CHAPTER 1

Toward Sustainable Growth

In this chapter, the JGC Group's business environment and progress in growth initiatives are discussed by the chairman and president, with insight on financial strategy from the chief financial officer.

Message from CEO

Our Third Transformation for Sustained Growth

1 Dual challenges of 2020

Many aspects of society, industry, and everyday life have suffered a tremendous impact from the new coronavirus pandemic ("Covid-19") since the beginning of this year. The world as a whole now faces an unprecedented situation. It only reinforces my strong impression that we are living in VUCA times, in a situation of Volatility, Uncertainty, Complexity, and Ambiguity.

We have seen a complete reversal in the plant market which until 2019 had been recovering but now seems uncertain. Given that oil prices have dropped sharply from a failure of OPEC+ to agree on production cuts, and that Covid-19 has sapped energy demand, clients including oil majors have made the decision to reduce capital investment this year. This means that 2020 presents me with two challenges as CEO. Not only must we grapple with somehow meeting our fiscal 2020 order target and earnings forecasts in the midst of this uncertainty, but we must also do this at a time when people appear to be redefining what is normal in society, industry, and everyday life. Through all of this I must chart a course to sustained growth as well as higher corporate value, and lead the Group as a whole to achieve these.

2 Long-term vision behind the next medium-term business plan

As of October 1, 2019, the JGC Group adopted a holding company structure. We had struggled for years to develop a diversified business portfolio that does not rely solely on overseas oil and gas, having faced turbulence about once every decade in the natural resource market. Our total engineering business now serves three segments; besides overseas oil and gas, we are also targeting overseas infrastructure and domestic EPC, as well as functional materials manufacturing. This gives the Group an updated management structure for revenue from a multi-business portfolio. With this, we have fulfilled my commitment to establishing a permanent Group management structure poised to build our second and third pillars of business after overseas oil and gas, as we pursue continued growth and gains in corporate value. (Reference: "JGC Story: JGC Group's Business," p. 27–28)

Significant changes have emerged this year in the wake of the emergence of Covid-19, as everyday life and our awareness change and new needs give rise to new business. In the energy and environmental segments intimately linked to the Group's business, low-carbon and decarbonization trends are accelerating and we have also seen speculation that the world may pass peak fossil fuel demand sooner than expected.

Representative Director, Chairman, and Chief Executive Officer

Masayuki Sato

Has worked in finance and accounting since joining JGC in 1979, overseeing finance for Middle East, North Africa, Southeast Asia, and CIS projects.

Appointed as a director in June 2010, CFO and Managing Director, Senior General Manager of the Corporate Administrative & Financial Affairs Division in July 2011, and Executive Vice President in June 2012.

Representative Director and Chairman as of June 2014 and CEO as of June 2017.

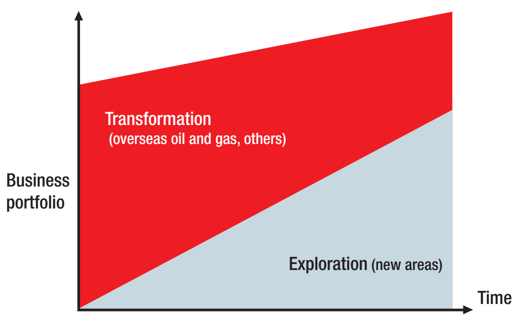
Expanded investments in renewable energy by oil majors and statements by chemical companies about switching to a circular economy can be viewed as developments that reflect changes occurring in a “post-Covid-19” energy and chemical industry.

With the understanding that for the Group it is essential to establish a long-term vision premised on post-Covid-19 changes and acceleration toward low carbon and decarbonization in the energy and environmental segments, we are currently developing a long-term vision for 2040.

