FYE 2024 Q3 Financial Results Online Analyst Conference: Q&A Summary

Date: February 5, 2024 (Mon.) 14:15 to 15:15
Respondents: Tsuyoshi Hachimura, Chief Financial Officer
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1. P/L Related

Q: I would like to ask about each segment's trajectory for core profit in the next fiscal year. Regarding results for the first three quarters, my impression is that businesses with good results will maintain solid performance while those with bad results will continue to struggle. Are there any signs of change in the current trajectory for each segment? And, regarding the stagnating pulp and pork businesses, what is the forecast for recovery in performance in the next fiscal year, such as your projection regarding the market conditions going forward and the status of implementing improvement measures?

A: Heading into the next fiscal year, we are not expecting a downward or even horizontal trajectory for either core profit or consolidated net profit. It is true that we aim to achieve an upward trend, not necessarily a significant one, but a slight improvement. Currently, based on factors other than market conditions, we expect results to recover for the struggling Metals & Minerals Company, Energy & Chemicals Company, and General Products & Realty Company. The Metal & Minerals Company underperformed compared to the initial plan because we did not go through with the large-scale investments that were included in the initial plan and because expected profit contributions were unrealizable due to a delay in launching new projects for coking coal and iron ore. On the other hand, we announced multiple projects for reduced iron related to business transformation and non-iron-related decarbonization businesses, such as promoting DX and decarbonization in response to changes in the business environment, and we will achieve growth in core profit by making these new projects profitable. Although the volatility of the price of iron ore has stayed within a narrow range over the last year, we think there is a risk of the price falling in the next fiscal year due to economic conditions, such as infrastructure demand in China. However, we are still in an environment where resource inflation is likely to continue, and we do not forecast a drastic drop in prices. Based on this situation, the Metals & Minerals Company is striving to achieve a higher profit stage. As for the Energy & Chemicals Company, a surge in the price of LNG in the previous fiscal year provided significant profit contributions for trade earnings, but this led to a surge in the price of acquiring new investment candidates, so we opted not to go ahead with the investments we had been considering. While LNG is a fossil fuel, from the perspective of energy transition, demand for it is expected to remain firm over the medium term. Because energy interests are depleting assets and projects where revenues gained from existing owned interests continue to decline, we are considering initiatives that will lead to an expansion in investment and trade. The Power & Environmental Solution Division tends to focus on extraordinary gains related to the revaluation gain on a lithium-ion batteries company in the current fiscal year, but we expect a further expansion in the current profit scale of around ¥10.0 billion by promoting renewable energy businesses and initiatives aimed at optimization and GHG emission reduction through electricity sales and the construction of power networks using electric storage systems. The drop in the General Products & Realty Company is mainly attributable to the weakness of IFL, but since conducting investments in FYE 2013, this prime Group company have repeatedly made profit contributions of between ¥10.0 to ¥20.0 billion in the past despite being impacted by the cyclical volatility of the pulp market. In the current fiscal year, in addition to stagnant paper demand in Europe, there is a significant impact from the large drop in sales prices and declining demand in China, so we expect to barely maintain profitability. Heading into the next fiscal year, there are signs, such as a rebound in the Chinese pulp market in the third quarter, that profit will bottom out. The Company's pulp business has strengths in trade and other solid businesses and has worked to refine businesses through asset replacement.

As for the pulp market conditions in China, although prices have been falling again since January, we will continue stably running businesses with partners without being too jittery about market conditions. As for ETEL, there is high sensitivity to interest rates caused by the high ratio of interest-bearing debt, and although there was downward pressure on profit from rising interest rates, trading income increased. The North American construction-materials-related business is an industry expected to continue to grow, and we will continually uncover investment opportunities. The Metals & Minerals Company, Energy & Chemicals Company, and General Products & Realty Company have been struggling this fiscal year, but expect turn around in the next fiscal year, and we are considering measures to achieve growth.

