1st Quarter FY2020 Explanation by article

A. Financial Highlights for 1st Quarter FY2020

A-1：Financial Results for 1st Quarter FY2020

Due to the impact of the novel coronavirus disease (hereinafter “COVID-19”), consolidated operating revenues in the first quarter declined about 20% compared with the same period of the previous year to 152.2 billion yen. Operating loss totaled 6.6 billion yen, ordinary loss was 1.0 billion yen, and net loss attributable to owners of parent was 1.0 billion yen. The average exchange rate was 107.74 yen per US dollar, and the average bunker price was 377 US dollars per metric ton.

In terms of financial indicators, as of June 30, 2020, our equity capital was 100.2 billion yen, about on par with the end of the previous fiscal year. Interest-bearing liability was 586.6 billion yen, an increase of 43.1 billion yen from the end of the previous fiscal year, while cash and cash equivalents totaled 161.7 billion yen, an increase of 49.8 billion yen from the end of the previous fiscal year. We have secured liquidity on hand equivalent to more than three months’ revenues. Our equity ratio was 11%, on par with the end of the previous fiscal year, and 15% when including the equity credit in subordinated loans. The impact of COVID-19 in the first quarter totaled a loss of about 8.0 billion yen, mainly from Car Carrier Business and the Dry Bulk segment.

A-2：Financial Results for 1st Quarter FY2020 by Segment

In the Dry Bulk segment, Capesize market conditions slumped from the start of the year due to weak shipments from Brazil owing to poor weather. Before conditions had a chance to recover, the spread of COVID-19 caused the market to slump further. Meanwhile, in Japan, crude steel production declined more than 30% versus the first quarter of the previous year. At the same time, there was a postponement in COA contract fulfillment, which dealt a double blow to the segment. The total impact was a deterioration of 4.0 billion yen versus the same period of the previous year, for an ordinary loss of 4.4 billion yen.

The Energy Resource Transport segment generated stable profits, mainly due to mid-long-term contracts in Thermal Coal Carrier and LNG Carrier Businesses. The segment posted an ordinary income of 1.6 billion yen, on par with the first quarter of the previous fiscal year.

In the Product Logistics segment, Car Carrier Business cargo volume declined by more than half year on year due to COVID-19. The segment posted an ordinary loss despite efforts to rationalize vessel allocation through suspension of vessels and temporarily changing services. In Containership Business, ONE succeeded in flexible vessel deployment in response to cargo demand, and East-West route market conditions stabilized. As a result, ONE posted higher profits. The entire segment, therefore, posted 3.0 billion in ordinary income, a year-on-year improvement of 1.2 billion yen.

B. Forecasts and Initiatives for FY2020

B-1 ： Forecasts for FY2020

For the full fiscal year, we forecast operating revenues of 600.0 billion yen, a year on year decline of nearly 20%, an operating loss of 27.0 billion yen, and an ordinary loss of 28.0 billion yen. We expect to be break-even in terms of net income attributable to owners of parent. The impact of COVID-19 will be significant mainly in the first half of the fiscal year, and we expect a challenging business environment to continue. Although we foresee a moderate recovery in the second half, the pandemic's effects will be felt and the situation will remain unpredictable.

When we announced our forecasts at the start of the fiscal year, we stated that damage control to the financial results in FY2020 would be our highest priority. These include measures to reduce operational costs through flexibly reducing the fleet scale, rationalizing vessel allocation, and suspending vessels. It also includes securing adequate liquidity on hand and selling assets to bolster shareholders' equity. We are making steady progress in each of these areas.

We forecast an ordinary loss of 28.0 billion yen in conjunction with the decline in operating revenues. However, we expect to break even in terms of net income attributable to owners of parent, partly due to the transfer of our outstanding shares of a consolidated subsidiary operating container terminals on the North America west coast which we have agreed to sell as we announced on August 5. Our full-year assumptions include an average exchange rate of 107.25 yen per US dollar and an average bunker price of 368 US dollars per metric ton. At the current time, we are undecided on interim and year-end dividend payments. Improvement of our financial strength remains our priority and we are taking steps to raise profitability.

