stopped completely. The main reason for our company's very large volume decline in transportation, especially in April and May, is that the worldwide dealer network has been disrupted and sales have been hampered, resulting in cars being unable to be put on the supply chain even if enough cargo exists for marine transport. If the functioning of the dealer network begins to normalize, marine transportation demand will increase and production by manufacturers is expected to recover. However, we are anticipating that we will be unable to expect a recovery until at least June.

Q6) I understand that the ordinary loss of ¥10 billion presented in the forecast is not the best case scenario. What factors will make you profitable?

A6) The current price of compliant fuels is around $220/MT and our assumptions are higher in comparison. We have been unable to disclose the sensitivity of fuel oil prices at this time, but there is a possibility that benefits will emerge depending on future price trends.
As for the tanker market, we have not incorporated a rebound in winter, which is usually the period of high demand, and we assumed that the current favorable market will decline in June. If the market moves differently, we may be able to increase profits.
In addition, recent domestic sales of cars in China have been recovering dramatically, and there have been requests from German manufacturers to ship their cars as soon as possible.
Also, the big difference from the Lehman Shock is the number of on-order ships. The order backlog of newly built ships is limited, and the basic supply and demand situations are completely different. Considering these factors, there is room to assume that the market can be slightly higher, but this time we made forecasts under a stress scenario, so it is not included.

Q7) According to your forecast, the Containerships business in the first quarter of the fiscal year will be - ¥4.5 billion. Describe why you forecast a decrease in profits in the first quarter of fiscal year 2020, despite the fact that ONE increased its profits year-on-year in the fourth quarter of fiscal 2019 regardless of a decrease in cargo movement.

A7) The majority of - ¥4.5 billion will be equity in earnings of ONE. With container cargo movement recently declining by 10 to 20%, we expect demand to decline the most in the first quarter. We do not expect freight rates to fluctuate much, but due to the impact of COVID-19, ONE has already reduced the number of services considerably. We calculated the figures used for the forecast independently based on the assumption that redeliverable vessels will be redelivered.

Q8) The Energy Transport Business is also expected to see a decrease in profits compared to the same period last year. Describe how the recent surge in the tanker market is reflected.

A8) There are two main points. First, the positive effects of the favorable market conditions for VLCCs and product tankers will emerge more in the second quarter than in the first due to the timing of revenue recognition and so on. In addition, the number of spot vessels in our company that can benefit from a rise in market prices is limited.

Q9) Compared to the past, there have been no large orders for vessels, and the book value of the ships has been lowered due to past impairment. Am I correct in understanding that the risk of further asset impairment has been reduced?

A9) Capital investment in vessels owned by the Company over the past four to five years has been limited to projects backed by long-term contracts, so asset risk is insignificant under the influence of COVID-19.

Q10) Describe whether there are any changes in the capital investment policy.

A10) Shipping company investments do not require immediate cash out. Even if we do not make any new investment decisions in the current fiscal year, the cash out from investments made over the past two or three years will be commensurate. In fiscal 2019, we set the investment at a level where operating cash flows and investment cash flows are almost matching. In the current fiscal year as well, we will take measures to close the gap between our investment cash flow and our operating cash flow, with the first priority being to minimize cash outflows, while considering the possibility of a partial review or postponement of investment decisions.

Q11) It was explained that MOL FSRU Challenger has a lag period until it starts its next contract. Describe the specific timing and whether it has been fixed.

A11) The current contract in Turkey will be terminated early this fiscal year, and the scheduled contract in Hong Kong is not planned to commence during this fiscal year. Until then, it remains undecided whether she will be used as an LNG carrier or an FSRU, but we believe that we will be unable to make the same profit as before.

Additional Q) Can we safely say that the business performance deterioration caused by MOL FSRU Challenger accounts for less than half of the entire energy transport business deterioration?

A) In terms of scale, it does not account for a large percentage of the energy transport business.

Q12) Describe any changes to the stable profit accumulation plan (¥55.5 billion in fiscal 2019, ¥58 billion in fiscal 2020, and ¥65 billion in fiscal 2021).

A12) Existing contracts will not be cut off suddenly. In the Dry Bulk Business, where there is a large margin of decrease in profits, of course there are stable profits, but there are market-linked vessels to support long-term contracts. If these are affected by weak market conditions, profits may decrease considerably.