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, 2024, to Institutional Investors and Analyst

Date and time: Friday, August 9, 2024, 11:00–11:45 (web conference)

Attendance: 44 attendees (institutional investors and analysts)

Key Questions and Answers:

Q1: What is the investment amount for the U.S. tight oil development project in which you have acquired additional interests? Also, what is the production volume and revenue forecast for the next fiscal year?

A1: We expect to invest about $100 million in FY2024 and another $100 million in FY2025, for a total development investment of about $200 million. Since drilling is likely to begin in the near future, production will start contributing to our profit in FY2025 or later. For FY2025, we expect to be able to maintain the same level of operating profit as in FY2024, assuming that market conditions remain unchanged. However, since the production volume of the interests acquired in FY2022 will decline from FY2026 onward, profit will also decrease unless we acquire additional interests.

Q2: Please explain how your investment in the Freeport LNG Project will contribute to revenue in the next fiscal year and beyond.

A2: We have acquired an interest in Gulf Coast LNG Holdings LLC (GCLH), which is a U.S. sub-subsidiary of JERA, and plan to start taking in equity method profit in June this year (the seven months from June to December will be reflected in our consolidated financial results). In terms of revenue for the next fiscal year and beyond, the main business of LNG liquefaction tolling will be stable. However, the business that utilizes excess capacity of facilities to sell LNG will be affected by market conditions. Therefore, we will closely monitor the revenue of the Freeport LNG Project for FY2025 and beyond.

Q3: What are the reasons for the approximately ¥75 billion increase in cash flows from investing activities in the full-year forecast?

A3: The increase in purchase of property, plant and equipment of approximately ¥20.0 billion is largely due to the development of the additional U.S. tight oil interests acquired in June 2024. The increase in purchase of investment securities of just under ¥60.0 billion is mostly for the acquisition of GCLH.

Q4: What is the expected increase in the marginal gain on LNG procurement in the I/U business for FY2024 compared to the forecast at the beginning of the year?

A4: The marginal gain on LNG procurement is expected to increase to ¥10.0 billion from the initial forecast of ¥9.0 billion. The assumed oil price, which corresponds to the purchase price of LNG, was lowered by $5/bbl from the initial forecast while JKM, which is part of JLC price corresponding to the sales price, was left unchanged at $10/mmbtu. Accordingly, we assumed that the sales price would not fall as much as the purchase price.

Q5: Is it correct to assume that the loss will be larger than initially expected due to the acquisition of JAPEX Norge AS (J Norge) as a wholly owned subsidiary? What is your outlook going forward?

A5: J Norge was an equity-method affiliate for which we owned 49.9% of shares until June, and it became a wholly owned subsidiary from July. When we acquired the remaining 50.1% of shares for $2.5 million at the end of June, the fair value was measured and about ¥1.2 billion of impairment loss on goodwill on the shares of the affiliate was recorded as equity method loss for the first quarter ended June. However, the company will contribute to operating profit as a subsidiary from July onward. Despite this loss, we expect that the full acquisition will allow us to speed up the decision-making process, boost exploration, development, and production exponentially, and contribute to our profit to a greater extent.

Q6: Why has the U.S. tight oil sales volume decreased compared to the previous forecast?

A6: The sales volume is lower because the production volume from the well interests acquired in May 2023 is not as high as originally forecasted.

Q7: What is the reason for increasing interest expenses and interest-bearing debt in the full-year forecast?

A7: Interest expenses were incurred when we borrowed foreign currency through a cash pooling agreement, although the borrowings were not shown on the balance sheet because they were offset by yen deposits. In addition, we borrowed ¥20.0 billion in short-term borrowings at the end of June. We are also considering issuing commercial paper and anticipate an issuance of around ¥10.0 billion at the end of August or the beginning of September, which is also expected to increase interest expenses and interest-bearing debt.

Q8: Please tell us about the balance between profit and production volume stability and investment cash flow for investments in U.S. shale oil projects. Will you continue investments of this scale to maintain profit and production volume? Or should a significant drop in production volume be included in the financial forecasts?

A8: We would like to continue further building on the assets we have accumulated in our U.S. shale oil projects to date. When acquiring assets, we evaluate the effectiveness of investments by carefully assessing the level of returns on the anticipated investment amount can potentially yield for each project. In addition, we are also considering the possibility of uncovering investment opportunities that differ from our current investment approach. Shale oil projects typically have the highest production rate in the early stages of production and decline significantly within a few years. Despite this characteristic, we can maintain certain stable profit levels by accumulating assets over time.

Q9: When you say you are considering different investment approaches, do you mean entering the shale oil business with the possibility of becoming an operator?

A9: That is correct. We also believe we can gain business opportunities in combination with CCS and create synergies by developing upstream and downstream businesses in addition to the LNG liquefaction tolling business at the Freeport LNG terminal.

Q10: What are the circumstances surrounding the increase in the marginal gain on LNG procurement in this 1Q compared to that of last year. Have you changed your procurement portfolio since then?

A10: The marginal gain on LNG procurement in the previous 1Q was small because it is the net total of raw material inventory adjustment and other factors. No changes have been made to our procurement portfolio.

Q11: Please provide us with the ROIC and ROA by segment in the Explanatory Materials.

A11: We are aware of the issue and are discussing internally when and how to disclose them.

Q12: Please tell us about the profitability of the Freeport LNG Project from a long-term perspective.

A12: Stable revenue can be obtained over the long term without being affected by oil and gas prices because Freeport's revenue is basically based on LNG liquefaction tolling contracts. On the other hand, since this type of business cannot be expected to be highly profitable on its own, we would like to develop peripheral businesses that can add further value. Since expansion of the fourth train is expected to drive up profitability in later years, we would like to make efforts to increase the value of our assets.