FY2016 Q&A Summary of Investors Meeting for ICT, General Products & Realty Co.

Presentation Date and Time: December 14, 2015 (Monday); 13:30 to 15:00

Attendees: Tomofumi Yoshida, President, ICT, General Products & Realty Company

Nobuyuki Kizukuri, Executive Vice President, ICT, General Products & Realty Company; Chief Operating Officer, Construction, Realty & Logistics Division

Nobuya Urashima, Chief Operating Officer, Forest Products & General Merchandise Division

Shunsuke Noda, Chief Operating Officer, ITC Division

Shuichi Kato, Chief Operating Officer, Financial & Insurance Business Division

Akira Tsuchihashi, Chief Financial Officer, ICT, General Products & Realty Company

Minoru Araki, General Manager, Planning & Administration Department of ITC, General Products & Realty Company

※ PS: PrimeSource, PEF: Private equity fund, BPO: Business process outsourcing, CAPEX: Capital expenditure

【Financial results and forecasts for FY2016 and beyond】

Q: Could you tell us about the performance of net profit after tax in the current fiscal year? It is believed that this segment can achieve 100 billion yen, excluding one-time profit and loss. What are your thoughts toward net profit after tax from the next fiscal year and on?

A: The original plan for net profit after tax has two parts, one part is 27 billion yen as a one-time profit and loss and the other part is 63 billion yen as an ordinary profit and loss. We already realized 33 billion yen as a one-time profit in the first half of the current fiscal and we estimate -3 billion yen as a one-time loss in the second half. Therefore, the total one-time profit and loss will be 30 billion yen in the current fiscal year. At this moment, we believe that we can achieve 90 billion yen, under a conservative view, and 100 billion yen being optimistic. We have realized capital gains in ordinary profits last 4 years, and we will aim for this style of business moving forward. Our core profit level is estimated to be around 60 billion yen, excluding unordinary profit. We will raise this level gradually and aim to achieve more capital gains in the future.

Q: What is the reason why this segment has raised the profit level for several years?

A: We don't have a particular reason, but we do believe that the CEO, Mr. Okafuji, has made the right decisions regarding the restructuring for this business segment. The message I tell the staff in our segment is that we will try to double our current profit in the same way we have done in the past 4 years. Fortunately, factors such as the commodity market and FX have affected our business positively.

【FY2017 organizational changes】

Q: Concerning to the FY2017 organizational changes, do give any considerations in terms of the personnel distribution?

A: I always give considerations toward this matter. The CEO, Mr. Okafuji, has been managing the organization as if it were an ameba, increasing the staff in profitable segments and decreasing them in non-profitable segments all at once. However this time the organizational changes were not made because there was a non-profitable situation in this segment.

【Investment/Cash Flow】

Q: What do you think about the time frame for creating added value through your business? From the perspective of investing, when can you add value to each business and how much can you add?

A: We have many investment businesses in our segment and our competitors are not only other trading companies but also PEFs. Normally, PEFs aim to achieve 20% return in 5 years. We have a different style than PEFs, such as using money toward CAPEX. Therefore, it is not easy for us to realize the same level of return as PEFs. However, it is necessary for us to be aware of their return level in in order to compete with them.

Q: At this moment, is it time for this segment or is it time to take a wait-and-see approach?

A: We have some limitation toward spending money in the current medium-term business plan. From the point of view of placing importance on cash flow management for the Company as whole, the framework for allotting money to each segment is rather small. Accordingly, we do not have much room to use funds in the next 3 years. But, our segment has already sold some assets, and now has space for using more money than other segments. We are looking for chances to acquire new assets in the future. The profit from the top 20–25 companies occupies over 90% of the total profit in this segment. Going forward, we will give priority to investments for CAPEX, or investments that give more strength to each existing business. Currently, we believe that investments in new business fields where we have little experience will be limited. We will instead invest more toward the roll-up strategy of each business, and we will also make investments to give additional functions to existing businesses.

【Segment/Each Business】

Q: With respect to investments and exits, what kind of business assets would be the subject of exits in the Forest Products & General Merchandise Division?

A: While we made several large investments, such as Kwik-Fit and METSA FIBRE, in the past 4 to 5 years, we also strengthened asset replacements, such as the sale of PS in the current fiscal year. We will continue to consider exits from existing businesses, such as businesses performing poorly in both of sales and procurement and businesses that have large debts.

Q: Could you tell us the reason why you sold PS? Also, what kind of new investments will you make with the money acquired by the exit from PS?

A: PS has taken over several competing companies, one after another, over the past 10 years and more. One of the factors behind the business success of PS was that PS had become the only company that can handle logistics of about 6,000 kinds of nails and screws. The business environment surrounding PS had been good until 2006. However, after that, the pace of increasing shops of retailors drastically declined, and requests to reduce sales price from retailors to suppliers became stronger. Under such circumstances, we have been seeking the opportunity to sell PS since around 2010. We would like to consider new investments following the sale of PS. But, taking into account the business environment in which PS was sold, we believe that it is currently not the time to make new investments in North America. We will keep a close watch on business conditions going forward.

