FYE 2022 Q1 Financial Results Online 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: August 4, 2021 (Wed.) 16:50 to 18:00

Respondents: Tsuyoshi Hachimura, Chief Financial Officer
Kazuaki Yamaguchi, Deputy CFO, General Manager of the General Accounting Control Division

1. P/L Related (Including Full-Year Forecasts)

Q: Could you explain the rationale behind the current forecast for FYE 2022? Core profit in the first quarter of FYE 2022 was the highest ever and considering the still high resource prices, the one-off gains outside the plan, the upward revision of CITIC (Positive Profit Alert), and the unused loss buffer, I would guess that consolidated net profit in FYE 2022 could exceed ¥600.0 billion, which is the target in the medium-term management plan. On the other hand, considering the steady increase in profit heading into the next fiscal year, does ITOCHU plan to streamline its assets?

A: Compared with the around ¥450.0 billion in core profit in FYE 2021, we were expecting growth of around ¥60.0 billion during the year, but core profit in the first quarter of FYE 2022 grew approximately ¥91.5 billion year on year, and we are already around ¥30.0 billion higher than expected. In addition, one-off gains outside the plan were around ¥37.5 billion (first quarter results of around ¥87.5 billion − ¥50.0 billion included in the initial plan). Compared with initial assumptions, we now expect an improvement of around ¥10.0 billion in pandemic effects. If ¥30.0 billion of the loss buffer remains unused, we can calculate from disclosed figures that the result will exceed the forecast by around ¥100.0 billion. From the second quarter on, without taking the currently high resource prices into consideration, this could be the impetus for starting a discussion about revising the initial plan of ¥550.0 billion for FYE 2022 upward by around ¥100.0 billion to ¥650.0 billion. However, it is currently very difficult to accurately forecast effects of the COVID-19 pandemic, and we are discussing where we should set the FYE 2022 forecasts that we announce externally. In addition to reflecting the increase in profit from surging market prices, including iron ore and crude oil, in the FYE 2022 forecast, we are carefully weighing how much the non-resource sector will grow going forward. If we revise the FYE 2022 forecast upward, the announced figures will be a commitment. We also want to disclose the revised FYE 2022 forecasts for each segment at the same time and highlight the strength of each segment. FYE 2019–2021 had been a stage where we aimed for ¥500.0 billion, but we positioned FYE 2021 as a year of preparation for heading into the ¥600.0 billion stage and worked to eliminate future concerns. While maintaining the fundamental strengths in each business that we built up to achieve ¥500.0 billion in FYE 2020, we want to connect that strength into FYE 2023 onward. We will thoroughly implement our “earn, cut, prevent” principles without changing our lean management structure. We want to continue striving to expand core profit and prove that the strong FYE 2022 results were not a fluke.

Q: What is the state of progress of improvement in performance for FamilyMart?

A: Because the partial sale of Taiwan FamilyMart was conducted in June, the impact of this one-off gain was not included in the ¥13.5 billion first quarter consolidated net profit that was disclosed by FamilyMart, whose fiscal year-end is in February. Mainly because FamilyMart opened many stores in urban areas and there was a significant bounce back from the drop due to the pandemic in the same quarter of the previous fiscal year, core profit increased ¥10.6 billion on a stand-alone basis. Around half of the increase in profit is attributable to an improvement in daily sales per store (up 105.4% year on year). Daily sales returned to around 90% of the first quarter of FYE 2020, but the recovery is not yet complete. By enhancing the efficiency of the supply chain and hiring Hikaru Adachi as chief marketing officer (CMO), the company is taking measures steadily to enhance the attractiveness of its products and stores. FamilyMart is rolling out its “40 Good Things” campaign in commemoration of its 40th anniversary and is little by little raising the attractiveness of its products, including crispy chicken and curry fairs. We want to continue steadily racking up accomplishments through these strong efforts. In addition, we established Data One with CyberAgent and NTT Docomo, launching a digital advertising distribution business. In the advertising media business, we are rolling out a store media platform utilizing digital signage. The initiative has been rolled out to 100 stores since December 2020 and around 20 manufacturers are participating. We expect an expansion in advertising business going forward. In the financial business, the FamiPay app reached 8.77 million downloads as of June 30, and we aim to further expand downloads. We expect to increase downloads through an alliance with JA following FamilyMart's privatization. Famima Digital One is promoting such new initiatives as adding functions for post payments and loans to FamiPay. Management is also gradually changing. We hope the impacts of the pandemic will be minimized, as we head to the end of the fiscal year, so that this year could be a good 40th anniversary. We want to close the gap in daily sales with 7-Eleven as much as possible.

Q: Is your assessment that you are making steady progress on the reform of FamilyMart following its privatization compared with initial plans?