B-2 ： Forecasts for FY2020 by Segment

In the Dry Bulk segment, signs of a demand recovery are emerging, particularly in raw materials transport. Still, a full-scale recovery will take more time. We forecast a profit for the segment for the second half, but for the full year, we forecast an ordinary loss of 6.0 billion yen, a year-on-year deterioration of 10.1 billion yen.

In the Energy Resource Transport segment, LNG Carrier and Tanker Businesses are forecast to generate stable profits. However, the Offshore Energy E&P Support Business with KOAS is expected to record lower profit due to the decline in oil prices, while Thermal Coal Carrier Business is forecast to see lower utilization due to a temporary drop in demand. Overall, the segment is forecast to generate full-year ordinary income of 4.0 billion yen, a year-on-year decrease of 5.9 billion yen.

In the Product Logistics segment, cargo movements in both Car Carrier and Containership Businesses are expected to recover from the slump caused by COVID-19 moderately into the second half of the fiscal year, but not to pre-COVID-19 levels. In Car Carrier Business, total units carried are forecast to decline by more than 40% year on year in the first half and by about 20% in the second half. The Containership Business loss will include a provision for losses related to chartering contracts. Logistics Business is expected to post a net profit, although the profit margin would decline. Short Sea and Coastal Businesses are forecast to fall into a net loss due to a severe impact from COVID-19, especially in ferry services. Overall, the segment is forecast to post an ordinary loss of 21.5 billion yen, a year-on-year decline of 18.1 billion yen.

B-3 : Forecasts for FY2020 by Segment

In total, we forecast that COVID-19 will lower profitability by approximately 35.0 billion yen. More than two-thirds of this will be concentrated in Car Carrier Business and the Dry Bulk segment.

B-4 : Progress in coping with COVID-19

Regarding our measures to cope with COVID-19, we are ensuring safe vessel operations by prioritizing safety and health both onshore and offshore, while also fulfilling our mission of offering stable logistics services as part of the social infrastructure. We have taken thorough measures to prevent infections among vessel crew. Border crossing restrictions in various countries have impeded our crew turnover plans. Among the 4,300 crew on our 194 vessels, the number of crew members on board for over 10 months peaked at around 1,100. At present, the number remains high at about 1,000. As we prepare for a possible second wave of infections, we are taking various measures to ease the difficulties in changing crew. On land, we have set up plastic panels in offices to prevent droplet infection, and we have instituted workstyle systems such as telework and flextime.

C. Management Plan

C-1 : Positioning of Management Plan

Turning to our new Management Plan, we have laid out our key initiatives for this and next fiscal years as well as our basic approach to business. As the spread of COVID-19 has had a significant impact since the start of this year, we have set forth our medium- and long-term global perspectives, rather than merely a short-term one, on the post-COVID-19 world. From these perspectives, we have established a clear business direction as well as specific challenges to meet in the near term.

One of the effects of COVID-19 was to manifest various latent issues and concerns. Many concerns and issues that we believed could occur in the near future have actually come to pass right before our eyes. In this sense, COVID-19 has accelerated issues that were likely to appear at some point. Two examples are the declines in domestic crude steel production and car carrier shipments in Japan.

The business environment surrounding our customers is changing dramatically amid the unpredictable economic situation. We expect our customers to show more restraint in their investment activities as a result. In accordance with this outlook, each of our business units fully reconsidered their business environments in a post-COVID-19 world and reviewed their investment plans accordingly. The improvement of our financial strength remains an important initiative for us. Additionally, we will be reviewing each business and each contract under a more conservative scenario and market conditions to revise our business plans going forward.