3 Sustained growth by addressing social issues

The long-term 2040 vision is based on the concept of creating shared value, or CSV (Creating Shared Value), and the affirmation that our business is fully aligned with solving social issues. It will combine exploration of new business areas with the transformation of current business, such as overseas oil and gas. In all of this, we can leverage our core competencies of technical expertise, project execution capabilities, problem-solving, and adaptability to contribute to solutions for specific social issues, with SDGs firmly in mind. (Reference: “JGC Story: Path to Sustained Growth,” p. 29–30)

Transformational and exploratory



In exploring new business areas, we have identified six segments as candidates for key Group businesses as of 2040. As resource-related or environmental segments, we will be exploring “new energy”, “low-carbon/decarbonized engineering”, “recycling”, and “functional materials supporting carbon reduction and environmental protection”. As segments pertaining to health or other social issues, we will explore “infrastructure/industrial innovation” and “healthcare/life sciences”. Four of these six new areas relate to resources and the environment because the world will inevitably shift toward low carbon and decarbonization, and because we anticipate significant future business opportunities here for the Group. We will continue to study specific business and strategies in this exploration of new segments, and we will work with a sense of speed and profitability over the next 5–10 years.

4 Transforming our project execution capabilities in total engineering

The course of action Group management will be taking will gradually increase the ratio of new business areas while maintaining the stability of revenue from existing overseas oil and gas operations.

In the total engineering business, fiscal 2020 will see us pursue an orders target of ¥670 billion by securing orders in all of the projects which are expected to materialize.

The matter of securing our orders target and earnings forecasts initially announced for fiscal 2020 calls on us to transform our project execution capabilities and, in particular, gain competitiveness in overseas oil and gas projects. I also view this as essential to ensuring success in the very competitive environment we will see when the world overcomes Covid-19, global energy demand recovers, and large-scale LNG projects and others that are currently paused resume. It is clearly desirable to enhance our technical expertise in engineering and cost competitiveness, and to strengthen ties with overseas engineering subsidiaries. I would like to make overseas oil and gas operations fundamentally more competitive.

5 Attaining greater corporate value

Sound corporate governance is the bedrock upon which continuous growth of the Group's corporate value depends, and this year was no exception to our constant improvements and reinforcements to governance. For fuller discussions on medium- to long-term group strategies and issues at the holding company board meetings, we reduced inside board directors by three and added an outside board director after the June 2019 general shareholders' meeting. This nine-director system, which now has three outside board directors, will continue to be used after the June 2020 general shareholders' meeting.

Besides matters related to our adoption of a holding company structure and our long-term vision, in discussions on group governance the board reviews basic internal control system policies, establishes new organizations and committees under the holding company structure, reviews agenda items and approval criteria, and studies delegation of authority to operating companies, as well as the addition of matters for deliberation. In my view, we have succeeded in making the board more effective. (Reference: “Foundation for Creating Value: Corporate Governance,” p. 50–57)

6 Key year 2020 for sustained growth

We have undertaken two major transformations since the company was founded in 1928. The first occurred in the 1930s, as we moved on from our original business model in oil refining to become an engineering company. The second happened in the 1960s, as we took on a larger, global market from the previously targeted limited domestic market. Since then, despite facing many risks in a turbulent global market, we have achieved sustained growth and sought higher corporate value by constantly anticipating and overcoming market changes. (Reference: “JGC Story: Growth Trajectory,” p. 21–22)

Low-carbon and decarbonization trends are accelerating as the world continues to move toward a sustainable society, and we can also expect far-reaching changes to society, industry, and everyday life in the wake of Covid-19. Accordingly, I believe it is by contributing to the solutions for a broader range of social issues in the areas of resources, the environment, health, and society, that we will achieve sustained growth as a corporate group. The third major transformation in a corporate history long focused on overseas oil and gas will surely be implementation and success in the long-term 2040 vision that we are currently formulating. In this context, we recognize that for sustained growth linked to solutions addressing a wide range of social issues, 2020 represents a key year for developing the long-term 2040 vision.

Our next medium-term business plan, to be effective as of fiscal 2021, will be positioned as the first step in the long-term 2040 vision, and details will be announced around May 2021.

We appreciate the ongoing support of all stakeholders.

Message from CEO

Toward Sustainable Growth

Message from COO

Representative Director, President, and Chief Operating Officer

Tadashi Ishizuka

Managed numerous projects outside of Japan after initially working in the Domestic Project Construction Division in 1972. Appointed Managing Director and Senior General Manager of the Project Operation Services Division in June 2008, Senior Managing Director in 2010, Executive Vice President and Board Director in June 2011, Senior Executive Vice President and CPO in February 2017, and President and COO in June of that year.

