

Integrated Transportation Systems Business Unit — Q&A Session

1. Date and time: July 10, 2015, 15:00-16:30
2. Location: Convention Room AP Tokyo Marunouchi
3. Speakers: Hiromichi Yagi, Managing Officer, Chief Operating Officer of Integrated Transportation Systems Business Unit  
Yoshimi Namba, General Manager of Strategic Planning Department, Integrated Transportation Systems Business Unit  
Michihiro Nose, General Manager, Investor Relations Division

4. Questions and Answers:

Q Concerning the cost of engine development with GE, what is the timeline for achieving profitability, and what will be the scale of earnings?

A This project is expected to yield income over a long period.

Q Stock prices are fluctuating wildly in China, and economic conditions are unstable. What are the potential risks that must be taken into consideration if the Chinese economy stalls? Also, we suffered losses resulting from the cancellation of shipping contracts at the time of the 2008 global financial crisis triggered by the Lehman Brothers bankruptcy. The Integrated Transportation Systems BU has significant exposure in emerging countries, especially Brazil. Are there any signs of abnormal trends at present? Are you aware of any potential risks, including risks in Brazil?

A Apart from investment relating to automotive parts and Toyota logistics, this business unit's activities in China are small, and therefore we would not be directly impacted by the stalling of the Chinese economy. Our shipping business could be affected if customers that have placed orders anticipating cargo transportation to China become unable to use the vessels due to a decline in cargo traffic. However, we carried out thorough credit checks in advance, and we do not expect major losses. The passenger railway business in Brazil provides commuter transportation. It would not be affected unless there is a decline in passenger numbers or a deterioration in passenger comfort. Freight traffic in Brazil is around 10 times greater than VLI's capacity, and about 90% of freight is carried by truck or by ship. Any increase in VLI's capacity would be likely to result in a proportionate shift of freight to the rail system. Also, the freight consists of export goods, such as grain, and should not be affected by domestic economic trends in Brazil.

Q The Integrated Transportation Systems BU is aiming for a PAT of ¥40-50 billion by 2020, and in the previous financial year the BU invested a substantial amount in the acquisition of various businesses. You will probably not continue investing at the same pace, but how will you match investment cash inflows and outflows, and at what rate will your investment assets increase?

- A It is difficult to answer this question, since investment policies are decided at the corporate level, and decisions cannot be made solely according to the wishes of this business unit. If there is a project that we consider justifiable for investment, we should advocate it to the company, but it would not be appropriate to use funds on the same scale as in the previous financial year. We invested close to ¥200 billion, and we expect the benefits of that investment to emerge progressively. We believe that it should be possible to achieve a PAT of ¥40-50 billion without significant further increases in assets through investment and loans. Furthermore, to achieve continual growth in income we need to recycle our assets by selling businesses that have entered the decline phase, and steadily foster new projects.
- Q I understand that following Mitsui & Co.'s investment in VLI, VLI plans to invest additional ¥300-400 billion to expand its business. At what pace do you expect VLI's business scale and earnings to expand?
- A We project a 10-fold increase in VLI's freight volumes by 2025, so we also expect a 10-fold increase in its sales. We anticipate a steady upward trend in the period to 2025.
- Q Approximately what is the percentage of the Integrated Transportation Systems BU's PAT of around ¥30 billion for each of the BU's five business domains?
- A A rough breakdown shows that the automotive business accounts for around one-half, and shipping business accounts for about half as much, or one-quarter overall. The remainder comes from construction and industrial machinery, aircraft, and transportation. Costs relating to engine development by GE ended in the previous financial year, so the contribution from aircraft will rise in the current year.
- Q Because PTL is unlisted, it is difficult to visualize its PAT. Since it is likely to be the biggest source of income growth in the current financial year, we would like to get a feel of the size of its income and your expectations regarding future income growth.
- A Because of the timing of our investment, PTL did not contribute to earnings in the previous financial year. It will start to contribute in the current year. The amount will depend on the method used to amortize goodwill, but we expect it to be in excess of ¥1 billion.
- Q The Integrated Transportation Systems BU seems to be engaging in a significant number of initiatives in collaboration with other business segments. I believe that you will be starting such collaborations in specific projects in Mozambique and other locations. How are these activities positioned within Mitsui & Co., and how have you strengthened them? Will they result in any major income opportunities?

A Compared with other trading companies, initiatives involving multiple business segments are extremely significant for us. In 2013, we established seven planning & administrative divisions known collectively as the “Business Supporting Units.” About half of our 13 current business units have COOs who were previously GMs of planning & administrative divisions. People with experience of debate about lateral collaboration across multiple business units currently occupy the top positions in business units. If a COO believes that information gained by his own business unit may be useful to another business unit, that information will be shared through dialogue among COOs. The results of such collaboration are shared by all. Examples include Penske’s sales of commercial vehicles in Australia, and engine sales by Detroit Diesel. The Mineral & Metal Resources Business Unit introduces us to mine operators, leading to sales of trucks and Komatsu mining machinery.

Q The Integrated Transportation Systems BU has projected an image of organic growth, based on growth by VLI, leading to the achievement of PAT of ¥40-50 billion by 2020. Are there any other projects that will provide increased income levels?

A We will start to charter vessels for the Cameron LNG business in the second half of 2018. The one-shot income when the business starts will be substantial. The charter agreement will cover around 20 years, and there will be income from both transportation and LNG sales. The level of income will depend on the exchange rate, but the earnings for this business unit alone will continue at around ¥1 billion per year for about 20 years.

Our passenger railway business with OTP is currently operating at a loss, but there will be major income growth once passenger numbers pass the breakeven point. We expect that to happen in 2018.

