FYE 2023 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 5, 2022 (Fri.) 15:00 to 16:00
Respondents: Tsuyoshi Hachimura, Chief Financial Officer
Kazuaki Yamaguchi, General Manager of General Accounting Control Division

1. P/L Related (Including Inflation Effects, etc.)

Q: Based on the first quarter, excluding foreign exchange yen depreciation effects, what segments do you think will continue to perform well and which ones will continue to fall?

A: Taking a broad view of the business results in the first quarter of FYE 2023, performance was varied for each Division Company in the non-resource sector. The resource sector accounted for only around 30% of consolidated net profit, but it showed remarkably strong results. The price of iron ore was lower year on year but stayed at a relatively high level, while soaring coal and crude oil prices had a large impact on results in the resource sector. In forecasting results going forward, a key point will be how long these high resource prices will continue. In the non-resource sector, the General Products & Realty Company and the Machinery Company seemed stronger than expected. We expect the General Products & Realty Company to outperform the initial plan. This is because of soaring pulp prices, the solid performance of the construction materials business in North America and Japan, steady real estate property sales in North America and Japan, and the strong performance of UK tire business, ETEL, with stable good performance expected to continue going forward. Like the General Products & Realty Company, we also expect the Machinery Company to outperform the initial plan. In addition to strong performance in the shipping market, the automobile-related business, with increased dividends and the solid dealer business, is experiencing steady growth. In the energy business, if the current oil price level persists, I think we can maintain strong performance, but oil prices can be significantly influenced, especially by geopolitical risks and OPEC trends. There are currently no major changes to the situation of Sakhalin-1 (as accounting treatment, we reviewed the fair value as of March 31, 2022, recognized a loss of around ¥30.0 billion in other comprehensive income (OCI) and then reduced the book value to around ¥10.0 billion). We will need to pay attention to the trends of these risk factors going forward. In the chemicals business, we expect to make progress mostly according to initial plan. Although we will steadily accumulate revenue, performance will be poor for the specialty films business of C.I. TAKIRON and some of our trade business due to the effects of lockdowns in China. Organic growth alone will be insufficient in the Food Company, as well as the ICT & Financial Business Company, where performance is weakening so we seek to recover by steadily taking improvement measures for underperforming businesses. The Food Company is taking measures to improve HYLIFE, which is in the red. With pork prices currently on an upward trajectory, we expect performance to recover going forward. Dole is focusing on reforming its business mainly by cutting business costs, making operations more efficient, and revising the supply chain. On the other hand, in the North American grain-related business, performance was especially solid for grain handling and soybean processing operations. We think results for NIPPON ACCESS will also remain firm as long as consumption in Japan does not fall rapidly. We aim to achieve profit growth at a pace faster than slow organic growth. In the ICT & Financial Business Company, although we expect results for ITOCHU Techno-Solutions (which is in a well performing industry) to remain strong, we cannot expect performance like that of FYE 2022 for fund management profit (venture capital). It is possible that the situation for CONEXIO and Mobile-phone-related business will remain challenging for the near future due in part to a decrease in fees. Going forward, we need to take various measures to create new sources of revenue. In addition, FamilyMart in The 8th Company is performing at a steady pace compared with its company plan, and the main point going forward is how much profit will accumulate. An increase in lighting and heating costs, including electricity costs, has been incorporated into the initial plan, and we are currently taking various measures. But going forward, we are worried about an expansion in the effects if electricity costs further increase. We are gradually raising product prices to pass on the costs, and we currently have not seen a decrease in sales, and business has remained solid.

Q: I understand that the strong performance of the Metals & Minerals Company in the first quarter of FYE 2023 can be attributed to the large impact of soaring resource prices, but what is the state of hedges for iron ore and coal prices in the second quarter on?

A: The results of the Metals & Minerals Company remained strong due in part to soaring coal prices for IMEA, strong sales of oilwell pipes and sheet construction materials in North America for Marubeni-Itochu Steel, and an increase in dividends received from the Brazil-based JBMF. While we cannot reveal specific hedge ratios for iron ore and coal, we have not significantly increased our hedge ratios. The functional currency of IMEA is Australian dollars, so we make appropriate foreign exchange hedges when the Australian dollar is depreciated. Because iron ore prices have currently stabilized, we aim to carefully assess hedges going forward in consideration of discounts and other factors. In addition, ITOCHU's thermal coal exposure is low, but thermal coal prices could continue to stay high going forward depending on demand for fuel. Coking coal prices will stabilize like those of iron ore in line with a slowing economy and trends in China.

Q: What is the forecast for the Machinery Company and the North American construction materials-related business in the General Products & Realty Company, which had solid performance in the first quarter?

