1Q 2020 Earnings Release

Conference Call Transcript

April 23, 2020

IR Department

1. Page 1 – Consolidated Results Overview

Consolidated financial results for 1Q 2020 recorded
5.5tn won in sales, 145.8bn won in operating profit, and 64.3bn won in net profit.

Although **sales have decreased** due to the global economic slowdown and production cuts of key customers caused by the COVID-19 pandemic, we have **minimized the negative impact on our operating profit** through preemptive risk management and stable gas sales from the Myanmar gas field.

Regarding the **Trading Business**, earnings were maintained by minimizing one-off losses through reducing low-margin, long-term credit based transactions. We have also maintained stable earnings from the **Myanmar gas field** by supplying **570Mcf per day on average** during 1Q, despite a slight decrease in the gas sales price caused by the drop in international oil prices.

Our net profit for the quarter has been affected by foreign currency translation losses for USD denominated debt in key overseas investment subsidiaries caused by the depreciation of local currencies in Asia, CIS, and South America due to the COVID-19 pandemic. This translation loss is expected to be reversed once the foreign exchange rates normalize in the markets above once the COVID-19 issue subdues.

While **sales have inevitably decreased** due to the overall global economic slowdown and crash of raw material prices, our **earnings recorded comparably better results** considering the market conditions.

2. Page 2 – Consolidated Results Details

The next page shows the **consolidated results in detail.**

The **operating profit of 145.8bn won** is comprised of **48.2bn won from the trading business** and **97.6bn won from the Myanmar gas field**.

The 48.2bn won from the trading business is comprised of **36.5bn won** from trading activities from our head office and **11.7bn won** from subsidiaries. Earnings were evenly recorded from our steel, agro, and industrial materials businesses while the Indonesian palm oil business has outperformed from our subsidiaries due to an increase in both sales volume and price of CPO.

Our Myanmar gas field recorded **97.6bn won** in operating profit through **stable gas sales of over 500Mcf** per day. This was achieved amid difficulties arising from the spread of COVID-19 in China as well as the low demand season during the Chinese New Year holidays. Further details will be provided after an explanation on the non-operating profit and loss for 1Q.

In terms of the **non-operating P/L** for the quarter, loss resulting from financial activities was **-60.9bn won**, which is comprised of **-20.2bn won** in net interest expenses and **-40.7bn** won related to F/X.

Net interest expenses have decreased greatly compared to **-41.3bn won** YoY and **-30.2bn** won QoQ due to the decrease in LIBOR rate. Considering that the interest rates are expected to continue to be low for some time, our yearly net interest expenses could be maintained below 100bn won for the year.

3. Page 2 – Consolidated Results Details

Losses related to F/X was -40.7bn won, which was mainly attributed to **foreign currency translation loss of -41.1bn won** incurred in the Indonesian palm oil subsidiary and the Ukraine grain terminal subsidiary. Specifically, **-34.7bn won** is attributed to the **Indonesian palm** oil subsidiary.

The palm oil subsidiary's debt stood at **174mn USD** at the end of March, 2020. This amount is not hedged at the moment considering the high hedging costs and the fact that the expiry is in 2026.

For your information, we maintain a square position on our assets/liabilities at our head office and hedge our market exposure of F/X. However the position of a few of our subsidiaries, such as the Indonesia palm oil subsidiary and the Ukrain grain terminal subsidiary, is strategically exposed considering the cost and benefits.

Although we do have some exposure when it come the F/X, 1Q was a very special situation where the F/X market was overly volatile due to the spread of COVID-19. We expect little risk of large-scale foreign currency translation loss once the market stabilizes.

In terms of key profitability and stability indices, **ROE rose to 9.5%** due to the increase in net profit.
The **debt to EBITDA multiple was 4.1x**, a slight increase compared to last year. This increase is attributed to the securing of over 500bn won of cash liquidity as a preemptive measure to counter the economic slowdown.

4. Page 3 – Results and Outlook by Business Group

Page 3 is the **results and outlook by business group**.

Overall, the earnings of each of the business groups increased QoQ due to factors such as base effect of 4Q19 and restructuring, while sales and earnings decreased YoY due to the worsened business environment.

The **Steel Business Group** recorded **6.00mn tons** in sales volume, **2.6tn won** in sales, and **27.5bn won** in operating profit. Although sales slowed due to an increasing number of global customers entering shutdowns, we were able to maintain a stable operating margin through expanding the e-Sales platform and preemptive risk management.

While the market outlook does not look to be favorable due to prospects that the COVID-19 pandemic will prolong for an extended period, we will strive to maintain stable earnings through increased cooperation with POSCO in new developing markets, minimizing one-off losses, and focusing on earnings-centered transactions.

The **Energy & Infrastructure Business Group** recorded **374.6bn won** in sales and **93.6bn won** in operating profit through increased number of long-term LNG supply contracts and stable gas sales from the Myanmar gas field.

