October 31, 2018
Mitsui O.S.K. Lines, Ltd.

Explanation by the CEO and Major Q&A

[Overall]

As you know, the new container shipping joint venture Ocean Network Express (ONE) launched its service in April of this year, and we expected it to record a surplus from the initial year. But I regret to say that ONE made a major downward revision for both the first-half results and full-year forecast. It is truly regrettable that we had to make such a large downward revision just three months after we announced the first quarter financial results at the end of July, and I bear a great responsibility as one of ONE's three shareholders. I am sure that most of your concerns and attention focus on the background behind a downward revision in the outlook for ONE's business performance, and I will explain this as much as possible.

So today, I will explain the first-half financial results and full-year forecast first, and then provide a detailed explanation about ONE all at once.

1. Outline of Q2 FY2018 Financial Results

[Overall]

Operating profit for the first half of FY2018 totaled ¥14.7 billion, ending with an upturn of ¥5.7 billion over the previous outlook. The factors for the upturn include:

- Profit in the Dry Bulk Business improved mainly due to recovered Capesize market,
- Profit in the car carrier business improved,
- We continued to scale down our own transitional costs related to the integration of the containership business, and
- Profit in the Energy Transport Business also improved in the first half, though it was partly due to recording of profits in the second quarter that were previously expected in H2.

On the other hand, ordinary profit ended at ¥10.2 billion, a ¥1.7 billion deterioration from the previous outlook, despite these positive factors. Non-operating profit declined by ¥7.4 billion from the previous outlook, resulting from the combination of a ¥9.6 billion deterioration in MOL's ONE-related equity in affiliate earnings and a certain gain in foreign exchange and other factors.

[By segment]

<Dry Bulk Business>

Spot markets for each bulker type in the first half of the period improved in a year-on-year comparison.

Momentum in the Capesize spot market was weak from May through June, but then shipments of iron ore from Brazil recovered, pushing the market up to the $24,000 per day level from July through August. It's said that the industry average Capesize cost ranges from $20,000 to $25,000, so the spot market nearly reached the break-even point. But afterwards, sentiment deteriorated due to U.S.-China trade friction, and overall remained at the $17,000 level in September.

The impact on our mid- and small-size bulker market became smaller due to our significant scale-down of market exposure through the Business Structural Reforms, which we implemented in recent years. Trade was relatively solid for coal, grain, and other cargoes, and the market remained firm.

Ordinary profit in the Dry Bulk Business for the first half of the year increased in a year-on-year comparison, and ended with a slight upturn from the previous outlook, by steadily recording stable profits from long-term contracts, mainly for Capesize vessels, while the spot market remained firm

overall.

<Energy Transport Business>

■ **Tankers**

The overall VLCC market remained weak due to periodic seasonal repairs at oil refineries in the Far East, in addition to the slack demand season from early spring. But from the aspect of vessel supply, more aged vessels have been withdrawn from service for scrapping. From January through September of this year, 34 vessels were scrapped, more than the 30 newbuilding vessels delivered. We see an increasing possibility that the number of vessels scrapped will outstrip the number of newbuildings throughout 2018. In this case, the number of VLCCs may decrease for the first time in 17 years. We are monitoring the situation with strong expectations for improvement of the demand and supply balance in the future.

The demand and supply balance of the petroleum product tanker market has not tightened, resulting in overall weakness. We have worked to counter these losses by reducing the number of vessels, and have cut the fleet down to 34 vessels as of the end of September, compared to 39 at the beginning of the year.

Although the market was weak in the overall Tanker business, this segment recorded stable profits by steadily executing long-term contracts. As a result, this business ended with a slight upturn from the previous outlook, thanks in part to the impact of pushing dry dockings from the first half of the year to the second half.

■ **LNG Carriers/Offshore Businesses**

In our case, most vessels operate under long-term contracts, recording stable profits. During this first half of the year, three LNG carriers and one FPSO started operation. These are progressing almost as initially planned, but this business segment ended with an upturn from the previous outlook, by moving up recording of a part of profits, which were projected for the second half in the previous outlook.

Meanwhile, losses on selling ships by the equity-method company were recorded in the same period of the previous year, so the profit margin became larger in a year-on-year comparison.

The LNG Carriers and Offshore Businesses, which are key strategic field in the current management plan, have steadily accumulated new projects. During this first half of the year, we concluded a long-term contract for FPSO, which will serve for Brazil, increased portion of ownership in the subsea support vessel operating company in Norway, and in June, reached a basic agreement on a long-term charter contract for an FSRU serving the LNG receiving terminal in Hong Kong. In the Yamal Project in Russia, our operated ice-breaker LNG carrier sailed on the east-bound route in the Arctic Ocean, and smoothly completed discharging in China.