A: New initiatives do not immediately contribute to profits; they need some time to generate profits. Initiatives to raise daily sales and increase the attractiveness of stores in existing businesses as well as the optimization of the supply chain including NIPPON ACCESS will contribute to revenues more quickly. My assessment is that as we promote various initiatives, we are witnessing the speed-up enabled by privatization.

Q: In line with the improvement in FamilyMart's results, the results of NIPPON ACCESS are also improving. What is the reason that it appears NIPPON ACCESS is growing even more than the improvement rate of FamilyMart?

A: The trade that NIPPON ACCESS does with convenience stores is less than 40% overall, and they have a lot of trade with supermarkets and drug stores as well. In addition to the bounce back from the one-off losses from the same period of the previous fiscal year and the recovering convenience store results, the strong trade with supermarkets and drug stores has also helped. In addition, as a "cut" measure at NIPPON ACCESS, we are actively promoting initiatives to reduce logistics-related expenses, and we expect a reduction in business expenses during FYE 2022. Due to these factors, the growth in NIPPON ACCESS's numbers has been larger than the improvement in FamilyMart.

2. B/S Related (Including Investment and Shareholder Returns)

Q: Could you tell us what kind of discussions are being held internally regarding shareholder returns, such as dividend payout ratio and share buybacks, based on dialogue with investors and shareholders.

A: When we released the medium-term management plan in May, we announced our intention to increase dividends if we upwardly revise the initial plan from ¥550.0 billion. With the release of the results for this quarter, we also stated that we will upwardly revise the plan. We expect to increase our current dividends of ¥94 per share, but we are still conducting discussions internally regarding the amount of the increase. After announcing the medium-term management plan, we held dialogue with investors, shareholders, and analysts and explained that during the medium-term management plan, we will raise DPS under our progressive dividend policy, achieve dividends of ¥100 per share, and will neither decrease nor neglect to raise them. In addition, during the dialogue, we mentioned that we would be happy if dividends increased alongside profit in FYE 2023 and FYE 2024 but also communicated our commitment to increasing dividends even amid an uncertain business environment where we cannot forecast consolidated net profit in the near term. We committed to increasing dividends through FYE 2024, for a total of nine consecutive years, and have not changed our financial policy of growth investments and controlling interest-bearing debt. Through dialogue, we understood the market's expectations for shareholder returns and concerns for the dividend payout ratio. We are discussing internally a revised shareholder returns policy, enhanced from the shareholder perspective, and intend to announce it at an appropriate time. We plan to complete the Company's annual report by the end of August and, in it, the CEO and CFO messages state that we are positively considering our responses going forward in light of dialogue with investors and shareholders.

Q: Core profit in the first quarter of FYE 2022 was around ¥180.0 billion. In light of the current situation, how much is the actual level of ITOCHU's earning power? In addition, will you maintain the current dividend payout ratio of 25% even if results exceed plans?

A: ITOCHU commits to increasing dividends through FYE 2024, for a total of nine consecutive years, and we will increase dividends even if profit declines from FYE 2023. As for pandemic effects, consumption rebounds around the world as vaccines become more available. While there may be some differences in the timing, we generally assume the economy will recover in Japan and overseas, but we currently refrain from expounding on the forecast for FYE 2023. Considering that the IMF pushed back the economic growth rate in 2021 but has raised the growth rate for 2022, the generally accepted scenario is that the level of profit will rise more in FYE 2023. Of the around ¥180.0 billion in core profit, a certain amount comprises iron ore business. Production of crude steel remains high, especially in China, due to demand related to automobiles and construction materials. Currently the price of iron ore could stay high, but as supply rises, we think the price will gradually fall. Although it is difficult to forecast profitability related to resources, we commit to increasing dividends and not keeping the level even if income declines. While we increase dividend amounts every fiscal year, we are holding discussions regarding the payout ratio of 25% based on consolidated net profit of ¥550.0 billion. The Company's management emphasizes dialogue with investors and shareholders, and we are organizing information gained from dialogue since announcing the medium-term management plan. Discussions are currently being held on what we should do about shareholder returns when revising the forecast upward, including our direction for the medium to long term.

Q: NET DER and shareholder equity ratio continue to improve, but could you explain the relationship between your understanding of the current levels of these indicators and shareholder returns?