Fully Committed to Overcoming Market Uncertainty

1 Completely changed market environment

In early 2020, the market conditions faced by the JGC Group changed drastically in the wake of sharply lower crude oil prices and the subsequent new coronavirus pandemic (Covid-19). As energy demand plunged from the global economic slowdown, six oil majors including ExxonMobil and Shell announced that they would reduce fiscal 2020 capital investment by more than $30 billion relative to their original plans. Large-scale LNG projects and many other capital investment plans have been postponed, and the outlook for the plant market remains uncertain.

Despite our ¥800 billion order target for fiscal 2019, final investment decisions for several expected orders were postponed, including the Rovuma LNG project in Mozambique, the Jordan Cove LNG project in the U.S., and an LNG receiving terminal in the Philippines, resulting in ¥189.6 billion of orders. In business results, analysis of the impact of Covid-19 on current projects, accounting for risks, led us to conclude that net income attributable to owners of the parent remained at ¥4.1 billion, in comparison with the forecast of ¥10 billion.

As COO, I would like to ensure that we meet our fiscal 2020 order target and results forecasts even in the current uncertainty. Moreover, as we formulate our long-term 2040 vision for the Group's third major transformation in its corporate history, I will be encouraging proactive efforts.

2 Securing orders for projects likely to proceed

In fiscal 2020, we are targeting ¥670 billion in total engineering orders, which breaks down to ¥400 billion in overseas oil and gas, ¥140 billion in overseas infrastructure, and ¥130 billion in domestic EPC. We are in the difficult position of having to achieve our target for orders amid this uncertainty as to when large-scale LNG plans will materialize in a market served by our total engineering business, and especially in overseas oil and gas. Nevertheless, we are fully committed to meeting this target, in line with the following policies. (Reference: "Business Strategies," p. 79–84)

In overseas oil and gas, we were awarded the Basra refinery modernization project in Iraq. As an order amounting to nearly ¥400 billion, the project places us in a good position to reach our target for the fiscal year. For other projects too, we will continue to assess the possibility of materializing and securing orders for projects that are likely to proceed.

In overseas infrastructure, we are aggressively engaged in sales activities aimed at winning orders for a non-ferrous metal refining project in Indonesia. Additionally, we are stepping up efforts to receive orders for solar power plants in Asia as we establish a proven record in renewable energy outside of Japan, following our completion of three solar power plants in Vietnam. Overseas infrastructure is also a segment where we are increasing our workforce, and to enable the JGC Group to be profitable in multiple businesses – both nominally and in reality – we are striving to achieve our order target of ¥140 billion in fiscal 2020.

In domestic EPC, despite some impact from Covid-19, we can expect orders for biomass power plants, pharmaceutical manufacturing facilities, hospitals, nuclear power plant-related services, and refinery and petrochemical plant maintenance. There may be a strong sense of uncertainty in markets outside of Japan, but domestic EPC remains a supporting force in our total engineering business. We hope to achieve results surpassing the order target of ¥130 billion.

In functional materials manufacturing, Covid-19 has been a cause for concern, with refineries and other sites operating at reduced capacity due to a global economic slowdown and lower energy demand. Nevertheless, we view this as a critically important business accounting for 25% (¥5 billion) of operating income in the results forecast for fiscal 2020. As we monitor market developments, we are aiming to achieve our initial sales and operating income targets.

3 Impact of Covid-19 on current projects

As stated in the fiscal 2020 results forecast, we project net sales of ¥480 billion, gross profit of ¥43 billion, operating income of ¥20 billion, ordinary income of ¥23 billion, and net income attributable to owners of the parent of ¥8 billion. The gross margin ratio is expected to remain the same as in fiscal 2019, at 9.0%, but the net income mentioned will continue to be partly impacted by a higher effective tax rate from increases in foreign income taxes in fiscal 2019.

As for the effect of the pandemic on current domestic and international projects, we calculated the impact on each project, accounting for additional costs expected in major projects and client terms and conditions, to total approximately ¥8 billion in fiscal 2019.

Unless there are significant changes in the business environment, we expect the impact on our fiscal 2020 results forecast to be minor, but we will continue to negotiate with clients to recover additional costs that have arisen as a consequence of Covid-19.

