Condensed Transcript of Q&A Session at Fiscal 2009 Second Quarter Results Briefing (October 30, 2009)

Q: The Consumer Lifestyle Business Division had penalty income from real estate contract cancellation penalties. Excluding this income, the division still seems to be severe. Can you provide more detail on the division's second-quarter results in terms of additional valuation losses on real estate inventories, improvement in the fertilizer business, etc.?

A: Its earnings are in a recovery trend driven by food resources, including fertilizer. For the division as a whole, we project a roughly ¥7 billion sequential improvement in earnings in the fiscal second half compared with first half. No additional valuation losses on real estate for sale were incurred in the second quarter.

Q: Your revised full-year forecast projects additional ¥9 billion in SG&A cost cuts. Going forward, which is a higher strategic priority: financial restructuring (e.g., reducing inventories) or growth strategies (e.g., new investments and loans)?

A: Our policy of reducing inventories to appropriate levels basically remains unchanged, but we do not intend to do so across the board. We will manage inventories while targeting their appropriate level on a case-by-case basis.
The relative ranking of strategic priorities will partly depend on the extent of earnings recovery, but signs of recovery have emerged across all business segments. We expect further improvement relative to the present. In parallel with this improvement, we will solidify the foundation of the new energy and environmental business and agribusiness over the next three years to substantially supplement future earnings from existing businesses.

Q: Can you give us a breakdown of the ¥57 billion in planned new investments and loans in the fiscal second half? And what is your budget for new investments and loans for next fiscal year?

A: In the current fiscal year, we plan to split new investments and loans between resource and non-resource businesses in a ratio of 55:45. New energy and environmental businesses' share is somewhat over 10%, which we want to increase to 20–30%. Regarding the investments and loans budget for next fiscal year, I currently cannot comment except to say that we want to increase it relative to the current fiscal year.

Q: In the current fiscal year, net income has been bolstered by gain on sales of investment securities. Should we assume that gains from the sale of assets, including securities, will very likely continue next fiscal year also?

A: As part of our asset reallocation, we have been roughly predetermining net extraordinary income/loss on an annual basis and executing selection and focus initiatives. We basically have no intention of selling assets just to generate gains.

Q: What are the factors behind the ¥30 billion increase in risk assets in the fiscal first half (from ¥350 billion at end-March 2009 to ¥380 billion at end-September)?

A: Most of the ¥30 billion increase was attributable to equity market appreciation and yen depreciation.

Q: You said that you reclassified some real estate for sale to real estate for investment. What is your real estate related exposure as of end-September 2009?

A: We have divided our real estate operations into two categories: condominium and retail property business that we intend to keep and other operations that we plan to exit. Of our roughly ¥120 billion in real estate assets as of end-September, condominium and retail property accounted for somewhat over ¥50 billion. The remainder of over ¥60 billion is assets to be exited.

Q: To what extent is second-half earnings recovery at LNG Japan and Metal One factored into your revised full-year forecast and what is the background of these recoveries?

A: Our equity-method affiliates' earnings are largely a function of market prices. LNG prices are in an uptrend because crude oil prices are rising, but the revised forecast does not factor in much improvement in LNG prices. For steel products, we expect better performance in the second half than in the first half, but we lowered our full-year forecast.

Q: You are projecting net extraordinary income/losses of ¥5 billion in the fiscal second half. What does this include?
A: The projected net extraordinary income/losses of ¥5 billion are not based on any specific items. It is merely our initial forecast, which we have left unchanged.

Q: Your newly revised forecast projects second-half ordinary income of over ¥20 billion. How much downside risk in the automotive business is factored into this forecast?
A: Regrettably, we are projecting a full-year loss in the automotive business, although we expect improvement in the second half in Venezuela. In Russia, we expect the automotive business to do worse in the second half than in the first half. We see no prospect of recovery in the automotive business in the current fiscal year and this outlook is reflected in our second-half forecast. Overall, the other business just about bottomed in the first half. We believe that our forecast has a high probability of attainment.

Q: To what extent do you expect energy and metal production growth to contribute to earnings in the second half and next fiscal year?
A: We project that coal production will grow 50% from 2.5 million metric tons in the current fiscal year to 3.7 million metric tons in fiscal 2010. If current coal prices persist, we expect this production growth to boost fiscal 2010 earnings considerably. We expect growth in oil and gas production to also contribute to earnings growth in fiscal 2010, assuming that current prices persist.

Q: Given that your overseas subsidiaries end their fiscal years in December, I presume that you already have a pretty good picture of fiscal third-quarter results. How does your second-half forecast look in light of overseas subsidiaries' recent operating performance?
A: We do not anticipate much deviation from our second-half forecast, which factors in the current status of the overseas automotive business and fertilizer business.

Q: You lowered your forecast of your oil and gas production to 21,000 bbl/day as of end-March 2010. What is the reason for this downward revision?
A: Because production in the Gulf of Mexico is running behind schedule. With gas prices below our initial forecast, we have also reduced gas production. We have spare capacity to increase production depending on gas prices.

Q: Molybdenum is the only metal that is underperforming your price forecast. What are your views on molybdenum prices today and looking ahead?
A: We were impacted by the large decline in the price of molybdenum, which averaged $9/lb in January-June 2009, but the price has rebounded in tandem with the steel price, which averaged $14.70/lb in July-September, above our forecast of $13/lb. Given that molybdenum is a raw material for high-grade steel products, we believe that demand for it is firmly entrenched.

Q. How much progress have you made in disposing of the ¥60 billion of real estate inventory that you plan to divest? And is there any risk of additional losses?
A. We by no means have a rosy view of real estate prices. We are monitoring vacancy rates and declines in rent levels on a daily basis and have an accurate picture of market conditions. Basically, we have no expectations of an upturn in real estate prices or of being able to earn substantial income on a flow basis. We are analyzing properties' status individually and plan to hold on a long-term basis those properties with positive cash flow potential. During the holding period, we plan to add value to the properties and ultimately exit them.

Q: Am I correct to conclude that you do not plan to utilize your commitment lines much for funding in the current fiscal year?

A: Our policy is to hold cash and deposits equivalent to 80% of our short-term interest-bearing debt. This 80% level equates to ¥350 billion. At end-September, we had cash and deposits of approximately ¥440 billion, more than ¥90 billion above our target. We accordingly expect to be able to adequately manage our funding program without utilizing our commitment lines.