Q You just spoke about the contributions of each business domain to the Integrated Transportation Systems BU’s PAT in the previous fiscal year. What will be the breakdown of your target PAT of ¥40-50 billion in 2020?

A Assuming that we achieve PAT of ¥50 billion in 2020, there would be growth in the performance of the railway business, especially our investments in Brazil, and PTL. In addition to income growth in the United States, PTL’s earnings would also be boosted by income from its planned expansion into Mexico. On this basis, I would expect to see significant contributions from the transportation and automotive businesses.

The Cameron project will increase income for the shipping business, but overall performance in this business is partially dependent on market trends, and I expect the total to remain at a similar level or perhaps increase moderately.

The key will be the contribution from construction machinery and mining equipment. It is difficult to predict how far income will recover, and we do not anticipate major growth, but if these market-linked areas recover from now on, we could easily exceed ¥50 billion.

In aviation, we expect investment related to the engine development with GE to generate income at a significant level over a long period of time. We do not plan to accumulate assets worth 100s of billions of yen for the aircraft leasing business, and we do not expect the figures to change significantly from their present level.

This means that the biggest growth areas will be the rail and automotive businesses in the transportation domain. We have not so far formulated any projects that will produce sudden income growth in other business areas, and we will move forward carefully and avoid mistakes.

Q You spoke about the impact from current economic trends in China. What are the risk factors for your business unit over the next 5-6 years? What would be the risk scenario in which you cannot achieve PAT of ¥40-50 billion, and what countermeasures would you implement?

A There are various risk scenarios. For example, if the outlook for India became uncertain, our situation would frankly be tough, given the extensive positions that we have established in India and the positions that we plan to build going forward. If the Indian economy stalls, motorcycle sales will decline, and we would suffer because of our involvement in Yamaha's motorcycle business. If production shrinks, our income from logistics transaction will fall, and deterioration of economic conditions would lead to reduced imports of goods, and the performance of Global United would also be adversely affected.  
On the other hand, the U.S. economy should remain strong over the next 4-5 years. We believe that growth in the U.S. would to some extent offset problems in other regions.

Q Do you envisage the path leading to PAT of ¥40-50 billion in 2020 as a somewhat linear trend? Can you achieve yearly increases in income solely through investments already in progress, such as VLI, without undertaking new investments? What will happen to FCF if there is no new investment?

A We anticipate a steady rise in PAT. The fact that EBITDA reached almost ¥50 billion in the previous financial year shows that compared with its PAT results, this cash generation capability of the business unit is extremely strong. If there is no investment, we would also expect FCF to reach a similar level.

As far as VLI is concerned, we will not underwrite further capital increases, and the company will meet its needs through its own borrowing. This means that there will be no increase in assets on a consolidated basis. This business unit's assets will trend around the ¥1.2-1.3 trillion level in the period to 2020.

We will move toward the deconsolidation of finance and lease assets, which have hindered our efforts to improve ROA. The dilution of 50% of our equity in the U.S. freight car leasing business has reduced our assets by around ¥25 billion. Our policy for our financial and lease assets is to find partners and carry on the businesses with them. We would like to take this approach with a number of businesses in the current financial year.

Q Does your business unit see finance and lease assets as targets for portfolio restructuring? Do you aim to reduce them gradually through repositioning, while increasing other assets?

A Yes. For example, our financing activities relating to Yamaha motorcycle sales now face competition from new multi-brand leasing companies. As the financial sector matures, there will be direct involvement by financial institutions, and we will lose our competitiveness gradually. In countries where these changes are occurring, our basic policy is to reduce our assets relating to both motor vehicles and motorcycles.

Q Would you say a few words about Mitsui's strengths, vision, and future strategic direction?

You have said you are expanding and stratifying your playing field in the automotive area. What do you regard as Mitsui's strengths in relation to the motor vehicle industry, and how do you plan to use those strengths? PTL is extremely unique, but is it really a source of strength for Mitsui, when you only have a 20% minority interest? I'd also like to hear about your approach to investment going forward. Will you continue to acquire minority interests, or will you take a hands-on approach?

A Our strength in relation to the motor vehicle industry is the quality of our partners. For example, Toyota allows us to sell vehicles under their brand in Canada, Peru, Colombia, and Chile. Hino trucks have a reputation for fuel efficiency and sturdiness in the United States, and sales are rising persistently. Penske sells more Toyota vehicles than any other dealer in the United States, and Toyota is aware that we have built an excellent relationship with that company. However, there are limited opportunities for synergies in relation to passenger cars, and we can only realize our strengths in the area of commercial vehicles. Every company needs logistics, regardless of the business field, whether it is chemicals or iron and steel products. By introducing our customers to PTL, we can achieve greater synergies in relation to commercial vehicles. We can also expect additional synergies by developing activities in South America and Australia, in addition to the United States.

Q In the transportation field, your freight car leasing business and transportation business in Brazil are very unique compared with the activities of other trading companies and are an important source of strength for Mitsui. Is your ultimate goal to become a railroad company? If not, what is your goal?

A We are close to winning an order relating to a ¥100 billion-plus EPC project in India. We need to continue with the EPC approach to maintain the knowledge levels of junior employees. Similarly, unless we maintain a certain level of engagement in the construction and maintenance business, we will simply be operating as investors, and we will not be able to develop our skills as employees of a trading company. While we are repositioning, we are also acquiring business assets, and at the end of the day we cannot halt either of these processes. The areas that we need to target can change over the years, and by expanding the scope of our activities we can often achieve synergies with our existing activities. Instead of thinking about what we should target and what we should do next, our vision calls for the achievement of greater growth by expanding and strengthening individual businesses.