As LNG prices rise, we think new projects that have been delayed may start to move again. We will expand our stable profits by leveraging our strength in this field.

<Product Transport Business>

I will explain the containership business all at once later on. And now I will talk about the car carrier business.

■ **Car Carriers**

First, about the Car Carrier Business, the number of units exported from Japan during the second quarter decreased in a year-on-year comparison, due mainly to the impact of Europe’s tightening environmental regulations, in addition to heavy rainfall and typhoons in western Japan, not to mention the earthquake. The number of units on our vessels decreases by 25,000 in a year-on-year comparison. On the other hand, our trade increased by 20,000 units for the inbound and cross trades on Intra-Europe routes and from Europe to North America and China. Declining trade for the Middle

East has hit bottom, but we expect it to take some time to achieve a full-scale recovery.

A fleet oversupply occurred due to decreasing shipments, mainly for Europe, but we worked to improve profitability by proactively chartering vessels to other operators and expanded slow-steaming operations.

As a result, operating profit decreased in a year-on-year comparison, but we saw improvement in the second quarter, after a deterioration in profitability in the first quarter due to an insect quarantine issue. We also ended with an upturn from the previous outlook.

2. Outline of the Full-year FY2018 Forecasts

[Overall]

For the full-year FY2018 forecasts, again I regret to say we made a downward revision of ordinary profit, a decrease of ¥18.0 billion, from the previous ¥40.0 billion to ¥22.0 billion. ONE's downward revision of its full-year forecasts, a decrease of $720 million, from the previous announcement will reduce our ordinary profit by ¥24.2 billion. But this is mitigated to some extent by improvements in the Dry Bulk business, and this situation—the Dry Bulk Business mitigated the profit decline due to ONE's performance to a certain degree—is similar to the first half of the year.

Our assumption of foreign exchange has been revised from the previous ¥105 to ¥110. On the other hand, we have revised our assumption of bunker prices from the previous $450 to $480.

[By Segment]

<Dry Bulk Business>

Overall trade is firm, but there is a concern about U.S.-China trade friction, which may affect the market sentiment, so we made a small upward revision in the market assumption for the second half of the year, but only for Handymax and Small Handy vessels.

We expect a solid Capesize market within this calendar year due to seasonal factors, but are factoring in a softening from the effects of the rainy season in Brazil and so on early next year.

Market exposure for small- and mid-size dry bulkers has been reduced and curtailed significantly, and in addition, we have moved ahead with efforts to fix earnings in the Capesize future market (FFA) to a certain extent, so the sensitivity to swings in the market for the second half of the year is not significant, and we think this business will record profits in line with the outlook, unless the market significantly fluctuates.

<Energy Transport Business>

■ **Tanker**

The VLCC market, which has remained stagnant, is finally on track toward recovery. This year, the fleet supply may show a net decrease. The effects of rising exports from West Africa as an alternative to Iranian crude oil, in addition to the market entering the winter demand season, may lead to an increase in ton-miles. Thus, we expect the market to remain firm. We also made an upward revision of our previous market assumption for the second half. However, we don't have many VLCCs operating on the spot market, so this will have a limited impact on improvement of profits.

On the other hand, the petroleum product tanker market continues its long-term doldrums. We expect a recovery as we enter the winter demand season, but we made a downward revision of the market assumption in consideration of the current market conditions. We continue to further reduce the fleet.

Speaking of the tanker business, we project nearly the same level of profit as in the previous

outlook. We aim to end the term just slightly in the black thanks to the contributions of stable profits from VLCCs, methanol carriers, and other long-term contract vessels, although they show a downturn from the previous year.

■ **LNG Carriers/Offshore Businesses**

We expect full-year profits to match the initial outlook. In this fiscal year, seven LNG carriers and one FPSO start operation. We expect these newly operating projects to steadily contribute to profitability.

<Product Transport Business>

■ **Car Carriers**

The initial assumption for the second half for trade from Japan is unchanged, but inbound and cross trades are expected to decrease due to the impact of U.S.-China trade friction and delays in response to stricter inspection of completed cars by European automakers. We continually strive to improve profitability by boosting ship allocation efficiency, but made a slight downward revision in the full-year forecast from the previous outlook.

