Japan Petroleum Exploration Co., Ltd. (JAPEX)
Securities Code: 1662 (Prime Market of the Tokyo Stock Exchange)
Summary of Q&A Session in Briefing on Results for the Six Months Ended September 30, 2022
to Institutional Investors and Analysts

Date and time: Friday, November 11, 2022, 11:00–12:00 (both offline and online)
Attendance: 47 attendees (institutional investors and analysts)
Main Questions and Answers are below:

Q1: Please let us know how domestic E&P business is affected by the increase in the JLC price linked to normal oil price and other additional factors in the full year of fiscal 2022.

A1: Compared to the usual assumption linked to the crude oil price, we recognize that there was a rise in JLC price by about ¥20,000/t, due to the impact of spot LNG price hikes. This impact is equivalent to ¥15/m^3 of domestic natural gas sales price. In the first half of fiscal 2022, this was a factor to increase operating profit for about ¥3.0 billion, based on the sales volume of domestic natural gas amounting to about 200 million/m^3. For the second half of fiscal 2022, we expect the fluctuations in JLC price to slightly calm down but the amount to remain higher than the usual JLC price, assuming the JKM price to be around $25/mmbtu.

Q2: Please share the progress of each project and the investment opportunities you consider in the overseas E&P business under the headwinds of higher oil prices and weaker Japanese yen?

A2: For the tight oil development project in the United States, we expect an annual production of about 840,000 bbl and operating profit of $32 million for our consolidated subsidiary Japex (U.S.) Corp. overall. In the next fiscal year, we expect an operating profit of more than 10 billion yen, due to an additional production volume from the interests acquired in May 2022. The Seagull Project in the U.K. North Sea is expected to start production in the first half of fiscal 2023, and its operating profit is assumed to be several billion yen. However, as the specific plan, including the production commencement date and the volume, is under examination, we will provide an update once it is fixed. We recognize that building our business portfolio beyond those two projects is essential, since they will contribute to our profit over the next several years only.

In general, weaker yen and higher oil and gas prices are headwinds for acquiring new interests. We also consider that it will be challenging to make decisions regarding acquisition in a very volatile environment. Even under such an environment, we will consider investing in projects from which certain profitability can be secured with resiliency for the volatility of oil prices, or those that can recover investment in the short term with low risk of stranded assets.

Q3: While the dividend level has risen significantly, cash and deposits in the balance sheet have increased in this fiscal period. In order to improve capital efficiency based on the balance sheet condition, please consider the further enhancement of shareholder returns.

A3: Although cash and deposits have increased at this moment, we will be expanding the growth investments. We will consider the possibility of further enhancing shareholder returns under various conditions.

Q4: Please explain the long-term LNG procurement strategy.

A4: Since we can procure our required quantities of LNG for this year and next year by the term contracts, we assume that we are able to avoid the direct impacts of rising spot LNG prices. In the medium- to long-term LNG condition, the prevailing view had been that LNG prices will fall as the supply and demand will be weakened by operation commencement of new LNG plants around 2025 to 2026. However, in response to the recent Russia-Ukraine conflict, there appears to be a view that the LNG supply and demand will not easily be weakened. Although it is difficult to explicitly state how to secure our LNG cargoes under such circumstance, all we can do is to secure certain part of the quantities by the term contract and endeavor to procure the rest according to the market conditions. Therefore, we are gathering market information with raising our antenna higher.

The LNG procurement by term contracts varies by contract in terms of contract term. Our basic stance is securing LNG in stages while combining contracts with different contract terms, rather than securing a large volume at one time under a specific market condition.

Q5: Although JAPEX has currently recognized profits on LNG procurement, are there any ideas to secure all LNG procurements by long-term contracts and to lock in a certain profit for the long term by contractually passing on fuel cost adjustments to clients in the future?

A5: We think it is not easy to implement such an arrangement because consent with our clients is required, and we also need to take into account price competition with other companies.

Q6: Please let us know about the approach of fuel procurement for biomass power generation.

A6: Our basic rule is to secure all the necessary fuel by long-term procurement contracts by the time we make decision to launch each project. All projects we have participated in have completed the procurement of necessary fuel, except for a certain part that is under negotiation.

