The Management Policy and FYE 2025 Management Plan Briefing: Q&A Summary

Date: April 3, 2024 (Wed.) 16:00 to 17:00
Respondents: Keita Ishii, President & Chief Operating Officer
Tsuyoshi Hachimura, Chief Financial Officer

Q: I would like to confirm the level of long-term shareholder returns and profit assumed under the Management Policy of "aiming to achieve sustainable enhancement in corporate value." First, regarding shareholder returns, the target for the total payout ratio in FYE 2025 is aiming at 50%, but under the long-term Management Policy, it is lower at 40% or higher. I would like to reconfirm your policy on the total payout ratio. And, regarding long-term profit levels, considering the dividend policy (the higher of 30% dividend payout ratio or dividend ¥200 per share), profit is expected to grow to around ¥970.0 billion. I would like to ask about the core profit level based on consolidated net profit of ¥880.0 billion in the FYE 2025 Management Plan and the timeline for achieving the profit level estimated from this dividend policy?

A: To answer your question, I would first like to explain the background of our financial policy that led us to announce the discontinuation of a medium-term management plan and announce a new medium- to long-term management policy and single-year management plan. The Management Policy starts off with the three target levels we have previously outlined: 1) ROE of 15%; 2) dividend payout ratio of 30% as committed under the previous medium-term management plan; 3) total payout ratio of 41% for FYE 2024. We considered these targets based on dialogue with the market where we received more responses for "disclosure of profit growth levels going forward" and "strong expectations for shareholder returns." Regarding profit growth, we began accelerating growth investments as evinced by the strong phrase "No growth without investments." Regarding shareholder returns, we responded to market expectations by allocating roughly half of the core operating cash flows forecast for FYE 2025 to growth investments and the other half to shareholder returns. In addition, cash allocation planned for FYE 2025 is decided based on the idea of maximizing the amount we can invest by allocating to investment the entirety of core free cash flows after deducting shareholder returns carried over from the previous medium-term management plan. We first settled on ¥1 trillion in growth investments. Although this is slightly ahead of time, we decided to target a total payout ratio of 50%. Our pipeline of growth investments exceeds ¥1 trillion, and we will steadily proceed with investments while also heeding past lessons.

Next, I would like to talk about our highly efficient management, which is a major appeal of ITOCHU. When we announced the new Management Policy, we clarified that there are things we would change and things we would not change. As with the financial policies and strategies under the previous three medium-term management plans, there is no change in our policy emphasizing ROE. We explained that, as before, we will maintain a high level of ROE by expanding returns (R). Behind this strategy is the idea that we can realize an ROE of 15% or higher by maintaining a total payout ratio of 40% or higher and a CAGR of 10% for consolidated net profit. Although there is some wiggle room in single-year profit, as is disclosed in the materials released today, achieving a CAGR of 10% going forward is not an impossible level considering our track record between FYE 2011 and 2024 with a CAGR of 13% for consolidated net profit and an average ROE of 16%. When we announced the previous medium-term management plan, we lowered target ROE to between 13% and 16% in consideration of a ¥600 billion profit stage. Reflecting on that experience, under the new Management Policy, we do not intend to lower our current level of efficiency.

As we put the growth rate and total payout ratio into a matrix for the ROE level, we set the total payout ratio at 40% "or higher." There is no intention to cap the level at 40%. And while there is a gap between the total payout ratio of 40% or higher and the dividend payout ratio of 30%, there is no change in our policy of aiming for highly efficient management while utilizing share buybacks.

However, the root of "sustainable enhancement in corporate value" is, as always, profit growth. While securing shareholder returns capacity and accumulating capital, profit growth enabled us to maintain efficiency. What we most want to convey now is that we will realize highly efficient management by maintaining profit growth going forward at a rate similar to our track record. As seen in our newly announced dividend policy and the total payout ratio we increased ahead of time, we are reasonably confident we can achieve profit growth and there is no scenario in our new Management Policy where we do not achieve profit growth.

If the dividend payout ratio is 30%, we calculate that to pay the minimum dividend ¥200 per share , consolidated net profit would be around ¥960.0 billion. Conversely, if we maintain a dividend payout ratio of 30% with the FYE 2025 Management Plan of ¥880.0 billion, dividends per share would be ¥183. Going forward, if profit grows from ¥880.0 billion to ¥960.0 billion and dividends are set at ¥200, regardless of whether we call it a progressive dividend policy or not, the total payout amount will increase through share buybacks in consideration of the disclosed total payout ratio.

As of today, we will not offer a breakdown of the FYE 2025 core profit, as well as extraordinary gains and losses. As usual, however, there will be a buffer and extraordinary gains and losses for a certain level. The trends when we announced 3Q results are continuing, and we are making steady progress toward achieving ¥880.0 billion through organic growth in each segment, turnarounds in struggling businesses, and profit contributions from new growth investments.

