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, 2023 to Institutional Investors and Analysts

Date and time: Monday, November 13, 2023, 11:00–12:05 (both offline and online)
Attendance: 40 attendees (institutional investors and analysts)
Main Questions and Answers:

Q1: What are the factors behind your decision to undertake a share buyback worth ¥20.0 billion using temporary excess cash, and will this policy continue to be applied? If the current crude oil price hike continues, is there any possibility of another share buyback for shareholder return purposes?

A1: Our shareholder return policy of keeping the dividend payout ratio at 30% will remain unchanged for the time being. Recently, we posted higher-than-expected profit thanks to surging oil and gas prices and the depreciation of yen. This has led to our decision to undertake the share buyback to fulfill our responsibility to return the profit to shareholders, while allocating part of the profit to investment for growth. Down the road, we intend to consider agile shareholder return policies, while responding flexibly to the circumstances of the moment. The same can be said even if the crude oil price hike continues.

Q2: Has your cross-shareholding policy changed after having in-depth discussions to improve your corporate value?

A2: The reasonableness of cross-shareholdings has been repeatedly discussed by the Board of Directors from various perspectives, including cost and return on shareholding, as well as business relationships with the issuers and background of individual shareholdings. We will consider our future policy based on verifications and discussions by the Board of Directors.

Q3: How will the tight oil development project in the United States contribute to your profit? Also, please tell us when to be aware of a decline in production.

A3: We decided to invest $500 million in 2022 and additional $300 million in May 2023, having decided to invest $800 million in total. With the WTI price assumption of around $75/bbl, we have forecasted operating profit of ¥10.0 billion for this fiscal year, which is unchanged from our previous forecast announced in August, ten and several billion yen for the next fiscal year, and slightly less than ¥10.0 billion for 2025. In terms of sustainability, we expect operating profit for 2026 to drop further by several tens of percent from about ¥10.0 billion. The investment scheme we are currently using in North America is to bear some of the costs of drilling wells and obtain some of the revenue from the project. This scheme allows us to continue making investments without incurring any significant balance sheet risk. We will continue to employ this scheme to improve the sustainability of profit. Also, we will strive to achieve sustainable profit by acquiring even greater interests, including operator projects.

Q4: You have decided to undertake a share buyback in the second year of the current management plan. Can I interpret this to mean that you will undertake a share buyback at a pace of about once every two years if the oil price hike persists? Please also explain how you define "excess cash."

A4: It is not necessarily the case that if the oil price hike continues, then we will undertake share buybacks. We will decide where to invest excess cash based on future circumstances. Currently, the Company is at a major turning point for its business. It is thus of great importance for us to make various investments for growth, including those in new business areas. We intend to make such decisions taking into account, among other things, progress of new projects and the amount of cash on hand.

Q5: On what basis did you calculate cost of equity to be 8%?

A5: We obtained necessary information from external sources such as Bloomberg. We calculated the cost of equity using assumptions of a risk-free rate of about 1%, a beta of 1.0, and an equity risk premium of 6.5%.

Q6: Please describe what you mean by "investments focused on capital efficiency"?

A6: We have always focused on capital efficiency when making investment decisions, and will continue to do so even further. While different IRR requirements have been set for the high-risk, high-return E&P business and low-risk, low return non-E&P businesses, we aim to adopt investment projects with IRRs that exceed each of these requirements.

Q7: Please tell us whether natural gas-fired power generation in the daytime, when electricity is traded at lower prices at the Japan Electric Power Exchange (JEPX), has incurred any loss.

A7: Most of the electricity produced at Fukushima Natural Gas Power Plant is sold based on long-term power purchase agreements (PPAs). The forecasted electricity sales volume for this fiscal year has been revised upward from the initial forecast of 3.0 billion kWh to 3.4 billion kWh. This is attributable to the reallocation of raw materials for our gas business to power generation fuels, reflecting downturn in gas demand. We will sell this additionally produced electricity at JEPX. However, we do not expect to incur any loss from the sale because we produce electricity during the time of the day at which profitability can be secured.

Q8: Please explain the detailed forecast for the Infrastructure/Utility (I/U) business, which is the factor behind the upward revision of the financial forecast for this fiscal year. What is the basis for forecasting the business' profit levels for the next fiscal year and beyond?