While the forecast for LNG sales post-2Q is expected to be slow, we expect that the **gas sales from Myanmar will continue to surpass the contracted volume**, considering that the demand for gas has been strong amid the COVID-19 issue as well as the Chinese New Year holidays.

5. Page 4 – Results and Outlook by Business Group

The **Agro & Industrial Materials Business Group** recorded **1.9tn won** in sales, which is a decrease both QoQ and YoY. This decrease is mainly attributed to the price declines in petrochemical products which make up around 40% of the Group's sales revenue. In terms of operating profit, the result of **12.3bn won** was more positive throughout each of the division in the Group such as agro, chemical, non-ferrous, and auto-parts businesses, which was achieved through focusing on stable transactions with major customers.

The global agro supply chain continues to be unstable due to the growing number of countries restricting agro exports. Furthermore, as 2Q is the low season of agro supply in the northern hemisphere, earnings from our agro business is expected to be slow in the coming quarter, but we will strive to minimize the downward pressure through diversifying and expanding our customer base and by expanding the role of our grain terminal in Ukraine.

Our **foreign subsidiaries** recorded mixed results, with the **trading subsidiaries** posting weak sales and earnings, while 11.7bn won of operating profit was recorded by the **investment subsidiaries**, with strong performance from the Indonesian palm, IPP in Papua new Guinea, and Myanmar hotel subsidiaries.

Due to the prolongation of the COVID-19 pandemic, the outlook for 2Q of both the trading and investment subsidiaries is unclear. There are also risk factors such as the drop in CPO prices and decrease in hotel occupancy. We will however strive to maintain the current earnings floor by minimizing losses through strengthened risk management.

6. Page 5 – Status of 4 Strategic Businesses

Page 5 shows the current **status of our 4 strategic businesses**.

Regarding our **E&P business,** the stage 2 development of our Myanmar gas field is currently underway as planned. In the A-3 block, **we have discovered gas in the Mahar structure with an estimated contingent resources of approx. 660Bcf**.

The operating profit from the Myanmar gas field for 1Q was **97.6bn won**, with total sales volume of **51.9Bcf**, which amounts to an average sales volume of 570Mcf per day. The remaining TOP (Take of Pay) amount from China is **17.6Bcf**, and considering that the demand for gas was strong despite the severely contracted Chinese economy, we expect gas sales to **continue to be stable throughout the year.**

For our **Steel business**, we expect structural growth through expanding the volume of POSCO products handled. In the long term, our role as POSCO's combined sales channel in both global and local markets will be strengthened, and as a part of this effort we have begun to integrate and unify overseas sales subsidiaries since 2019. Through this integration process, we expect an increase of over 2mn tons in sales volume in the SE Asian, N. American, and Chinese markets. Our role as POSCO Group's steel business developer will also be stepped up.

In the domestic market, we will establish an efficient sales infrastructure by diversifying the supply network and expanding the **e-Sales platform** to new customers. We will also establish a strong base for local demand by further expanding our business with the local small to medium sized customers.

Furthermore, we expect expansion into new markets through utilizing and strengthening the steel processing capabilities of **POSCO SPS**.

7. Page 5 – Status of 4 Strategic Businesses

In the **Agro business**, the Ukraine grain terminal initiated full-fledged commercial operation and has handled **125k tons** of volume in 1Q. The production capacity of the Indonesia palm oil business has now been established at **100k tons** per year.

On top of this, we have actively responded to risks involved with the palm oil business and have become the first company in Korea to declare and adopt the NDPE policy.

Through these sales activities our agro sales for the quarter recorded **1.57mn tons**, and on a yearly basis we expect to surpass last year's record of 5.45mn tons.

In our **LNG business**, we have expanded our trading volume to **490k tons** through focusing on major customers and the captive demand of the POSCO Group, and it is hopeful that we will achieve the **yearly target of 2mn tons**. However, due to the drop in LNG prices caused by unfavorable market conditions and systematic oversupply, we are currently **reassessing our investment plans to acquire LNG linked assets**.

8. Page 7 – Status of 4 Strategic Businesses

Page 7 is the condensed financial position.

As of the end of 1Q 2020, total assets was **9.52tn won**, total liabilities increased by **570.2bn won** to **6.48tn won**, and equity was **3.04tn won**.

There has been an increase in short-term debt, such as trade finance, in order to secure a stable amount of cash. This resulted in an increase of **592bn won** in debt compared to EOY 2019, and an increase of **19.2%p** of liabilities ratio to **213.1%**.

While there has been an increase in the liabilities ratio, net debt to assets has **improved by 1.2%p to 30.9%** compared to EOY 2019, which reflects the continued improvement of our financial structure.

- End of 1Q 2020 Earnings Release Conference Call-