Inevitably, current international and domestic projects must proceed under various restrictions from the standpoint of containing infection in countries where construction is underway and other areas involved. This includes the LNG Canada project, three Algeria projects, two FLNG projects, and others. Project management will remain rigorous as we take the utmost care to prevent infection and maintain close communication with our clients.

4 Essential for sustained growth: transforming project execution capabilities

In line with the group management policy of steadily increasing the ratio of new business areas while ensuring revenue from existing operations, with a focus on overseas oil and gas, as COO I recognize that sustained growth for the Group is unattainable without transforming and improving our project execution capabilities in the overseas oil and gas area. I am determined to address this need.

We also intend to transform our overseas oil and gas business as a whole, by pursuing our vision of JGC one decade from now. Among other things, this entails rebuilding our global project execution framework, gaining non-price competitiveness, developing new areas, and expanding the scope of our services.

In this context, we view enhanced digital transformation (DX) efforts as a critical component. With regard to DX, we have established our IT Grand Plan 2030 and are engaged in a variety of activities to prepare for our vision of project execution in the year 2030. As we digitize engineering data from process engineering to detailed engineering with attributes and we link it to AI design, we will continue focusing on progress toward an engineering transformation. (Reference: “Feature 2: Business Innovation Through Digital Transformation,” p. 33–34)

New business areas of interest for 2040

Low-carbon/decarbonization engineering	Leading the shift toward reduced carbon and decarbonization of conventional energy sources
New energy	Building future energy infrastructure
Recycling	Promoting effective use of the world's limited resources
Healthcare, life sciences	Keeping people healthy and contributing to the well-being of society
Infrastructure, industrial innovation	Providing infrastructure that helps solve a variety of global social issues
Functional materials for low-carbon and environmental purposes	Creating innovative materials that help industries advance

5 Environmental business with large growth potential

In the environmental field, to date the Group has promoted use of relatively low-impact fossil energy through the design and construction of LNG plants while at the same time expanding renewable energy generation by the design and construction of solar, biomass, and wind power plants. We have also developed an array of environmental technologies.

Among new business areas for exploration identified in the long-term 2040 vision under development, we view several segments as likely to join the Group's portfolio of key businesses in the future: the environmental segments of new energy, low-carbon/decarbonized engineering, recycling, and functional materials supporting carbon reduction and environmental protection.

In October 2019, we established a dedicated organization in JGC Holdings that is now active in commercializing environmental technologies for applications such as CO_2 emissions reduction and waste plastic recycling. (Reference: “Feature 1: Accelerating Commercialization of Environmental Technologies,” p. 31–32). In functional materials manufacturing also, we have stepped up development and production of silicon nitride substrates for EV/HV power units, as well as microplastic alternatives. These are some examples of how we are already engaged in business consistent with our long-term 2040 vision. We plan to accelerate development of environmental business built on these promising technologies.

6 Concluding words

Fiscal 2020 is a year to meet target orders and results forecasts while establishing a long-term 2040 vision looking toward the third major transformation in our corporate history. As COO, I remain fully committed to overcoming current uncertainty and achieving sustained growth.

We sincerely thank you for your support.

Message from COO

Message from CFO

Director, Senior Executive Vice President, and Chief Financial Officer
Kiyotaka Terajima

After joining JGC in 1981, established business alliances and developed contracts for domestic and overseas projects in the Legal Department. Appointed Executive Officer and Deputy General Manager of the Corporate Administrative & Financial Affairs Division in 2014, Director, Executive Officer, and Senior General Manager of the division in 2016 (Senior Executive Officer in 2017), Executive Vice President and CFO in April 2018, and Senior Executive Vice President in April 2020.

Implementing Financial Measures that Support Sustained Growth

1 Current situation and duties as CFO

In an uncertain market environment that includes factors such as the drop in crude oil prices and the coronavirus pandemic (Covid-19), the Group is currently tasked with two challenges: meeting fiscal 2020 order targets and results forecasts while establishing a long-term 2040 vision for sustained growth as a corporate group.