Q: Could you tell us the current situation and future outlook for Kwik-Fit?

A: Currently, we realize about 5 billion yen of net profit as equity in earnings annually for Kwik-Fit, which has been supported by yen depreciation. However, we are not satisfied at the current net profit level of Kwik-Fit denominated in British pounds. We have finished shop renovation by using CAPEX and we have strengthened education of employees to improve the quality of services. Through these efforts, the business foundation of Kwik-Fit has greatly improved. However, the investment in Kwik-fit will not be regarded as a success unless we pursue further expansion of Kwik-Fit's earnings and aim for about 10 billion yen of net profit contribution from Kwik-Fit.

Q: Could you tell us the current situation regarding METSA FIBRE?

A: We are going to make new investments of about 23 billion yen in METSA FIBRE through capital increase and loans from shareholders. We have already carried our loans from shareholders to METSA FIBRE totaling 6.5 billion yen. While the current pulp prices for both hardwood pulp and softwood pulp cannot be regarded as stable, METSA FIBRE will have continuous competitive power. We think the investment in METSA FIBRE will meet our target of risk return.

Q: With respect to expansion of overseas operations in real estate businesses, would you tell us the current asset size in domestic and overseas businesses and the future plans for increasing assets?

A: The size of total assets of the Construction, Realty & Logistics Division is about 200 billion yen, including overseas assets of about 30 billion yen. My personal view as the Chief Operating Officer on the future size of assets of the Construction, Realty & Logistics Division would be about 300 billion yen, and 20–30% of the assets would be related to overseas. As the real estate markets are volatile from the global point of view, and the current markets are overheating, we have not yet set official numerical targets. As the real estate markets have a cycle of about 7 to 9 years, the timing of entry is important for investment in real estate businesses. We may make focused investments when the timing is good. We believe it is important to establish a value-chain or business model when making investments. We would like to vigorously seek opportunities to invest in projects where we can establish these structures. On the other hand, in the event that a project does not have value-chain or business model, we will keep cautious about making investments in such a project, and set a priority to build business models.

Q: Could you tell us the size of total assets and the composition of net profit in the Financial & Insurance Business Division? Also, would you tell us the current policy on Orient Corporation-related businesses and the current conditions for the ratio of net profit against investment capital?

A: The size of total assets in the Financial & Insurance Business Division is about 150 billion yen at present. The assets relating to financial retail businesses are about 100 billion yen, and net profit from financial retail businesses consists of almost 80–90% of the total net profit of the Division. Going forward, we would like to expand financial retail businesses, especially in Southeast Asian countries in which per capita GDP is around 3,000–5,000 USD. As for Orient Corporation-related businesses, while our equity share in Orient Corporation declined to about 16%, we will continue to pursue synergy businesses with Orient Corporation and make efforts to contribute to raising the corporate value of Orient Corporation. We invested about 100 billion yen in Orient Corporation. The amount of investment is almost the same as our total share in Orient Corporation's current corporate value as well as the amount of cash-in we have received so far. There is less possibility that we will recognize further impairment loss on Orient Corporation-related investments, as we have already recognized large amount of impairment losses in the past. While it may be more of a long-term perspective, we believe we can sufficiently recover our investments in Orient Corporation.

Q: What is the situation regarding the debt of financial businesses in emerging countries?

A: Basically, if the level of GDP per capita becomes 3,000 to 5,000 USD, it would represent the time to spend not only cash but also take on new loans for spending as well. We are thinking that we need to take a long-term approach to capture demand in areas where the middle class is increasing. United Finance Asia is doing well in Hong Kong, but the trend of bad debt from working capital loans for small- and medium-sized companies is increasing in mainland China. However, the existing type of small consumer loan businesses does not have that bad of debt. As such, we will focus our efforts on small consumer loan businesses once again. Regardless of the economic slowdown, Easy Buy in Thailand is performing steadily.

Q: How would the ICT division allocate profit and invested capital? How would investing in Bellsystem24 contribute to profit?

A: Roughly 40% of profit can be allocated to IT solutions, 30% can be allocated to mobile communications, and 20% or more can be allocated to media satellite BPO. The division has not carried out large investments in the past, and the investment in Bellsystem24 last year has been our largest investment. We have numerous Business-to-Consumer affiliate companies in the Itochu Group. By integrating each company's BPO, we recognize the investment in Bellsystem24 as an investment that can strategically produce added value in such ways as analyzing big data. In addition, we believe that startup investments are an important function of headquarters. Compared with other trading companies, we possess a high level of strength in startup investments.

Q: Could you tell us about any business collaborations with CP and CITIC?

A: Discussions are progressing, but we believe that any collaborations in new business fields should be carefully executed. For the time being, we are planning on establishing businesses that provide services to their existing business in the logistics and financial, insurance and real estate, and IT fields. We do not believe these businesses would become large investments.