A8: Operating profit of the I/U business is expected to increase about ¥5.5 billion from the previous forecast to ¥19.0 billion. This ¥5.5 billion increase is attributable to a ¥2.5 billion increase in marginal gain on LNG procurement, resulting from a rise in the JKM price assumption from $12.5 to $15 and a revision to the exchange rate toward a weaker yen from ¥130 to ¥140; as well as to a gain on resale of surplus LNG cargos of ¥3.0 billion. While gain of resale of surplus LNG was included in non-operating income for the previous fiscal year in accordance with the form of the transactions, it will be recognized as operating profit for this fiscal year. From the next fiscal year onwards, the I/U business is projected to post operating profit of about ¥10.0 billion. This can be obtained by deducting one-time factors, which consist of a marginal gain on raw material slide time lag of ¥6.0 billion and a gain on resale of surplus LNG cargos of ¥3.0 billion, from the forecasted operating profit of ¥19.0 billion for this fiscal year. We have set the core profit of the I/U business to be ¥2.5 billion. Given the fact that we have succeeded in securing a marginal gain on LNG procurement of billions of yen every year for the last few years, we expect the I/U business to record operating profit of ¥8.0 to ¥10.0 billion.

Q9: Will there be any impact of the delayed start of production at the Seagull Project in the U.K. North Sea on profit levels from the next fiscal year onwards?

A9: Production has started in November; however, we did not factor sales from this project in our financial forecast for this fiscal year because crude oil is sold by the tanker. Although the delay is causing a time lag in the recognition of sales, it does not mean that this will have a negative impact in the next fiscal year and beyond.

Q10: What kind of investment project do you think will lead to an increase in interest-bearing debt? Please share your thoughts.

A10: We are not referring to any particular project, but we think it is quite possible that, as we are looking for new projects both in E&P and non-E&P business areas, we will use interest-bearing debt to finance such investments.

Q11: I understand that you have participated in various CCU/CCUS-related projects and research in Japan and abroad. What are your criteria to decide whether or not to participate?

A11: We do not have clear criteria for participation. We have laid the foundation for the future both in Japan and abroad. In Japan, we are confident that we have played a central role in Japan CCS Co., Ltd. It has become widely recognized by society that decarbonization requires large-scale CCS/CCUS. We therefore believe that these technologies will play a vital role in a carbon cycle. Although there are challenges in the development of legal framework, technology, costs, and others, we will start a full-scale study for injecting CO_2 into the ground in 2030. Overseas, we intend to gain experience and earn revenue by participating in projects in the United States, which is one of the legally advanced countries. Meanwhile, in Malaysia and Indonesia, we are seeking to launch CO_2 injection projects by leveraging our technical capabilities. Both in Japan and other countries, we will work on CCS/CCUS while finding out what kind of social framework should be put in place to ensure the economic feasibility.

Q12: Please tell us whether the Fukushima Natural Gas Power Plant is capable of using co-combustion of hydrogen with natural gas.

A12: We have not yet assessed its possibility. We will consider it based on the results of ongoing experiment and demonstration undertaken by other electric power companies.

Q13: Are there any one-off factors other than market conditions that should be factored in the financial results for this fiscal year or the next fiscal year? If there are, please describe them.

A13: In this fiscal year, JAPEX UK E&P Ltd. (JUK) is expected to post an operating loss of about ¥1 billion as it is forecasted to incur SG&A expenses, while postponing the recognition of sales in the Seagull Project. However, we expect a substantial amount of contribution to operating profit next fiscal year. In our revised forecast, we have factored equity in earnings of ¥800 million from SODECO, mainly attributable to foreign exchange gains from its foreign currency deposits; as well as equity in losses of about ¥700 million from Longboat JAPEX Norge AS (LBJ) in Norway, in which we have recently acquired an equity stake, mainly due to the incurrence of exploration expenses. These could be variable factors depending on business development in the next fiscal year and beyond. Other than these, there are no major one-off factors that we have currently identified.

Q14: Given your high risk/return profile as an upstream company, isn't it naive of you to have the cost of equity of 8%, including the fact that you adopted a beta of 1.0?

A14: This time, we used a set of data obtained from Bloomberg and other external sources for the verification, rather than obtaining individual numbers in bits and pieces. Currently, businesses with high risks, especially the high-risk, high-return E&P business, still account a considerable portion of our entire business, and we intend to continue investment for growth in these business areas. Therefore, we will think about what an adequate level of equity ratio should be. We assure you that the Board of Directors did not use the data in a manipulative way, and we intend to continue to use available information for our analysis on a steady basis.

Q15: As for "investments focused on capital efficiency," I would like you to consider disclosing numerical targets for your business portfolio and optimal capital structure or quantitative figures for your vision.

A15: Thank you for your suggestion, we will consider the request for such disclosure.