Q: You have not disclosed your investment cash allocations in the past but have announced your investment plan for FYE 2025 with an upper limit of ¥1 trillion, and it feels like this announcement has made progress. Will you be able to build up ¥1 trillion in investments as expected based on the current business environment?

A: Between FYE 2022 and 2024, despite the uncertain business environment exemplified by the impact of COVID-19 and soaring resource prices, we recognized our accomplishment of establishing a ¥800.0 billion profit stage. On the other hand, it is also true that management felt a sense of wariness about consolidated net profit remaining flat at ¥800.0 billion level during the previous medium-term management plan. To establish an even higher profit stage in response to market expectations, we think we need to more actively pursue growth investments and therefore announced a hefty investment plan of ¥1 trillion. Unlike any other general trading companies, ITOCHU has a robust business foundation in the downstream field with such companies as ITOCHU Techno-Solutions Corporation (CTC), FamilyMart Co., Ltd. and DESCENTE LTD. We have raised our profit level by accurately assessing consumer and market data, and there will be no change in our policy of focusing on the downstream field going forward. In addition, ITOCHU's strength is its enhancement of business through hands-on management, and the Company will continue to approach engage investment targets where we can enhance corporate value through deep involvement on the front lines. During the previous medium-term management plan, we have conducted investments centered on increasing stakes in existing Group companies, such as CTC and DAIKEN Corporation (DAIKEN). But, to establish an even higher profit stage, we intend to also consider investments where we work with suppliers and partner companies in areas related to existing businesses where we can enhance corporate value by utilizing the Group's functions and expertise. However, we do not target investments only in downstream businesses and intend to continue investing in upstream and midstream businesses, which contribute to the growth of downstream businesses and respond to social demands. Given the existence of multiple pipelines, we think it is possible to build up ¥1 trillion in investments by carefully analyzing each project and moving forward with good candidates. We believe the 10% growth for consolidated net profit outlined in the FYE 2025 Management Plan is achievable through new investments as well as organic growth in existing businesses and turnarounds.

Q: Because you forecast 10% profit growth in FYE 2025 as well, I understand that it is your policy to aim for high profit growth going forward. EPS that accounts for share buybacks is forecast to grow more than 10% year on year, but is it possible to grow EPS around 10% from FYE 2026 onward?

A: The CAGR of consolidated net profit is important, or, in other words, the sustainable growth of EPS and BPS is crucial. Over the past decade, EPS has declined four times year on year, and this was due to share buybacks being relatively low and a slight decrease in consolidated net profit year on year. Even if operating results falter, it is important to raise EPS, which is value to shareholders as a unit per share. The significance of us committing to a total payout ratio of 40% or higher under the new Management Policy is to demonstrate the Company's stance of continually enhancing EPS and BPS over the long term.

Q: The investment plan of up to ¥1 trillion feels like an extremely ambitious management policy aimed at future growth. However, considering the current investment environment, including yen depreciation, I think there is a risk of overpaying for investments. Can we expect the projects in the pipeline to have a reasonable level of profitability?

A: We have not eased our investment discipline and will continue to diligently hold fast to the four lessons for investments going forward: Rigorously prevent 1) overpaying for investments; 2) investments aimed at seizing profit from investees; 3) overdependence on and overconfidence in partners; and 4) fields with limited insight. We will continue conducting detailed analyses of the profitability of each project as we have always done and will move forward with large-scale projects that have been carefully selected. In addition, without focusing on short-term profitability alone, we will continue considering investments from a medium- to long-term perspective, as well as projects that are in areas related to existing businesses pursuing synergy through investments that can be rolled out across the Group.

Q: Under the FYE 2025 Management Plan, you set the net debt-to-shareholders' equity ratio (NET DER) at less than 0.6 times, but could you tell me specifically what level would be allowable?

A: The NET DER is announced with special attention. Currently, it has fallen down to 0.5 times, and to maintain our financial policy over the medium- to long-term, it is important to maintain high ratings from credit rating agencies. In particular, considering we are entering a world with interest rates, we are focusing on diversifying fund procurement and must maintain high ratings. Although we assume that we will continue to accumulate stable operating cash flows going forward, because we announced the discontinuation of the medium-term management plan, our policy is not to secure positive core free cash flows after deducting shareholder returns during the cumulative period of the medium-term management plan but to look at single-year figures, and there could be positive or negative numbers depending on the fiscal year. Under the previous medium-term management plan, the ROE target was low, and we realize that the NET DER target was too high compared with the current result of 0.5 times level. Based on this, for interest-bearing debt control, we should invest within the scope of our earnings from a long-term perspective. At the very least, although we will make a major shift toward growth investments in FYE 2025, we believe that we will be able to manage within a level below 0.6 times based on the currently expected level of operating cash flows.

Q: Could you tell me about the level of investment over the next three years, including FYE 2026 and 2027, and the forecast for profit growth based on that level?