[Dividend]

While we will pay a ¥20 per share interim dividend as initially planned, we revised the year-end dividend from ¥30 in the initial plan to ¥20, and from ¥50 to ¥40 for the full-year dividend, reflecting this downward revision of the business performance.

3. About the Containership Business

Finally, I will explain the situation surrounding ONE, which made a significant downward revision in the outlook for its business performance.

Immediately after ONE commenced services in April, they fell behind with their booking and documentation operations because ONE staff were not completely familiar with the IT system and were shorthanded. This resulted in significant inconvenience to customers.

We must also accept that a lack of preparation, stemming mainly from the longer-than-anticipated time needed to clear regulatory approval in some major countries—also played a role in the staff IT system training issue. But this was essentially resolved by the time they announced the first quarter financial results. And the staff shortage had nearly been addressed by the time of the previous announcement, as the shift of personnel to ONE accelerated after operations by the three Japanese shipping companies to withdraw from containership business calmed down.

Under this situation, we thought that the operational teething problems immediately after the commencement of services were to a large extent resolved, and they would catch a part of the summer peak season to significantly improve utilization, which were stagnant in the first quarter. In addition, we saw the generation of synergistic effects from the integration more swiftly than in the initial outlook, and we thought they could maintain the initial profit plan with additional cost reductions aimed at offsetting the rise in bunker prices.

There are some points they could not achieve as planned, which, regrettably, led to this significant downward revision. Let me explain this.

The first issue is that they anticipated that customers that left due to the teething problems immediately after the commencement of services would return to ONE's services soon after those problems were resolved. I have to say they were too optimistic about this point in the previous outlook. Customers of containership services, particularly for cargoes from Asia to Europe and the U.S., import and export along with their in-depth supply chain plan. So in some cases, ONE will

have to wait until the next annual contract negotiations for the opportunity to win these customers back, if they switched to another shipping company once.

The cargoes went to other shipping companies because of the teething problems as I mentioned earlier. This situation was particularly remarkable on the Asia-North America Westbound and Asia-Europe Eastbound routes. In general, many cargoes on these routes are relatively low-value and not time sensitive, as typified by waste paper from the U.S., but on these routes, other containership companies have a lot of space available, which makes it easier for customers to switch to other companies immediately after the problems occurred. Before the integration, all three Japanese shipping companies could acquire many more cargoes on these routes compared to other liner operators. ONE's personnel in the business division were extremely busy resolving problems after the start of service, so could not roll out their sales activities. Utilization for the first half, particularly on the Asia-North America Westbound routes, remained extremely low at 33%. A decrease in cargoes on these routes not only resulted in a decrease in revenues, but also squeezed profits by increasing the costs of returning empty containers to Asia.

They have been making gradual progress in their efforts to recover their sales activities on both west- and east-bound routes. But they still need some time to completely resolve the lingering impact of the problems immediately after the commencement of services.

These are the factors behind the deterioration in profit resulting from the problems after the start of service. Another factor is the failure to fully achieve the product cost reduction plan, which was included in the previous announcement. The product cost reduction plan is aimed at the rationalization of the Asia-North America route and the reduction of fuel oil consumption. We projected an overall reduction of $240 million in the previous outlook. However, after another careful review of fuel oil consumption, they made a downward revision, a decrease of $80 million, in the reduction plan in consideration of adverse weather and ship congestion at major ports that made it impossible to achieve the target.

As a result of these factors, they had to make a large downward revision from the previous announcement of the outlook, which was projected to end with surplus, partly because our outlook was too optimistic. Once again, I sincerely apologize to our shareholders. We had forecasted various hurdles to overcome to some extent in the process of the integration, by taking an unprecedented step—the three Japanese shipping companies stopped their own services, and a new company, which was launched from zero, took over the businesses and commenced its own services. But, we cannot avoid some soul-searching over our underestimation of the hurdles we would face in putting ONE on track. Currently, ONE and three parent companies are pushing ahead toward improvement of earnings. First, we have been strengthening the business to recover the trust of customers and increase liftings, primarily address the urgent issue of "stabilizing and overcoming temporary negative factors for the initial fiscal year." Though we are still on the way to recovery, we aim to make a certain level of improvement toward the next fiscal year as we renew future annual contracts. The presidents of the three Japanese shipping companies, including me, will be more deeply involved in this issue as we work toward improvement of profits.

At the same time, we will push forward further improvement of yield management, which the three parent companies have emphasized since before the integration, as well as optimization of the cargo portfolio. In the initial fiscal year, various factors kept us from working on these issues. As a result, ONE relied too heavily on long-term contracts. We saw that we could not benefit sufficiently from rising spot rates, particularly on the Asia-North America Eastbound routes. We need to stabilize our services, and roll out these efforts once again.