A: The North American construction materials-related business remained strong in the first quarter, but as we entered the second quarter, housing starts and the number of mortgage applications were on a downward trend, and business performance is currently declining, albeit slightly. Although we are not optimistic about performance from the second quarter on, we continue to carefully manage inventory and new asset purchases, so we have high expectations for the North American construction materials-related business. The key point for the Machinery Company will be how long the current strong performance of the shipping market continues. In the automobile-related export business, although the semiconductor shortage is gradually easing up, there are still concerns about inventory shortages and sales in destination regions. Results for YANASE in the first quarter remained about the same year on year, but demand remains robust and we expect further profit contributions if we can secure enough inventory.

Q: You explained that the Food Company and The 8th Company are struggling due to the effects of inflation, but how do you expect them to recover in light of the macroeconomic factors from the second quarter on?

A: Manufacturing-related Group companies in the Textile Company and the Food Company are especially impacted by inflation. The key to performance recovery will be the degree to which they can pass on costs going forward. Currently, FamilyMart and Dole are steadily passing on costs to address inflation, but ongoing product price increases are expected going forward, and how much consumers will tolerate additional price increases will be an issue. Accordingly, from the second quarter on, we expect a gradual recovery, not a rapid L-shaped recovery. As costs soar, including for raw materials and processing, we are carefully monitoring whether the indicators of gross profit margin, inventory levels, and cash conversion cycle have worsened and are taking countermeasures. While we do not expect inflation to directly lead to a deterioration of the earnings base that we have cultivated to date, we will pay attention to the effects of a worsening economy on Group companies.

Q: Were there any special factors for why the SG&A costs in the first quarter of FYE 2023 only slightly increased year on year despite the increased costs attributable mainly to inflation?

A: The main factor was a decrease in SG&A costs after changing the classification of the Taiwan FamilyMart from a subsidiary to an affiliate at the end of the first quarter of FYE 2022.

Q: What progress has been made for growth investments in the Food Company, such as HYLIFE and Dole, and what is the growth potential going forward?

A: HYLIFE recorded major losses due to falling pork prices to China and increases in feed costs attributable to the soaring grain market, production costs attributable to spreading swine diseases, and logistics costs. Income for Dole fell year on year due to a decrease in volume and an increase in production costs despite soaring sales prices for bananas and pineapples in the Asian fresh produce business. In the packaged foods business, demand has remained firm in the main sales market of North America and costs are being passed on to consumers. However, this has not been able to fully cover the increased costs of storage in North America, higher manufacturing costs and marine shipping costs for exports from Asia, which is a production base. Profitability for FUJI OIL and Prima Meat Packers has worsened due to soaring raw material costs in line with the individual company announcements. In the first quarter, results remained firm for NIPPON ACCESS and ITOCHU-SHOKUHIN, which are food distribution businesses in Japan, and the North American grain-related business also remained strong. Going forward, however, we will need to reform these as mid-stream businesses struggle, especially those related to fresh food. The first quarter results of the Food Company were slightly behind the initial plan, but by steadily taking countermeasures, we will achieve our announced yearly plan. We already held various discussions at management meetings and began to take improvement measures for struggling businesses. Like the business integration of ITOCHU SUGAR and Nissin Sugar, which was publicly announced, we will continue considering various measures, including industry reorganization, in addition to organic growth.

2. Other (Including China and CITIC-Related)

Q: What was the impact on CITIC Bank regarding the denial of repayment of mortgages for individuals in China?

A: The ratio of real estate-related business in the total loan balance of CITIC Bank is relatively low compared with the four major banks, and it has sufficiently recorded allowances and assurance through collateral, making its financial position sound. The mortgage balances for which collection has been deferred for the Industrial and Commercial Bank of China and the Agricultural Bank of China is very low compared with their total loan balance, and CITIC Bank has an even lower level. Although we do not have an optimistic outlook, CITIC Bank has not been significantly impacted by real estate-related problems. CITIC Limited has not announced first half results for FYE 2023, and I will not go into the details, but as far as ITOCHU can discern, there were no big surprises in the first half results of FYE 2023.

Q: What is the progress on investment in Hitachi Construction Machinery? In addition, how have synergies with Tokyo Century and MULTIQUIP been incorporated into initial plans?

A: The investment in Hitachi Construction Machinery was planned to close by June 30 when it was first announced in January 2022, but we are still in the process of acquiring permission from relevant overseas agencies. We therefore issued an amendment on June 24 that we will complete the investment in the first half of FYE 2023. We hope to quickly receive permission, and as soon as we do, we will finally move forward with official steps. Under the initial plan, we expect to consolidate profit from the second quarter on, but because we are conducting consolidation adjustments of amortization costs, I cannot currently give a definitive figure. Regarding synergy, we have been holding in-depth discussions on Hitachi Construction Machinery's expected exports from Japan and business expansion in North America, and I have heard that there have been more export orders than anticipated. In addition to considering the construction machinery financing business in North America, we are also discussing collaboration outside North America and cooperation on construction machinery sales in Japan. I think we can have a more detailed conversation when the second quarter results are announced.