In the Dry Bulk and Energy Resource Transport segments, led respectively by iron ore and LNG transport, we will continue to build up our portfolio of long-term or medium-term contracts. We have held a certain amount of exposure in order to support these businesses and the mid-long-term contracts as well as prepare for temporary fluctuations in demand. Some surplus has emerged, however, among certain types of vessels in the segments' fleets, and we have decided to scale down the fleet to appropriate levels going forward.

Our goal in fleet scale optimization is to create a structure that generates stabler profit based on core contracts through fleet scale optimization. This means that we are adjusting the fleet scale to meet cargo contract levels. It does not suggest that we are shrinking our business scale in steps to cope with market stagnancy. We do not equate business scale with fleet scale. Instead, we will prioritize expansion of the business based on profitability and seek to maintain and expand business through long-term contracts. Our basic policy has not changed at all. Despite the challenging environment, we are confident we can expand the businesses by leveraging “K” Line’s strengths and advantages.

Our customers’ business environment is changing in Car Carrier Business as well. Our approach is to firmly grasp core customer needs and optimize fleet scale while building and maintaining the strong bonds of trust that we enjoy with our customers. In Logistics Business, which requires a meticulous approach to a variety of business factors, we will seek to expand our business, particularly in Asia, by addressing issues one at a time and incorporating outside expertise and partnerships. In Containership Business, as ONE’s profitability has begun to stabilize, we will collaborate with ONE to map out a future business plan as we continue to supply the company with superior vessels and support its human resources development.

The optimization of our fleet scale will lead to shrinking long-term fixed core fleet size. This will occur mainly through the retirement of aged vessels. At the same time, we will be introducing like LNG-fueled vessel with superior environmental performance driven by cutting-edge technologies for a more competitive fleet.

In a world where people are learning to live with COVID-19, awareness of the environment, which is the foundation of a sustainable society, continues to rise, and environmental concerns will become more important. We will strive to further promote the environment and safety as the foundation of our maritime transport. We, therefore, must refine our tangible and intangible technologies. To that end, beginning this April, we launched cross-organizational projects linking sales and technical departments, and maritime and onshore departments. This project aims to study and introduce new technologies directly related to safety and the environment in order to strengthen ship management. While we expect there to be some trial and error, we will integrate our offshore and onshore organizations to put new technologies into practice. We will make similar efforts for the environment as well, striving to achieve reductions in greenhouse gas in order to raise the quality of transport services.

We plan to steadily build our portfolio of contracts and our profits by providing transport quality with more sophisticated environmental and safety performance. At the same time, we will closely measure the levels of total business risk in each business and adjust our exposure to achieve an adequate fleet scale. We thereby aim to generate an ordinary income of 25.0 billion yen by 2025 under a conservative market and business condition forecast.

The new management plan outlines the initiatives we must take in the near term, given our current understanding of how the global economy will develop post-COVID-19. There are a number of other factors that will undoubtedly continue to have a major impact on our business, including second and third waves of COVID-19, growing tensions between the US and China, and service innovation driven by digital technologies. Accordingly, we plan to revise our forecasts annually as we monitor the post-COVID-19 environment.

C-2 : Review of Previous Medium-term Management plan “Revival for Greater Strides”

We have met nearly all of our major targets under the previous management plan, including Rebuilding Portfolio Strategy, Advancement of Management and Function-specific Strategies, ESG initiatives, and ROA in stable income business. Additionally, we have successfully spun off Containership Business, withdrawn from the heavy lifter and product tanker businesses, and systemized the measurement of the level of business risk in each business unit. We also introduced new environmental technologies through Advanced Technology Group and built up our stable-income business based around a standard contract period of two years or longer. These initiatives progressed according to our targets.