Q7: Please show the breakdown of the full-year operating profit forecast of ¥9.2 billion in the Infrastructure/Utility Business.

A7: The breakdown of the forecast is ¥2.5 billion for core profit, which we have explained before; ¥1.0 billion for an upward swing in the electric power business of due to the higher JEPX price; and ¥11.0 billion for margins on LNG procurement and other factors. On the other hand, a contingency reserve of 5.0 billion yen for spot procurement is included in the latest forecast. As a result, operating profit is expected to be ¥9.2 billion.

Q8: Please let us know about the LNG procurement status for the winter season. Also, please tell us if it is possible to pass on the contingency expense for spot LNG procurement to clients?

A8: There is no particular concern with our LNG procurement for this winter season. Under the higher market price of LNG, we have secured quite a bit more LNG by the term contracts to absolutely avoid spot LNG procurement. Also, to preserve our LNG inventory, we have been making efforts such as decreasing the amount of power generation for JEPX, and due to the efforts, the sales volume of electricity for the first half of fiscal 2022 decreased by 10% year on year. Therefore, we consider there is no concern for securing LNG as raw materials and fuel even during severe winter.

Meanwhile, we have posted the contingency expense for spot LNG procurement, considering the possibilities of a certain impact on clients in Japan by force majeure declaration of the LNG Dua project in Malaysia. We don't have any direct contract with the Dua project, so we will not procure any spot LNG in response to this matter. However, to prepare for the possibilities where JAPEX has to temporarily adjust or replenish inventory in an indirect manner in the relationship with its clients, we have posted the contingency expense of 5.0 billion yen. Therefore, we have not decided how to pass on the contingency reserve to clients yet as we have not found out whether we will actually need the reserve at this stage.

Q9: Within the target business profit for fiscal 2026 of 30.0 billion yen, you have set a target to earn 12.0 billion yen from businesses other than the E&P business. Could you tell us about the progress you have made in your business and what you will work on down the road to achieve this target?

A9: We have already participated in four biomass power generation projects, of which JAPEX is taking the initiative in three projects. In the meantime, we have been also working to explore new projects, such as pursuing new offshore wind power generation projects at home and abroad, and carrying out studies to further expand the gas power generation business. We believe that we will be able to achieve the target business profit of 12.0 billion yen by steadily proceeding such efforts.

Q10: I would like you to take a flexible approach for the enhancement of shareholder returns, rather than taking stance of not revising the policy during the period of the medium- to long-term target.

A10: We have conducted a share buyback worth 5% of the total number of issued shares, and revised our policy to shift from the previous policy of paying stable dividends to targeting a dividend payout ratio of 30%. We believe that we have done what had to be done first. For the next step, we will consider further enhancing shareholder returns as a challenge for the future.

Q11: What are the reasons behind the bookout transaction you carried out this fiscal period? Is there any possibility of another bookout transaction being made in the future?

A11: One of the reasons is that, given the persistently high LNG prices, we have secured LNG through term contracts to avoid conducting spot procurement. As a result of such efforts, we are expected to have some buffer inventory against our sales plans and power generation plans for the next fiscal year. As such, we carried out a transaction to resell LNG, which we are planning to receive during the first quarter of the next fiscal year through term contracts, at a market price and therefore recorded a valuation gain. I would like you to know such a transaction will not happen very often and the profit is only of temporary factor.

Q12: Crude oil production in the Garraf Project is expected to increase for this fiscal year. Could you tell us about the timeline for achieving the production target of 230,000 bbl per day?

A12: There is a delay in the timeline for achieving the daily production target of 230,000 bbl from the initial plan. This is mainly due to the temporary suspension of operations by the operator amid the COVID-19 pandemic, and deteriorating security situation in Iraq, as well as the hike in prices of materials and equipment. We are currently discussing with the operator on the specific timeline for achieving the target production.

Q13: Fill us in on your approach to the dividend policy for the next fiscal year. In case profits of the next fiscal year decreases due to absence of temporary profits such as gain on valuation of derivatives and foreign exchange gains in this fiscal year, will you reduce dividends based on the dividend payout ratio of 30%, or will you maintain the stable dividends?

A13: This is a matter to be considered, but at this moment, we do not consider the option to avoid a dividend reduction for the next fiscal year sorely for the purpose of maintaining stable dividends.