“Rolling Plan 2017”

(Explanation by the CEO at the analysts meeting on April 28, 2017)

In formulating this management plan, we first devised a vision for the MOL Group 10 years from now (2027). The external environment surrounding our company is changing remarkably. We are entering the era of so-called “slow trade,” due to various factors such as a slowdown of growth in emerging countries, the trend toward local production for local consumption, and a shift in consumer preferences from purchasing physical goods to using services and seeking experiences. On the other hand, as the winds of environmental protection become stronger, it becomes more difficult to forecast long-term demand for resource energy transport, in light of the accelerating shift from fossil fuels to renewable energies.

While such changes are occurring rapidly, concerns mount that management flexibility will be impaired if we fulfill strategies based on a three-year mid-term management plan as an extension of our conventional business models. Therefore, our first task was to discuss our vision for the MOL Group 10 years from now. When discussing matters internally, we traditionally focused on current markets and demand patterns. But we think developing a vision for the MOL Group 10 years from now is also a more effective way to encourage employees to develop a mindset of looking 10 years ahead when looking at our overall direction.

These discussions led us to the following three points as our “Vision for the MOL Group 10 Years from Now (2027)”

- The MOL Group will provide stress-free services that are truly convenient for customers worldwide, with the aim of serving customers as a solid and reliable partner at all times.
- The group will develop the environment and emission-free businesses into one of its future core operations.
- The group will strategically allocate resources to carefully selected businesses that have a clear competitive edge. The goal is to make the MOL Group a collection of businesses boasting the highest competitiveness in their respective fields.

We formulated long-term strategies to realize the “Vision for the MOL Group 10 Years from Now (2027)” based on those three points, and then formulated action plans for the coming three years as a process of realizing that vision. We will review these plans every year, so this year’s management plan is named “Rolling Plan 2017.” In our year-by-year reviews, we plan to implement “rolling” evaluations, reviews, and update of the three-year plan, which was formulated with an eye on 10 years out from the year under review.

Now let’s focus on this three-year action plan.

[Review of Previous Midterm Management Plan and FY2016 Single-Year Plan]

We established “three reforms” of our business portfolio, business model, and business domain in the previous midterm management plan “STEER FOR 2020,” which started in 2014. I regret to say that we had to drop the profit target under this management plan in mid-course due to historically sluggish markets. But we have shown substantial progress on these three reforms. In addition, due to the integration of the containership business announced last year, reforms of our business portfolio and business model will help us move further forward. The policy to further deepen these three reforms is not changed in the new management plan. However, we will further push forward with “selection and focus.”

[Business Portfolio and Strategic Fields for Resource Allocation] (P2, Supplemental Presentation Materials)

Unlike most overseas shipping companies, we have grown into a full-line marine transport group that operates various vessel types in the business. The current business portfolio is our big advantage that our presence can meet various customer needs, and also gives us an edge in stability — other businesses can support company-wide profits when a specific business falls in slump. We do not see this changing in the future. On the other hand, as a result of our investments in those various businesses from all directions, our operating cash flow cannot be commensurate with these investments due to the downturn of dry bulker and containership markets in recent years. So it is undeniable that our balance sheet is weaker than it should be.

We outlined investments focusing particularly on LNG carriers and offshore business even in the previous midterm management plan and actually carried out those investments. But in this management plan, we will further clarify strategic fields in which we will allocate our personnel and capital resources, and invest in businesses that can create stable profits and those that can demonstrate our advantages. We continue to preferentially make investments in LNG carriers, offshore businesses, and methanol carriers, which have shown steady business performance and increased our stable profits. In addition, the chemical tanker business is relatively stable, and requires expertise and is much more difficult for other companies to enter, so we think we can expand its business scale while maintaining our competitive edge.

Logistics, ferries, and other businesses can generate stable profits. We think these fields set us apart from other companies, and expect them to make significant contributions to our consolidated financial results in the future.

We will press forward with reforms of our business portfolio in the mid- and long-term by allocating our resources to these fields.

[FY2017-2019 Investment Cash Flows (Three-Year Total)] (P3, Supplemental Presentation Materials)

As a result of selecting and focusing our resource allocation, we will put more weight on these strategic fields for investment in the coming three years. We have already decided to invest a total of ¥250 billion for projects already settled. However, as for investments in new projects, we will reduce the burden on our cash flow by narrowing down to higher priority projects in consideration of the current balance sheet and projected level of profits in the next several years. We project ¥150.0 billion for new projects now. But we will re-examine measures to reduce this amount by seeking a business model that moderates cash expenditures, such as vessel sale and charter-back and utilizing used vessels in addition to more careful selection of projects. As a result, we anticipate turning our free cash flow to positive in fiscal 2019, although it will be negative for the coming two years.

Speaking of investment cash flows, when categorizing them by different angles — so-called growth investment and new business investment, instead of by business unit — ¥190.0 billion, about a half the total ¥400.0 billion for new and existing projects, is mainly growth investment in key business fields. And we will invest ¥80.0 billion in new businesses including offshore business and tank terminals. We will also push steadily forward to comply with environmental regulations, which represent another opportunity for differentiating our company from competitors. We also think investment in ICT is indispensable to our theme of “visualization of marine operation” that we have promoted in our Smart Shipping project.

[Highly Stable Profits and Other Variable Profits (Losses)] (P4, Supplemental Presentation Materials)

I want to explain how we will improve the level of operating cash flow in the future through our earnings structure: “highly stable profits” and “other variable profits (losses).” We refer to profits generated by mid- and long-term contracts for dry bulkers, tankers, LNG carriers, and offshore business as “highly stable profits,” along with the profits from associated businesses including real estate. These profits are not affected by volatility in the shipping market, and we are almost certain to gain highly stable profits of about ¥55.0 billion per year in the next few years.