In terms of our financial targets under the previous plan, we were unable to meet our targets for Returning to profit in three years from 2017, Ratio of Shareholder’s equity, and Dividend policy. Regarding fiscal year 2018, the second year of the previous plan, ONE posted a significant loss after missteps made after its launch. The dry bulk market conditions slumped significantly, and we embarked on structural reforms to dispose of high-cost vessels. This undermined our shareholders’ equity and made it impossible to pay dividends. These were the key issues we reflected on in creating the new plan based on conservative market condition forecasts.

C-3 : Corporate Vision ～“K”Line : trust from all over the world ～

Under the new plan, we will continue to prioritize improving our financial strength and maintain our corporate vision as set forth in the previous Medium-term Management Plan. We are logistics professionals centered around maritime shipping in support of the social infrastructure. As such, we will strive to enhance safety, the environment, and quality and be the company of choice among all of our stakeholders, including our customers, employees, shareholders, business partners, and financial companies. In this way, we will continually enhance our corporate value.

C-4 : Post-COVID-19 External Environment

As a result of COVID-19, we have been confronted with the reality that many of the things we took for granted are simply not sustainable. People’s behaviors and values are changing dramatically, and there are louder calls for creating a sustainable society and a heightened awareness of the environment. At the same time, we expect major changes to supply chains as protectionism and nationalism emerge. Latent issues are manifesting themselves. Issues that were predicted to occur are now occurring. As uncertainties grow, our customers will likely restrain their investment plans.

While the maritime shipping industry is expected to grow over the medium and long term, it is also true that the industry will require a substantial amount of time to recover from COVID-19. We do not expect fiscal year 2021 to return to levels of fiscal year 2019 and before, but rather it will take until fiscal year 2022 or 2023 for some business to recover to pre- COVID-19 levels.

C-5：Forwarding to Growth in Corporate Value（Business Policy in FY2020 and FY2021）

In the near term, we are focused on firmly protecting our business by optimizing our fleet scale and rebuilding a lean structure from the current year through the next fiscal year. As we monitor the post-COVID-19 environment, we will make a comprehensive review of our investment plans and invest selectively. Our initiatives will also include strengthening our technological capabilities and enhancing our proposal-based sales capabilities, as well as other measures to rebuild business to cover COVID-19-related losses and strengthen our finances. We plan to sell our overseas terminals business to ensure that we at least break even in terms of net income attributable to owners of parent in the current fiscal year.

C-6：Medium-term Business Environment Forecast

In the medium and long term, we expect the business environment to be characterized by continued high volatility and instability. In the dry bulk market, shipping of coking coal and iron ore is expected to decline as Japanese steel mills reduce their production to under 90 million tons to the 80 million-tons level. Steel industry growth is expected in Asia, particularly India, while China production growth is expected to slow.

In the energy resources market, LNG demand is expected to continue to grow steadily. Thermal coal is expected to be impacted by recent energy policy trends aimed at promoting decarbonatization, which will affect domestic industry consumption and shipping volumes. These trends are incorporated into the new management plan, and we will continue to monitor the trends. Regarding Car Carrier Business, global car sales this fiscal year are expected to decline around 20% year on year. It is likely that a full recovery will not be seen until 2022 or even after 2023. Logistics Business is expected to grow in Asia.

C-7：FY2020 & FY2021 Ordinary Income/Loss and Shareholders' Equity Forecasts; Medium- and Long-term Targets

We have set financial targets for ordinary income and shareholders' equity by the mid-2020s and 2030s. For fiscal year 2021, we expect 10.0 billion yen in ordinary and net income to be achieved by firmly executing our strategies going forward. As medium-term targets, we have set targets of 25.0 billion yen in ordinary income, 150.0 billion yen in shareholders' equity, and shareholder's equity ratio of 20% by the mid-2020s. By 2030, we aim to generate 30.0 billion yen in ordinary income, 250.0 billion yen in shareholders' equity, and shareholder's equity ratio of 30%. In setting these targets, we have full reviewed each business and taken a conservative approach to market conditions.

