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 Three Months Ended June 30, 2023 to Institutional Investors and Analysts

Date and time: Thursday, August 10, 2023, 11:00–12:00 (web conference)

Attendance: 37 attendees (institutional investors and analysts)

Key Questions and Answers:

Q1: Please tell us about the scale of the investment you made in May this year to acquire additional well interests in the tight oil development project in the U.S.

A1: We plan to invest approximately US$300 million to acquire the additional well interests, of which we will spend about US$200 million this fiscal year and US$100 million next fiscal year. At the beginning of the current fiscal year, we had planned to invest a total of ¥39.0 billion in the tight oil project in the U.S. during this fiscal year, but we have revised the amount upward to ¥69.0 billion, reflecting this additional US$200 million. As a result, we expect that the amount of purchase of property, plant and equipment in the consolidated statement of cash flows will increase to ¥84.1 billion, up around ¥30.0 billion from the previous forecast of ¥54.4 billion.

Q2: Please tell us how the acquisition of the additional well interests in the tight oil development project in the U.S. will contribute to your profit.

A2: We expect that the acquisition of the additional well interests totaling US$300 million will contribute to our profit in the next fiscal year (the fiscal year ending March 31, 2025) and beyond. We had expected that operating profit in the North America segment would decrease about 20% next fiscal year from ¥10.0 billion for the current fiscal year. With the additional investment this time, however, we now expect operating profit for the next fiscal year to exceed the level of the current fiscal year and also expect operating profit for the fiscal year after next (the fiscal year ending March 31, 2026) to remain significantly high.

Q3: Please tell us how the decline in the LNG spot price has affected sales of natural gas in the domestic E&P Business and marginal gain on LNG procurement in the Infrastructure/Utility Business.

A3: At the beginning of this fiscal year, we forecasted the LNG spot price (JKM) to stay at around US$15/mmbtu for the fiscal year ending March 31, 2024, assuming that the LNG spot market conditions would stabilize gradually over time. This time, however, we revised the forecast further downward to US$12.5/mmbtu. In line with this downward revision, for the fiscal year ending March 31, 2024, we have expected the marginal gain on LNG procurement to decrease about ¥1.0 billion from the previous forecast. In addition, during the first quarter ended June, the sales price of natural gas produced in Japan remained high due to the impact of gas price time lag. In fact, this served as a factor to push up profit from the domestic E&P Business by ¥2.0 billion. However, we believe the sales price will drop in the second quarter onwards as the impact of the time lag will fade away.

Q4: Please list main reasons why the upward revision to sales volume of electricity does not help increase profit.

A4: We have diverted LNG inventory from raw materials for gas businesses to fuels for electricity production as the sales volume of domestic natural gas decreased in the wake of growing gas-saving momentum and mild temperatures in April. We will sell the additional electricity we have produced at Japan Electric Power exchange (JEPX). As a result, the sales volume of electricity will pick up, but the contribution of increased sales volume to profit will be limited, as the electricity spot price has continued to fall far below the year-ago level.

Q5: PBR is currently below 1x. Please tell us about the status of your consideration of measures to improve capital efficiency.

A5: We need to analyze current conditions before implementing such measures. The Board of Directors has just started discussing this issue in full swing. Since PBR is equal to ROE multiplied by PER, we recognize that the low PER is one of the reasons why the

PBR is below 1x. We will continue to analyze current conditions and discuss what measures we should take. We would like to disclose the results at the right timing.

Q6: Please provide us with the overview of the additional well interests in the tight oil development project in the U.S., which you decided to acquire in May this year. Are you acquiring the interests in the Eagle Ford formation like before?

A6: The location is not limited to Eagle Ford but our target formations are rich in oil as they were previously. The scheme is basically the same as before, with the company sharing some of the costs of drilling the wells and sharing in the revenues that come from them.

Q7: What are the reasons for delay in the start of production at the Seagull project in U.K. Also, how much is the impact of the delay on profit?

A7: Production was expected to start from two wells, but encountered technical problems in the finishing process. This has caused the start of production to delay for a few months. Compared with the previous forecasts, operating profit and net profit are expected to decrease from about ¥4.0 billion to ¥2.0 billion and from slightly less than ¥3.0 billion to about ¥2.0 billion, respectively. These decreases are attributable to a time lag in the recognition of operating profit and net profit from the project; and they do not mean that the project itself has become less profitable.

Q8: Is the smaller decline in net profit compared to operating profit due to the UK's windfall profit tax? Does it mean that the contribution to net profit is limited?

A8: As you suggested, because the rate of tax, including the windfall profit tax, applicable to the project is 75%, its contribution to net profit is limited. As another reason, the oil and gas tax system in the U.K. provides an incentive that allows us to deduct taxable profit up to the amount exceeding the invested amount if it meets certain conditions. Therefore, as an accounting treatment, we recognize deferred tax assets in the investment phase and reduce them in the recovery phase. For the latest revision to the forecasts, we assumed a reduction in the amount of tax expense as we were unable to reduce deferred tax assets as scheduled due to a decline in profits. As a result, the project's impact on net profit was limited.

Q9: Please tell us how you have factored SODECO into the financial results for the three months ended June 30, 2023 and the financial forecasts for the fiscal year ending March 31, 2024.

A9: We have not reflected share of profit of entities accounted for using equity method in either the financial results for the three months ended June 30, 2023 or the financial forecasts for the full fiscal year ending March 31, 2024, as it is difficult to reasonably forecast the earnings of SODECO.

Q10: Do you intend to continue acquiring additional well interests in the tight oil project in the U.S.?

A10: We would like to pursue opportunities if available. Nevertheless, we are not necessarily satisfied with our current investment style. The current investment style in which we participate in the drilling of wells and receive a share of revenue from the well is attractive in that we can limit balance sheet risks. The investment style, however, has issues in that we need to accumulate short-term profits over time but are not sure whether we can continue earning profits. To improve the sustainability of profits, we will need other assets that generate profits over the medium- to long-term.

Q11: Please tell us about the progress of initiatives you have implemented to prevent natural decline in production volume at domestic oil and gas fields, such as Yufutsu and Katakai.

A11: The initiatives aimed at preventing natural decline in and maintain certain production volumes have progressed as planned. Over the next three to four years, we believe we can maintain the sales volumes of crude oil and gas produced in Japan at approximately 200,000 kiloliters and 460 million m^3, a level equivalent to that of the current fiscal year, respectively. We would like to raise the level of production volume by making appropriate investments.

Q12: In analyzing the current PBR of below 1x and discussing countermeasures, please provide us with the results of your analysis of scenarios regarding the allocation of increased operating cash flows due to surging oil prices, for about three years at the following oil price assumptions: US$60, US$70, and US$80.

A12: We are aware of the issue and would like to discuss it going forward.

Q13: To improve the current PBR of below 1x, we believe you need to discuss ROE and especially optimal capital structure over the time frame of a few years as priority topics. What do you think?

A13: We are aware that we need to discuss measures to improve ROE as well and would like to discuss them going forward.

Q14: Please tell us whether increases in shareholding ratios by major shareholders impede your share buyback?

A14: At the moment, we don't think increased shareholdings by major shareholders impede our share buyback.