Regarding the Food Company, ICT & Financial Business Company, and The 8th Company, we strongly expect solid business performance in the next fiscal year. The Food Company is in a transitional period, recovering from significant losses in the previous fiscal year, and although the profit increase in this fiscal year is significant, we believe there is still large room for growth. HYLIFE finished withdrawing from the U.S. business and is achieving a recovery in the Canadian business, although it continues to struggle with stagnant pork prices as it strives for turn around with their future and options at stake. Regarding Dole, the packaged foods business achieved profitability by realizing optimization and reducing costs, such as logistics costs and marketing costs, mainly in North America. The Asian fresh produce business is highly volatile due to weather effects, and we need to appropriately manage complex factors for production costs and sales prices. We are conducting hands-on management with unwavering determination, such as large-scale placement of personnel in the Philippines, which is closer to the front lines than Singapore. The domestic food distribution-related business, including NIPPON ACCESS, Inc. maintains favorable performance in part due to passing on costs to sales prices and the recovery consumer activity from the COVID-19 pandemic-related restrictions. Although there is the 2024 Problem in Logistics, we will achieve further growth by continuing to reduce costs and enhance efficiency in logistics. Considering the rate of progress, the forecast for the Food Company in the fourth quarter is very conservative. While keeping an eye on the turnaround of businesses that struggled in the previous fiscal year, we will not be satisfied with the current level of profit and expect an even greater jump in profit. The ICT & Financial Business Company expected to achieve a high rate of growth compared to other fields as we explained when we took ITOCHU Techno-Solutions Corporation (CTC) private. Our policy is to continue striving to expand the digital value chain, mainly CTC, by promoting inorganic growth measures; but even just looking at organic growth determined from the status of orders, we have very high expectations for profit growth in the next fiscal year. The 8th Company has improved the earning power of FamilyMart’s convenience store business and continued to perform exceptionally well, with the results for the first three quarters surpassing full-year forecasts. As new projects related to retail media became profitable, we will continue working to expand profits and build a new business model, such as expanding the use of data and AI. Furthermore, overseas businesses in Taiwan and China are improving profit, and we think there is large room for growth from the next fiscal year onward in the domestic convenience store business, new projects, and overseas expansion. We expect The 8th Company will demonstrate additional functions across Division Companies in businesses beyond FamilyMart, and we are considering these kinds of investment projects. Regarding the strong performance of the Machinery Company, some people are of the opinion that the current situation is the peak due to concerns about a recoil in automobile sales with the resolution of the semiconductor shortage and concerns about future demand for construction machinery, which is a barometer for economic forecasts. However, Hitachi Construction Machinery’s policy is to aim to further expand profits by demonstrating functions in additional initiatives, such as leases, and not just simple construction machinery sales. Also, we expect further profit expansion for Tokyo Century Corporation, which recovered from a recoil in losses on aircraft for Russia. Regarding the Textile Company, while we do not expect significant profit growth, we believe we can maintain profit of ¥30.0 billion while working to rebuild our portfolio, and we can expect stable profit contributions in the next fiscal year as well.

Accordingly, while it is too soon to talk about the level of profit in the next fiscal year, we will strive to achieve a rising profit trend in line with the implementation of investments as there are many opportunities remaining in the pipeline, which we have considered in the current period of the medium-term management plan, in addition to organic growth.

Q: The profit growth of NIPPON ACCESS, Inc. is especially eye-catching, but can you explain the reasons behind this and its sustainability into the next fiscal year? In addition, what is the background behind the delay in profit contributions from the Australian coking coal project Fitzroy and the Canadian iron ore project AMMC, and what is the forecast for the next fiscal year onward?

A: NIPPON ACCESS, Inc.'s results have been very strong thanks to the successful implementation of measures to improve logistics costs through efficient delivery routes in addition to a recovery of consumer activity and passing on costs to sales prices. Although there are consumers who prefer inexpensive private brands, there are also consumers who purchase expensive products, so price increases are currently tolerated to some degree. We expect the increased price level to continue from the next fiscal year forward, and we expand sales channels beyond FamilyMart into local supermarkets and drug stores so we can expect performance to remain strong. The Australian coking coal project revised its mining plan after determining that it would incur higher than anticipated costs if it conducted mining according to its initial plan. As a result, while there was some delay in coal production, given our understanding of the geological structures and the quality of the coking coal produced from this mine is high, from the next fiscal year, when the delays are resolved, we expect further profit contributions like the Canadian iron ore project.

Q: What is the current performance of CITIC and the forecast for the next fiscal year forward?

A: The consolidated net profit of Orchid Alliance, which invests in CITIC, has declined, but CITIC's performance has remained solid, especially in the comprehensive financial services sector. Main factors include a rebound in extraordinary gains related to revaluation of CITIC Securities contribution in the same period of the previous fiscal year and increased interest expenses in line with rising U.S. dollar interest rates. In terms of the preliminary annual results for FY 2023 recently announced, CITIC Securities has remained the largest underwriter of corporate bonds and equities in the Chinese market, but due in part to effects of the current IPO regulations and stagnating securities market, profit declined by approximately 8%. On the other hand, as for the mainstay CITIC Bank, interest income fell due to interest rate cuts that have been continually conducted from the previous year, however the improvement of non-performing loan ratio by 0.09% (end of FY 2022: 1.27%, end of FY 2023: 1.18%), and the decrement of allowance for doubtful accounts resulting in an around 8% increase in profit. Although profit in the advanced materials and new-type urbanization segments decreased, the profit scale is small, and the impact has been limited. CITIC is a listed company, and ITOCHU is not in a position to comment on the forecast for business results, but because it is a core state-owned enterprise, we do not anticipate a significant dip in the profit level from the next fiscal year. In addition, although a new Chairman has taken the reins, we think shareholder returns will stay in line with existing policies.