C-8：Profit Improvement Factors toward FY2021(Versus FY2020)

For fiscal year 2021, we are targeting ordinary income and net income of 10.0 billion yen based on the expected effect of our improvement measures. Specifically, the optimization of the fleet scale and profitability improvement measures are expected to raise ordinary and net income to 10.0 billion yen.

C-9：Budget Plan：Image of Ordinary Income/Loss

Behind these targets, we have separated business into two categories: the stable-income business based on mid-long-term contracts with core customers, and the market-exposed business comprised mostly of short-term contracts and specified shipping volumes, which includes some core customers.

Using Advanced of Management, we can measure the level of total business risk associated with each business unit and manage the invested capital in each business unit to optimal levels. Although some amount of exposure is necessary in each business unit, we are able to optimize the levels by shrinking the fleet scale and increase more mid-long-term contracts to expand our revenue. Hire income from ONE will decline as vessels are gradually returned.

C-10：Fleet Scale Optimization

We do not measure our business in terms of fleet scale. Instead, we will expand our business as our revenue expand. Additionally, we are minimizing our exposure. Specifically, in the current fiscal year, we are making steady progress shrinking our fleet by more than 20 vessels, mainly aged Capesize, Panamax and smaller-sized bulkers, Woodchip carriers, Thermal coal carriers, and Car carriers. By 2025, we plan to reduce our long-term fixed core fleet to about 300 vessels, while expanding core mid-long-term contracts.

C-11：Investment Strategy (5-year plan）

In preparation for future business, we have developed a selective five-year investment plan worth about 250.0 billion yen, a level within our operating cash flows. The focal points of the plan will be LNG Carriers and other energy transport vessels, along with cocking coal and iron ore transport. In Car Carrier Business, even as we optimize the fleet scale by disposing of aged vessels, we will introduce the vessels in which new environmental technology installed like LNG-fueled with superior environmental performance. Other investments will be targeted at technologies to bolster our safety, environment, and service quality, along with separate investments in technology development, renewable energy and other areas.

C-12：Initiatives for Strategic Growing Areas～Safety/Environment/Quality～

C-13：Specific Initiatives

Regarding safety, environment, and service quality, in order to accelerate initiatives, we have launched a cross-organizational project team combining sales and technical department staff. Moving forward, we will work with external partners to develop various necessary technologies.

C-14：Business Strategy

Each of the “K” Line business units will strive to execute the policies and initiatives we have explained today as we work to further define each of the initiatives. We will also be continuing to support ONE with superior vessels, human resources, long-term business operation, and business plan formulation.

ONE（Ocean Network Express）Financial Results for FY2020 1st Quarter

In the first quarter, ONE posted a profit of 167.0 million dollars, a strong year-on-year improvement. ONE executed extra void sailings by an average of 20% in response to the lower demand. Although liftings declined 13%, freight rates remained stable, holding the revenues decline to only 5%. Overall, the flexible fleet size adjustment was successful.

Regarding the second quarter, based on the current conditions, ONE does not forecast a major decline in business. For the second half, ONE has stated that it is unable to reasonably forecast financial performance. The figures of forecast in the second half are "K" Line's own estimates. In terms of risk factors, there are a possible second wave of infections and uncertainty over payroll and other fiscal measures in each country. It is uncertain when the impact of COVID-19 will hit bottom. Some concerns have been raised over whether or not there is a slackened sense of urgency while shipping companies executed extra void sailings in the first half because it is uncertain when the impact of COVID-19 will hit bottom. Overall, there are fewer major container shipping companies, and the aggregation of alliances have made it possible to flexible vessel deployment to meet actual cargo demand. Although we do not expect to achieve the same levels of profitability in the second half as that in the first half due to a certain amount of backlash over the supply-side adjustments, we expect our forecast to generally hold.

In case profitability declines significantly, ONE must execute extra void sailings and vessel deployment to match cargo demand the same as before. This is our view on ONE.