A: Because it is difficult to forecast medium- to long-term figures, we formulated our new Management Policy and the single-year management plan. We are eager to invest in FYE 2026 and 2027, but we will first dutifully complete our FYE 2025 Management Plan and then prepare a single-year management plan for next fiscal year. I am sorry I cannot provide specific numbers, but I hope you understand that we will continue striving to reach new heights as we achieve one goal after another.

Q: Could you tell me about your assessment of the global economy, especially the United States and China, for which assumptions have been made in the FYE 2025 Management Plan?

A: The economy is very hard to forecast. The IMF predicts the global economy will grow 3.1% in 2024, but the uncertainty is high due to the upcoming events such as the U.S. presidential election. The U.S. economy remains strong currently, but there is a feeling it could be overheating, and we will need to pay careful attention to the uncertainty of the impact if Trump is reelected as president. However, while it is true that it is difficult to forecast the future, we think that the U.S. economy will remain strong compared with other regions. China has set its growth target for 2024 at 5% as usual, but the outlook remains highly uncertain due to the protracted unfavorable conditions in the real estate market. However, we think that the Chinese government is also aware that economic recovery is extremely important and expect them to continue implementing macroeconomic measures, such as infrastructure investments, with the aim of achieving their growth target. Going forward, we expect the Chinese government to continue working hard to maintain a growth rate of around 5%.

Q: Could you tell me the key fields in the FYE 2025 Management Plan and the policy on growth strategies after increasing stakes in Group companies, including CTC and DAIKEN?

A: As for the key fields of the plan, we will first strive to maximize the synergy of investments conducted in FYE 2024. The digital value chain, centered on CTC, will be a profit pillar in FYE 2025. By investing to enhance upstream consulting functions and strengthening collaboration with companies forming the digital value chain, we will expand the functions we can offer and thereby further enhance our customer base. Regarding DAIKEN, we are promoting measures aimed at expanding business in the United States. When uncovering new potential investments, we intend to proactively acquire investments that can not only provide returns to investees but also create returns that include collaborative synergy and lead to the promotion of Group companies' growth strategies and the expansion of the Company's business fields. We will consider not just investments where we expect profit contributions within the same year we invested (FYE 2025) but also expanding the scope of investments where we expect profit contributions over the medium to long term.

Q: My understanding is that investment in FYE 2025 is capped at the high level of ¥1 trillion because of the surplus from the previous medium-term management plan. However, from FYE 2026 onward, will the free cash flows after deducting shareholder returns be the upper limit of investment surplus or will you maintain a similar level of investment as FYE 2025 by adding recovered funds through sales?

A: Under the Management Policy, we will not necessarily focus on achieving positive core free cash flows after shareholder returns for the single fiscal year. Regarding investment from FYE 2026 onward, that will depend on the status of the investment pipeline and the cash flows for the relevant fiscal year. Controlling interest-bearing debt will be even more important. And, of course, if we do not have enough core free cash flows after deducting shareholder returns, we will need to supplement investment funds with interest-bearing debt. It will be important to determine the amount of investment funds we can extract within the scope controlling interest-bearing debt.

Q: The phrase "progressive dividend policy" is erased from the Management Policy. But for example, do you have any intention that after increasing dividends per share to ¥210, you will lower dividends to the minimum of ¥200?

A: While it is a matter of concept and there are companies that establish maintaining the same amount as a "progressive dividend policy," more than the wording, because we set our policy as achieving the higher of 30% payout ratio or dividend ¥200 per share, we must first payout at least ¥200 in dividends per share. As explained earlier, the new Management Policy assumes profit growth going forward. Our shareholder returns policy is based on increasing dividends in line with profit growth. If dividends per share reach ¥210, based on the other condition of a dividend payout ratio of 30%, the profit level at that time would naturally have increased, it is currently hard to imagine that we will later on reduce dividends.

Q: To maintain an ROE of around 15% over the long term, are there any targets aiming to achieve a definitive amount of shareholders' equity, which is the denominator of ROE?

A: Regarding the long-term level of shareholders' equity, there are currently no targets for a definitive amount, and we will manage NET DER and other ratios. Currently, the Company's shareholders' equity is over ¥5 trillion, and we will certainly continue aiming to further expand shareholders' equity. The definitive amount of shareholders' equity is affected by the accumulation of profit as well as elements that cannot be controlled, such as currency exchange rates. For these reasons, it is difficult to set a target for a definitive amount, and we will continue building up shareholders' equity while being mindful of the level of our competitors who have larger shareholders' equity amounts.

Q: If the number of issued shares decreased due to further share buybacks, can we assume that the dividend per share of ¥200 will also change in response?

A: We set the dividend minimum at ¥200 per share, but, regarding shareholder returns, we do not expect to adjust the amount of dividends in response to changes in the total number of issued shares because we will continue to manage the total payout ratio and dividend payout ratio.