Needless to say we must continue our efforts on cost reduction. From the initial year, the synergistic effect of the integration showed more progress than the initial outlook. Therefore, we think it's quite possible to improve ONE's profits by calmly executing what the three Japanese

companies have done to solidly earn the trust of their customers. All the concerned parties will do their utmost to overcome the factors behind the temporary deterioration in the initial year and we expect our efforts to pay off in form of improved profits starting next year.

So that's the background for such a significant downward revision in the short term. We must also discuss ways that the parent companies can provide more efficient support. We will step up the action plan for this point, too.

I explained that temporary negative factors in the initial year account for large parts of the significant deficit anticipated for this fiscal year. But I think we, of course, need to review the business plan for the next year or so. We will disclose the results of this review at the appropriate time, as soon as we have completed it. So I ask for your patience.

4. Questions and Answers

[Containership Business]

Q1) Considering the downward revision of ONE's business performance, I feel the containership business itself still cannot make profits. At this time, you are taking various measures toward improvement, but supposing these measures are not effective, how will you deal with the containership business? I want a clear idea of MOL's thoughts on this once again.

A1) The major objective for the integration of the three companies was to realize cost competitiveness from merits of scale. Actually, terminal cargo handling costs and railway contract fees have been reduced, and the figures started showing a greater synergistic effect from the integration than the initial outlook. So in our judgment, it showed steady progress toward the objectives of the integration.
Now, what led to this significant downward revision? It is due to deteriorating utilization, mainly on Asia-North America Westbound and Asia-Europe Eastbound routes. The figure for the integrated company ONE was lower than the simply aggregated figure of the three parent companies. The teething problems immediately after the commencement of services is obvious, and we can take measures. The containership business' market exposure is high, so we need to prepare for large fluctuations in the bottom line. But if we can maintain a fairly strong position in the industry, we will see returns. We will address this issue to improve profits, which will strengthen the profits of the parent company.

Q2) I think it is very difficult for three companies to supervise ONE. Please explain how it can really function with this structure.

A2) The task we face now, is not a so-called policy matter. I think we should sum it up by saying that operations could not proceed as planned. ONE's operating company is located in Singapore, and is overseen by the holding company. It is a panel of six executives—two of them loaned from each of the parent companies. The executives have abundant experience as directors in the containership business. So three companies' ways of thinking, knowledge in definition of the terms, and senses of values are very similar. That is, the fact that there are three companies involved does not slow down decision-making. Therefore, we don't think there are deficiencies in the governance structure when it comes controlling the operational tasks.

Q3) I want to ask you about the downward revision of ONE's product cost reduction plan. I hardly remember a case where costs in the containership business could not be reduced as planned, so I am a little uncomfortable with this. Don't you think ONE overreached with an unrealistic plan because of the parent companies' strong pressure to achieve the targets?

A3) The production cost reduction plan mainly has two projects. First, they could reduce operational costs by reducing frequencies as planned. The unmet target is the fuel consumption reduction project. In particular, at ports in China this summer, ship speed had to be increased on many routes to recover from delays caused by fog and ship congestion. This was a major factor of the unmet target. They made a downward revision of $80 million in this product cost reduction plan because of these conditions.

Q4) Looking at ONE, recovering the trust of customers in underway. Can it achieve both improved yield management and recovered liftings by regaining customer trust?
They cannot increase business performance from the next year unless they can take measures to reduce the present scale and improve imbalance on round-trip routes, while freight rates on inbound routes are very low.

A4) On the Asia-North America Eastbound and Asia-Europe Westbound routes, they control bookings well and can increase the volume of higher yield cargoes as vessels are fully loaded during the brisk summer and autumn seasons. In negotiating contracts for the next fiscal year, which ONE already started, they are focusing on higher yield cargoes. They will not just acquire cargo, but will also focus on profitability on Asia-North America Westbound and Asia-Europe Eastbound routes.
First, we think securing cargo volume by recovering customer trust is important, but at the same time, yield management will become more important.

Q5) Speaking of the Asia-North America Westbound routes, you explained that would take some time to completely resolve the effects of the problems during the start-up period. Around when will the improvements be reflected in specific figures?

A5) Signs of recovery have already started showing up. It is getting close to the assumption for the second half outlook. Some routes have already recovered, and some have exceeded the outlook.

[END]