2. Investment-Related

Q: Currently, considering the investment environment, yen depreciation is continuing for overseas, and the stock market remains high for domestic. I think growth investment is needed for future profit growth, but to avoid over-paying for investments, how do you view the current investment environment. For example, do you think you will have to wait until the investment environment becomes more favorable?

A: We always say that we assess each investment project on a case-by-case basis. If you look at our investment record during the period of the current medium-term management plan, you will see that to date we have conducted new investments on a scale appropriate for the Company. We have not just conducted large-scale investments but also many small- and medium-sized ones. Aiming to achieve profit growth in the next fiscal year and beyond, we are thinking about how best to incorporate new investments into the organic growth of our existing businesses. Regarding the domestic investment environment, we do not have an intention of evaluating stock price levels and their sustainability, if a company is in a field where high profit growth is expected and can justify investment at the current stock price level, it is possible to implement investments. On the other hand, regarding overseas investment, we think we should focus most on whether there is synergy or expertise. However, while we are skeptical that the current yen depreciation of nearly ¥150 per U.S. dollar will continue indefinitely, the hurdle rate is also rising, and we are conducting even more meticulous analyses. In addition, as for overseas investment it is necessary to consider the Company-wide leverage, including the impact of interest rates. While we do foresee a turn in the trend in financial policies at the FRB and Bank of Japan, it is unlikely that there will be a significant change in current interest rate levels in the short term. Because we assume that the interest burden on foreign currency denominated interest-bearing debt will still be significant, we think that the hurdle to overseas investments will naturally become higher.

Q: At the start of FYE 2024, ITOCHU had around ¥1.0 trillion in surplus to invest, so it is my understanding that you forecasted profit contributions of around ¥40.0 billion, but new investment during the first three quarters amounted to around ¥542.0 billion. To what extent can these new investments help increase profits in the next fiscal year? Is it your policy to continue implementing new investments with just their original timing delayed? And are any of the specifics changing from your initial projections?

A: Predicated on positive core free cash flows after deducting shareholder returns during the period of the current medium-term management plan, we said that we would have a surplus of around ¥1.0 trillion to invest at the start of FYE 2024, and we have carefully studied the many investment projects suggested by the division companies to date. However, there were multiple projects that were rejected or did not make it to implementation, so it would be difficult to rack up investments in this fourth quarter and reach ¥1.0 trillion in new investments for FYE 2024. In the resource projects of the Metals & Minerals Company and the Energy & Chemicals Company, we have encountered delays in execution as well as projects that did not reach implementation, which was a factor in the low progress rate toward the full-year forecast. The majority of projects currently under consideration have been under consideration from the start of the fiscal year, so while we are carefully assessing the timing for implementing the investments, it is highly possible that we will implement them from the next fiscal year onward. In addition, there are projects in the initial consideration stage that were not in the pipeline at the start of the year, and their numbers are steadily growing. Of the new investments for the first three quarters, around three-fourths is accounted for by the privatization of CTC and DAIKEN CORPORATION, excluding CAPEX. For reference, in terms of profit contributions in the first three quarters in line with the rise in the ratio of ownership, CTC accounts for around ¥6.0 billion of the ¥9.5 billion increase in profit (¥11.7 billion -> ¥21.2 billion). DAIKEN CORPORATION accounts for around ¥1.5 billion, although DAIKEN CORPORATION's profit fell ¥1.2 billion (¥4.2 billion -> ¥3.0 billion), with the absence of extraordinary gains recorded in the same period of the previous fiscal year.

3. Other

Q: From FYE 2025, BELLSYSTEM24 Holdings, Inc.'s President Noda is slated to be appointed President of the ICT & Financial Business Company, while Kajiwara of the Chief Operating Officer, ICT Division and Director of CTC is expected to be appointed President of BELLSYSTEM24 Holdings, Inc. What is the background behind these appointments and the expected synergy between ITOCHU, CTC, and BELLSYSTEM24 Holdings, Inc?

A: In changes in Executive Officers and reforming the Executive Officer systems, as announced on January 18, we intend to accelerate the unification of appointment of Executive Officer with

Group companies. Mr. Noda will return to ITOCHU after four years to be appointed President of the ICT & Financial Business Company from April 2024. He has experience as the Chief Operating Officer of the ICT Division and as Chief Strategy Officer (CSO), bringing broad expertise in the ICT field and management strategy. I think he can further accelerate the efforts undertaken by Mr. Shingu, the current President of the ICT & Financial Business Company, to more aggressively invest in projects that expand the peripheral businesses of both CTC and ITOCHU as we promote digital value chain strategies. Regarding the Financial & Insurance field, we expect him to utilize his CSO experience and drive further growth, including alliances with other businesses. Regarding Mr. Kajiwara, who is set to become the President of BELLSYSTEM24 Holdings, Inc, we expect him to promote collaborative initiatives with ITOCHU that create synergy, mutually achieving profit for both companies, with the aim of further enhancing corporate value as a listed company while leveraging the business foundation reinforced by Mr. Noda.