However, we categorize profits (losses) of dry bulkers and tankers operated under short-term and spot contracts, and other businesses, most of which originally do not have long-term contracts — car carriers, containerships, terminals and logistics, and ferries and RoRo ships, as “other variable profits (losses).” As a matter of fact, many of these businesses record relatively stable profits. Most of them, including chemical tankers, terminals and logistics, ferries and RoRo ships, as I explained, record surpluses. However, I regret to say, large losses in the containership business push the total of “other variable profits (losses)” into negative territory, offsetting stable profits equivalent to ¥55.0 billion. This is the situation we are in now.

So the issue is how we can improve “other variable profits (losses).” We think losses in this column will be reduced substantially, and eventually move into the black, by first of all, reducing deficits in the containership business, and at the same time achieving a further increase of profits in the chemical tanker and other businesses, which are posting profits even now. Losses in the containership business will be improved, but the deficit will still be significant in FY2017. In the management plan, we reflect our target image — some of the synergy of the containership business integration will take effect in FY2018, the year the integrated company starts operation, and it will be even more powerful after the second year, showing a significant improvement and getting into the black. The integrated company will provide its own non-consolidated profit plan separately. As the parent company or shareholder of the integrated company, we expect it to move aggressively to reach profitability even in the first fiscal year of operation.

Accordingly, we anticipate a significant improvement in “other variable profits (losses)” for FY2019. We will have to count on some level of recovery in the dry bulker market, which is expected to show an improvement in the demand and supply balance, although moderate, in the future, in addition to higher profits of the ferry business as newbuilding vessels go into service. We think this can turn “other variable profits (losses)” to the profit side on the scale of several tens of billions of yen, and make a major positive impact on our ordinary profit.

Of course, “other variable profits (losses)” can move substantially due to market fluctuations. So we cannot honestly say that the image of improvement shown in this graph can or cannot be realized exactly as it is — that will depend on market trends. On the other hand, I can say that we are setting the stage for major improvements through measures in each business, including containerships, even without relying on a significant market recovery compared to the current situation.

[Medium- to Long-term Profit Level/Key Financial Indicators/Shareholder Returns] (P5, Supplemental Presentation Materials)

In this new management plan, we did not formulate detailed profit targets for the next several years as we conventionally did. But of course we have an image of the profit levels required for sustainable management. We project ¥80.0 billion to ¥100.0 billion of ordinary profit in the medium term. We need a substantial improvement from the ¥22.0 billion in our FY2017 outlook, and we will firmly improve “other variable profits (losses)” as well as steadily record stable profits. In the same way, we think ROE is a key management indicator. ROE for the past three years was lower than 8%, the level recognized as our cost of shareholders' equity. As a listed company, we believe we have the responsibility to raise ROE higher than 8% in the medium term, and when possible, maintain a double-digit ROE percentage. We need a little more time to reach that level, but we feel the path is in sight.

Speaking of gearing ratio, at present it is deteriorated to nearly 200% as a result of a slowdown in performance even as we maintain our diversified business portfolios. We think it will be difficult to improve in the next two years because of our future investment and projected profit levels. We anticipate that free cash flow will become positive in FY2019 and gradually improve afterwards. But we will control the ratio under 200% as the medium-term level, and try to improve to 100% as the long term.

Turning to dividends, we maintain our guideline of a 20% dividend payout ratio in the near term and work toward improvement of the dividend payout as a medium- to long-term priority, since it will take a while to balance investment cash flow and operating cash flow, and we need to enhance shareholders' equity again to operate the marine transport business, which is highly susceptible to market changes. We appreciate your understanding.

[Environment and Emission-free Businesses] (P9-10, Supplemental Presentation Materials)

Finally, I will touch on our long-term goal, "grow the environment and emission-free businesses as one of our core businesses."

Needless to say, we are moving assertively to respond to two major regulations — ballast water management and vessel emissions of sulfur oxide (SOx), both of which will be adopted throughout the marine transport industry. These new standards will place a burden on us, but we prefer to think of them as an opportunity to set our company apart as one that eagerly and effectively fulfills its social responsibilities.

Our additional plans call for growth of the emission-free business as a pillar of the next-generation business. CO_2 emissions per unit load from vessels are lower than those of other modes of transport, making it environmentally friendly. But the overall volume of emissions is huge, and the impact on the environment is significant. We think the industry must take responsibility for reducing our carbon footprint. The MOL Group will focus on this business field, aiming at various measures to offset the greenhouse gases produced by marine transport. Our customers are developing a greater awareness of environmental issues as well. So it is important to demonstrate that we are committed to addressing these issues and become the shipping company of choice for environmentally conscious customers. Seen in this light, the emission-free business represents a growth area for us. We have already started a new business by investing in the operator of a self-elevating platform vessel that supports the installation of offshore wind power generation systems, and continually take a proactive stance in evaluating the potential of other such projects.

This does not mean we will leap into risky endeavors. We must start by carefully assessing them and look for the right approach. Over the next decade, we plan to make environment and emission-free businesses a core of our activities.

This is the outline of the new management plan. Though I did not touch on it here, this fiscal year is a critical time to push for a historic event in our 130-plus years of history, specifically, the integration of the containership business. The path to improve profits, enhance ROE, restore our financial health, and more, as I explained here today, will require steady progress in each of our business strategies as well as success in integrating the containership business. This will put more of a burden on our employees, at least temporarily. But all of us, executives and employees alike, must take a positive stance on these initiatives and see them through to a successful conclusion.

[END]