A: Considering the current status of cash flow and the balance sheet, it is reasonable to think that there appears to be surplus returns capability. ITOCHU, however, most highly values the sustainable enhancement of EPS and DPS. We think that because we can expect consolidated net profit in FYE 2022 to significantly exceed ¥550.0 billion, we can forecast EPS that significantly exceeds that of FYE 2020. How we increase EPS from FYE 2023 is important, and although we intend to enhance it through profit growth, we will continue considering share buybacks as a supplementary method. In short, our policy of actively and continuously conducting share buybacks as a means of shareholder returns will also be considered if enhancing EPS through profit growth becomes difficult. In addition, we are currently focusing on increasing dividend amounts, including in response to upward forecast revisions in FYE 2022, but we are also discussing the dividend payout ratio. We are not considering utilizing share buybacks as a method of maintaining NET DER at the current level of 0.7 to 0.8. We will continue to maintain financial indicators at an appropriate level while being aware of balancing the impact on credit rating evaluations.

Q: What is the current status of the investment pipeline and what is the policy on initiatives for investment related to energy, such as ammonia and hydrogen?

A: Because we are currently in a period of transition toward decarbonization, we do not intend to accelerate investment in the resource-related sector. Currently, the non-resource sector accounts for around 90% of our asset portfolio, and resource sector accounts for around 10%. Although we will not significantly change the allocation, if there is a prime project connected to profit growth which clears our hurdle rate, we will consider investment regardless of the sector. However, there are some reports that even carbon capture, utilization and storage (CCUS) will not count toward CO_2 reduction, and the calculation method for GHG emissions has still not been defined. Currently, ITOCHU, especially the President & COO, is considering nearly 40 SDG-related investment projects, including blue ammonia and CCUS, but we have not yet determined to what extent we will invest. We will seriously consider these investment projects based on the clearance of hurdle rate and the significance of the investments, including their contribution to reducing GHG emissions, which is a long-term target.

Q: First quarter FYE 2022 results were significantly higher than the market consensus. One factor was that the market had not accurately grasped the drivers behind the growth in core profitability in the non-resource sector. Can you explain the management resource allocation method and investment strategies to grow core profit during the medium-term management plan?

A: If we assume that for each year of the medium-term management plan core operating cash flows total around ¥600.0 billion (cash-in) and shareholder returns total around ¥150.0 billion (cash-out, around 1.5 billion dividend eligible shares × ¥100 per share), excluding CAPEX of around ¥150.0 billion to ¥200.0 billion (cash-out), then around ¥250.0 billion to ¥300.0 billion will be surplus that can be used for net investment (cash-out for investments including cash-in from exiting) and shareholder returns in a single fiscal year. However, ITOCHU's business is not dependent on executing multiple large-scale investments or the profitability of specific large-scale businesses. Because many small investments steadily accumulate organic growth in each business, I assume it was difficult to see the growth drivers behind achieving consolidated net profit of ¥600.0 billion. In the first quarter of FYE 2022, I hope you understood that each Group company thoroughly implemented the “earn, cut, prevent” principles, and they have steadily accumulated each hundred of millions of yen. Even if resource prices fall and the macro economy deteriorates, if we can seize growth at the micro level through Group companies in various sectors, including ICT & financial business, food, and convenience store business, we will be able to secure the stage of ¥600.0 billion in consolidated net profit. We had aimed to achieve consolidated net profit of ¥600.0 billion during the medium-term management plan but, based on the first quarter results of FYE 2022, ¥600.0 billion is close to the bottom. We will work to firm up this foothold of ¥600.0 billion. I cannot talk about the details of the potential investments, but to upgrade our existing businesses, we continue promoting the investment plans we built up at the beginning of the fiscal year, specifically building up new investment in small monetary amounts, such as in response to the SDGs.

3. **Other**

Q: Although each general trading company had strong operating results in FYE 2022, what is ITOCHU’s advantage over other general trading companies, such as its strengths in the non-resource sector?

A: The entire general trading company industry had strong results, which is very positive. The market valuation of the general trading company industry is rising and the foundation of the entire industry has been strengthened. General trading companies operate businesses in various sectors and regions, and if the economy improves, the performance of all these companies will also improve. However, if the economy deteriorates, what matters is how much a company can leverage its strengths. ITOCHU has been able to differentiate itself with its stable earnings base attributable to the downward rigidity of its results. ITOCHU’s strong results for FYE 2022 amid rising economic conditions made the Company more attractive. We do have businesses that generate major profit such as IMEA’s iron ore business, but over two-thirds of ITOCHU’s Group companies have scales of around ¥2.0 billion, and around 80% to 90% are in the black. Even under the hard business environment in FYE 2021, each Group company expanded profit through the strength of its management. In the first quarter of FYE 2022, each Group company generated hundreds of millions of yen of profit. The fact that ITOCHU is not reliant upon a specific sector is, I believe, one of the most reassuring factors for investors and shareholders. In addition, although the forecast for the business environment in FYE 2023 and beyond is unclear, we need to immediately move forward with action on GHGs. The Company has announced specific measures to reduce GHG emissions, and its other strengths include the fact that when transforming its portfolio, the Company will not experience pain and will not need to purchase expensive emission credits.