FY2019 3Q Financial Results Analyst Conference: Q&A Summary

This document is an English translation of a statement written originally in Japanese. The Japanese original should be considered as the primary version.

Date: February 5, 2019 (Tue.) 16:30 to 17:30

Respondents: Tsuyoshi Hachimura, Chief Financial Officer;
Mamoru Seki, General Manager, General Accounting Control Division

1. Shareholder Returns, Cash Flows and Investments

Q. Regarding the ¥160.0 billion + α (¥160.0 billion and upside) for core free cash flows in FY2019, does this "+ α(=upside)" include the ¥100.0 billion of share buybacks announced today? Why were the share buybacks announced at this time? Adding the 55 million shares set to be acquired by June 30, 2019 to the already acquired 15 million brings the total up to 70 million, which feels like the Company is making quite quick progress toward buying back 100 million shares.

A. After the end of the third quarter, we closely examined core operating cash flows and the investment pipeline for the fourth quarter onward and revised core free cash flows for FY2019. In addition to strong core operating cash flows, we expect investment cash outflows to be smaller than assumed, providing us with some breathing room, due in part to the fact that the investment in Pan Pacific International Holdings (formerly Don Quijote) has not currently been completed. In addition, regarding excess cash, the management team regularly discusses how to allocate it. With that the team decided it would be best to quickly execute this buyback of 100 million shares because, whenever possible, we should quickly respond to external commitments. Executing the 100 million share buyback in advance is the proper management policy for the Company in terms of following through on its promises. Regarding the schedule for the buyback of 100 million shares, our policy has been to provide returns to shareholders while maintaining balance with growth investment. Therefore, if circumstances allow, the buybacks will be completed within the period of the current medium-term management plan, and possibly, depending on the situation, some buybacks may extend to the next medium-term management plan. We can also think that if we quickly carry out share buybacks within FY2019, ITOCHU can have more capability for investments from the next fiscal year onward.

Q. After completing the buyback of 100 million shares, what will ITOCHU's stance be toward the medium- to long-term shareholder return policy?

A. Although it is too early to think about policies after the completion of the share buybacks as there are still around 30 million shares left to buy, ITOCHU's policy is to continue working to raise earnings per share and in that way demonstrate management's commitment to enhancing corporate value.

Q. In terms of striking a balance with share buybacks, is there any change in the Company's stance or policy on investment?

A. There is no change in our stance or policy on investment. ITOCHU has put in place clear investment hurdles for almost 40 business fields. We carefully scrutinize the appropriateness of investments by considering the hurdle rate, free cash flows and the present value of target companies, the present value including synergies brought from trading with ITOCHU group, the scale of earnings and dividends. Despite exercising such strict criteria as myself being the chair of the Investment Consultative Committee, we have no intention of backing off from investments. We will actively take on good prospective investments while steadily providing returns to shareholders.

Q. What is the balance between the share buybacks and the increase in dividends from a minimum of ¥83/share (around a 25% payout ratio)?

A. Looking at the total return ratio, the increase in dividends and the share buybacks will have the same effect. We will first allocate excess cash to share buybacks. Although it is possible that the minimum dividend of ¥83/share will be revised upward depending on consolidated net profit, we will nevertheless continue to raise the total return ratio.

2. Results for the 3rd Quarter of FY2019 and Forecasts for Full-Year Results

Q. In the Food Company, net profit decreased year on year for many affiliates. Do you think there will be a recovery in the next fiscal year and beyond?

A. Regarding main group companies, net profit declined year on year in Dole, NIPPON ACCESS, and HyLife. As for Dole, although we have not currently changed the original target of ¥10.5 billion, result declined due to lower profit in the world wide packaged food business resulting from the lower sales of frozen foods as well as the market impact such as a fall in the price of canned pineapple. Although we have not reached a level of stably earning ¥10.0 billion as originally targeted when making the investment, we are striving to approach the original assumption. For instance in the Asian fresh food business, we are continuing to make essential capital investments, such as upgrading irrigation facilities and combining agricultural land to secure production targets and suppress volatility from weather-related events.

As for NIPPON ACCESS, although net profit declined year on year due to special factors, including expenses related to moving the head office and an increase in depreciation expenses following system upgrade, there won't especially be any concern from next year onward if we achieve our full-year forecasts this year. Compared in Japan's distribution industry, NIPPON ACCESS has robust distribution infrastructure across the entire temperate zone. Taking into consideration synergies with other operating companies, I think there is sufficient room for growth. We are considering various strategies, including overseas expansion. We expect continuing growth as the core company of ITOCHU group in the distribution field for the next fiscal year onward.

FUJI OIL HOLDINGS actively pursued acquisitions, including that of a U.S. chocolate business, and has laid the foundations for major growth going forward. We will continue to maintain good relations in the supply of high-quality raw materials. As for Prima Meat Packers, competition is heating up within the industry for sausages and other products, but the company has maintained the high quality of its products and will reportedly introduce a raft of new initiatives in the lead-up to the next fiscal year. As for HYLIFE, although the pork market has remained weak, exports are expected to remain firm, including for Japan, China, and South Korea. FamilyMart UNY Holdings revised its consolidated net profit forecast upward from ¥40.0 billion to ¥44.0 billion, and we expect the company to continue expanding earnings along with ITOCHU to achieve ¥60.0 billion.

The Food Company has successfully assembled a coalition of operating companies that drive ITOCHU's earnings. However, as CFO, I worry that investing significant management resources in the food distribution field may lead to a deterioration of the high efficiency (ROE, ROA, etc.), which ITOCHU strives for. Accordingly, I have offered guidance to further boost asset efficiency by making new investments and replacing assets in companies other than the Food Company as well as improving asset efficiency in the Food Company including operating companies.