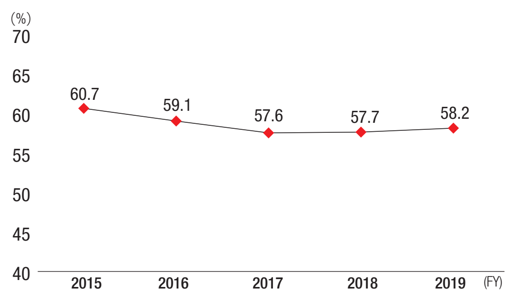
As CFO, I intend to support our efforts in the face of these two challenges through financial measures.

2 Maintaining sound finances

To secure and execute large-scale projects in overseas oil and gas engineering operations, our goal is to sustain robust finances largely unaffected by short-term market trends, and to keep flexible our funding capacity for large-scale investment. We aim to maintain a stable equity ratio of 50% or higher. As of the end of fiscal 2019, the equity ratio stood at 58%. Despite sluggishness in the plant market from 2015 to 2017, our discipline in financial operations over this time has placed us on a solid financial footing.

Early 2020 saw crude oil prices plummet after OPEC+ failed to agree on production cuts, and Covid-19 has resulted in reduced energy demand. This has made market forecasts difficult for total engineering as well as for functional materials manufacturing. For the Group to prevail in this severe environment, we recognize that sound finances are more important than ever.

Shareholders' equity ratio



3 Liquidity in hand and stance on allocation

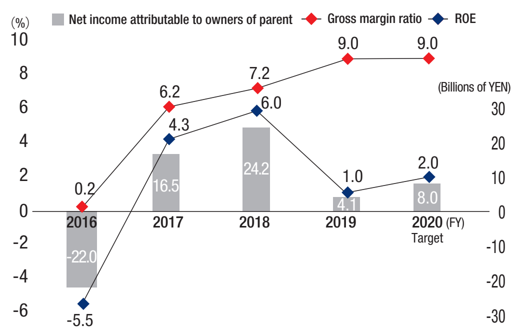
Liquidity in hand has improved significantly. Now that replacement cost no longer applies in the Ichthys LNG Project and capital recovery is in progress from projects in Algeria, net operating cash flow has increased. We have also obtained revenue from the sale of business investment assets after cross-holdings sales and a review of cross-shareholding. Current cash and cash equivalents as of the end of fiscal 2019 stood at ¥261.8 billion, a year-on-year increase of roughly ¥100 billion.

Financial needs for the Group include ample working capital for steady execution of total engineering projects, investment in AI/IoT in order to keep effective business operations, capital investment in functional materials manufacturing, and growth strategy investment in order to explore and commercialize potential new pillars of business. To meet such financial needs, it is our policy to consider cash in hand, among other options.

4 Toward greater capital efficiency

The Group has a target ROE of 10% or higher, accounting for cost of equity. Although ROE improved to 4.3% in fiscal 2017 and 6.0% in fiscal 2018 in part from our success in reinforcing project risk management after recording a net loss in fiscal 2016, ROE subsequently declined to 1.0% in fiscal 2019. The reasons are that corporate tax rose on higher foreign taxes, among other factors, and risk to current projects posed by Covid-19 was partially reflected in construction profitability, leading to lower net income attributable to owners of the parent.

Net income attributable to owners of parent, gross margin ratio and ROE by year



In order to improve ROE, it is required that the Group continue its thorough project risk management and that it cut costs to ensure profit from current and future projects. Also important is to continue generating and expanding stable and reliable revenue from functional materials manufacturing and total engineering consisting of three businesses that include overseas infrastructure and domestic EPC, instead of relying solely on overseas oil and gas which as a business is affected by fluctuations in the resource market. Moreover, the long-term 2040 vision under development will map a course for sustained growth by addressing a broader range of social issues including resources, the environment, society, and health, which promises to hold a greater potential for generating profit. As CFO, I am committed to timely and accurate allocation of resources for growth investment, based on suitable evaluation of risks and returns from investment projects, in order to improve capital efficiency through expanded profit.

5 Shareholder return

The Group positions shareholder return for investors as a key management issue and the basis of cash dividends. Our dividend payout ratio target is 30% of net income attributable to owners of the parent. Although this net income for fiscal 2019 was below the forecast announced at the beginning of the fiscal year, in consideration of liquidity in hand and other factors we maintained the same cash dividend as announced, ¥12 per share. We anticipate the same amount of ¥12 per share in fiscal 2020.