- Q. Has YANASE's profit level recovered? In addition, why did the third quarter figures for ETEL seem weak?
- A. YANASE needed to optimize its inventory levels, and it has largely achieved that goal. Also, orders of new models have been brisk. Looking at the earnings structure, around one third is new car sales, around one third is maintenance-related (including after sales service), and the remaining third is sales of parts and others. Each of these areas has improved and we expect the company will be able to achieve the full-year forecast that was revised downward in November. As for ETEL, the tire market has stagnated due to Brexit and there was an impact from higher personnel costs due to the tight labor market. While the current performance outlook tends to appear bleak due to the impact of Brexit, the company is working hard to maintain good results. They are improving services as a one-stop shop to add value in addition to tire changes. They are also accepting orders online, locking in exchange rates to avoid raising the prices of imported tires, and increasing the types of non-brand tires they carry.

3. Chinese Economy Related

Q. Given the current status of the Chinese market, which is affected by rapid changes in the country's macro economy, what management approach do you intend to take in the upcoming fiscal year?

A. Our expatriates in China have seen these changes placing downward pressure on personal consumption and a cautious approach toward capital expenditure. These negative factors are more significant than the changes' implications for the real economy. Also, plastic trading, which represents ITOCHU's major earnings pillar in China, has been decelerating. However, we have already prepared to secure resilience against economic fluctuations and other matters of concern associated with our Chinese operations.

Specifically, we have built a well-diversified portfolio and a balanced profit structure that is not overly dependent on any particular field. Among around 300 operating companies included in the scope of consolidation for the result of 3rd quarter, approximately three fourths of them have earned ¥2 billion or less. The steady accumulation of their profit helped us forecast somewhat stronger full-year operating results.

Generally speaking, China's GDP growth rate may eventually drop to lower half of 6%, but our view for China's economic growth to remain steady is unchanged. Currently, China is facing trade friction with the United States while struggling to raise its GDP per capita to more than $10,000 to overcome the challenging middle-income trap that typically confronts nations on the way to becoming advanced economies. Accordingly, we believe that the Chinese government will intentionally keep the GDP growth rate at 6% mark in the course of the implementation of its planned economy policy, placing the priority on maintaining the stable growth rate. Therefore, although we must formulate our business plans based on somewhat lower GDP growth rates, we also expect that the Chinese government will execute a variety of policies aimed at securing the stability of the GDP growth rate. In fact, the government has already put in place some policies which, in turn, began impacting the economy. It has also promoted monetary easing as part of policies aimed at reducing debt. Thanks to this, liquidity has been improved, making it easier for private sectors to procure funds. Meanwhile, efforts are under way to stimulate currently stagnating personal consumption. For example, the government reinstated once-abolished preferential tax systems in addition to increasing the number of personal income tax exemptions in January.

We have seen the negative impact of U.S.-China trade tension on individual consumers' purchasing behaviors and businesses' stance on capital expenditure. However, we nevertheless believe that both countries will reach an agreement before too long. Although we expect that disputes over cutting-edge technologies and rights for intellectual properties may take quite some time to be resolved, ITOCHU has not been deeply involved in these areas anyway. We think that the impact of these issues on our operations will be extremely insignificant.

Looking at the results of ITOCHU's Chinese operations, the performance of CITIC Bank has been firm as it has already announced. Overall results of CITIC Limited were quite strong, too. With this in mind, in conjunction with the announcement of the first half results, we upwardly revised our forecast for CITIC-related profit, which had been set at ¥60 billion at the beginning of the fiscal year, to ¥63 billion. With regard to our Chinese operations other than CITIC, we have assessed the current status of their overall profitability and concluded that we wouldn't face any significant challenges attributable to these operations in the course of pursuing a targeted consolidated net profit of ¥500 billion.

In short, ITOCHU is ready to counter the slowdown of China's economic growth. We forecast that from the next fiscal year onward, China's GDP growth rate will hover around somewhere between 6% and 6.5%. Based on this forecast, ITOCHU will take a meticulous approach in terms of risk management. We also expect to announce some synergy projects related to CITIC in the next fiscal year and beyond. We will maintain a firm grip on these and other projects in the course of our Chinese operations.

4. Other Topics

Q. When analyzing ITOCHU, are there any indicators that need to be checked?

A. The rapid expansion of the pulp market has taken a momentary break and pulp prices have dipped somewhat since the third quarter, but product shortages have currently stalled the decline. Accordingly, we do not foresee a significant fall in pulp prices and expect the current level of prices to hold for a while. In addition, in the resources-related field, we are carefully watching trends in Brent crude oil prices and iron ore prices. The Vale project issue has affected iron ore prices, which are now exceeding US$70. However, given the oversupply from Australia, ITOCHU does not consider itself to be in an advantageous position. In addition, we need to keep an eye on exchange rates and interest rates. Regarding the latter, as the Fed says there is a high probability it will reduce the number of times it raises rates, we remain ever vigilant of the risk of interest rate hikes.

Q. In light of the collapse of Vale's dam, will there be any impact on ITOCHU, such as reviewing operations of its owned mines? Is there any need to consider the risk to production volumes in addition to market conditions?

A. The Vale accident involved the collapse of a tailings dam, a special type used in mining. The mines owned by ITOCHU in Western Australia do not have similar facilities, and we have not considered reviewing operations there (which are mainly handled by BHP) based on this accident. BHP's management team strictly adheres to safety rules, and there has been no problem in operations and we have a high level of confidence in their abilities. As long as we look carefully on iron ore-related prices, there doesn't appear to be any big issue. But there is already a lot of excess supply in Australia, and with the South Flank beginning production in 2021, we do not expect supply to run short nor iron ore prices to remain high.

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