Recognizing that share buy-back is a form of shareholder return, we will consider this based on an overall assessment of market environments, the outlook for business performance, cash in hand, stock price developments, financial needs such as growth strategy investment, and other considerations.

We appreciate the understanding and support of all stakeholders.

Financial Highlights

(Millions of yen)

	March 31, 2011	March 31, 2012	March 31, 2013	March 31, 2014	March 31, 2015	March 31, 2016	March 31, 2017	March 31, 2018	March 31, 2019	March 31, 2020
Performance Highlights										
Net Sales	447,222	556,966	624,637	675,821	799,076	879,954	693,152	722,987	619,241	480,809
Operating Income or Operating Loss (–)	63,559	67,053	64,123	68,253	29,740	49,661	–21,496	21,495	23,249	20,234
Net Income Attributable to Owners of Parent or Loss Attributable to Owners of Parent (–)*1	25,477	39,111	46,179	47,178	20,628	42,793	–22,057	16,589	24,005	4,117
New Contracts	618,203	793,278	594,091	818,161	769,680	320,626	506,293	547,826	935,451	189,643
Outstanding Contracts	1,163,256	1,506,146	1,549,813	1,767,814	1,772,036	1,192,625	1,045,684	846,157	1,208,365	941,618
Financial Position at Year-end										
Total Current Assets	319,464	376,172	460,231	575,886	533,538	522,747	480,865	521,320	541,747	537,955
Total Current Liabilities	174,293	205,771	262,439	333,353	286,533	225,203	226,457	215,773	223,559	228,386
Total Assets	468,502	526,169	628,757	746,102	719,754	689,782	646,291	684,921	708,855	671,273
Total Net Assets	264,483	291,042	336,083	379,882	388,496	419,673	383,260	395,779	410,350	390,979
Shareholders' Equity	263,983	290,415	335,534	374,654	387,480	418,695	382,215	394,701	409,254	390,516
Cash Flow										
Net Operating Cash Flow	48,214	97,847	85,010	120,576	–71,416	–49,764	–28,884	5,539	–55,259	92,442
Investment Cash Flow	116	–18,746	–28,370	–18,728	–23,411	8,696	–12,979	11,736	–4,662	19,364
Financing Cash Flow	–7,317	–20,536	–3,695	–10,687	3,836	–4,374	–19,674	33,781	–13,878	–7,699
Cash and Cash Equivalents at End of Year	161,894	222,556	284,777	385,252	297,707	247,947	185,603	235,394	160,841	261,898
Financial Highlights										
ROA (Return On Assets) (%)	14.1	14.6	12.6	12.2	6.1	7.4	–2.3	3.8	4.6	3.2
ROE (Return On Equity) (%)	10.0	14.1	14.8	13.3	5.4	10.6	–5.5	4.3	6.0	1.0
Net Income per Share or Net Loss per Share (–) (in yen)	100.83	154.90	182.91	186.90	81.73	169.60	–87.42	65.75	95.14	16.32
Cash Dividends per Share (in yen)	30.0	38.5	45.5	46.5	21.0	42.5	30.0	25.0	28.5	12.0
Gross Margin Ratio (%)	18.2	15.6	13.5	13.1	6.6	8.3	0.2	6.2	7.3	9.0
Operating Income Ratio or Operating Loss Ratio (–) (%)	14.2	12.0	10.3	10.1	3.7	5.6	–3.1	3.0	3.7	4.2
Shareholders' Equity Ratio (%)	56.3	55.2	53.4	50.2	53.8	60.7	59.1	57.6	57.7	58.2
Current Ratio (%)	183.3	182.8	175.4	172.8	186.2	232.1	212.3	241.6	242.3	235.5
Payout Ratio (%)	29.8	24.9	24.9	24.9	25.7	25.1	–	38.0	30.0	73.5

*1 As a consequence of applying "Accounting Standard for Business Combinations" (ASBJ Statement No. 21, September 13, 2013), "Net income" is referred to as "Net income attributable to owners of parent" from the fiscal year ended March 2016 onward