FY2019 1st Half Financial Results Investors Meeting: 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: November 7, 2018 (Wed.) 13:30 to 15:00

Respondents: Masahiro Okafuji, Chairman & Chief Executive Officer; Yoshihisa Suzuki, President & Chief Operating Officer; Tsuyoshi Hachimura, Chief Financial Officer; Shunsuke Noda, Chief Strategy Officer; Mamoru Seki, General Manager, General Accounting Control Division; Hiroyuki Naka, General Manager, Corporate Planning & Administration Division

1. CITIC-Related Issues

Q. Given the impairment of CITIC investment, do you intend to amend your initial plans for investment in CITIC? Also, please tell us your future strategies for this investee.

A. Our original objective was to create businesses by employing the considerable amount of assets in CITIC's possession, with ITOCHU and CP working in collaboration. This objective remains unchanged. However, there were some critical issues that we had to resolve before tackling the main project. For example, we have had to reorganize existing businesses and contracts involving certain stakeholders. It took three years to clear up all such issues, but we were able to resolve most of them and are now in the final stages of this work. We expect that with the successful resolution of the last issue, we will be able to announce a project by the end of the current fiscal year. Thus, our silence to date about CITIC doesn't mean we have been just sitting by idly waiting for something to happen.

Q. How do you explain ITOCHU management's responsibility for CITIC's impairment loss? Hasn't this recent experience of impairment loss prompted you to reconsider ITOCHU's investment policy, for example, stop holding as the equity method investment?

A. At the time of investment, CITIC's stock price was higher than its book value; the price fall came later. While it is difficult to raise the stock price of a company with poor performance, we believe it is relatively less difficult to raise those of companies whose stock prices are stagnant despite good performance. As CITIC has the same view, CITIC is currently making serious efforts to raise its stock price. One of the objectives behind the collaboration between ITOCHU and CP to create business through the utilization of CITIC assets is to raise CITIC's stock price. Also, CITIC has provided ITOCHU with considerable support—we cannot tell you in detail at the moment—when we were tackling a variety of issues. In sum, we are acutely aware of innumerable benefits brought about by the alliance with CITIC. We believe CITIC's stock price will rise as a result of CITIC's efforts. If it is necessary to divest in the future, we can sell CITIC stock at that time.

Q. How do you plan to incorporate synergies with CITIC and thereby mitigate impairment risk in the future?

A. There are multiple candidates for synergy projects now in the pipeline, such as aircraft leasing and used car loan businesses. Some of these projects are slated for launch in the near future. In the trade business, we are involved in methionine exports in tandem with Sumitomo Chemical, with CP as the primary client. Furthermore, CITIC has announced the decision to build a BtoB and BtoC customer database, drawing on its relationships with banks, securities firms, McDonalds and others. CP, meanwhile, has a plan to establish a data exchange platform for use in partnership with external corporations, with its cell phone business functions serving as a core component. Once completed, the platforms may serve as strong tools supporting our expansion into China and elsewhere in Asia. We intend to mitigate impairment risk by generating cash through synergy projects and raising both dividends and stock prices.

2. FamilyMart UNY Holdings-Related Issues

Q. ITOCHU will invest in Don Quijote Holdings (Don Quijote HD) via FamilyMart UNY Holdings (FamilyMart UNY HD). Tell us about your future policy regarding collaboration with Don Quijote.

A. The aim of integrating UNY and FamilyMart was to acquire Circle K Sankus. Also, we wanted to revitalize UNY by adding a new type of business. We recognized the potential of Don Quijote HD at that time. When we set up joint management stores experimentally, sales at those stores doubled. The ownership of UNY is currently FamilyMart UNY HD 60% versus Don Quijote HD 40%. We decided to acquire 20% of Don Quijote HD through FamilyMart UNY HD and leave all of UNY to Don Quijote HD. We will incorporate Don Quijote HD as a group and establish new model encompassing CVS, GMS and retail. We also plan to expand overseas. What we have been working on UNY with the belief that we take responsibility if we undertake UNY should be evaluated.

Q. Could you elaborate on your future strategies for Don Quijote's food retail business? Also, what are you going to do to reinvent the FamilyMart business?

A. There are not many customers buying groceries at Don Quijote. Focusing on such fields as settlement services, we will work with Don Quijote and FamilyMart as we consider the creation of a novel type of store. The new businesses will be more than merely selling products; they will expand their scope to meet the customer needs by utilizing data gleaned via settlement and other operations. FamilyMart is attracting a great number of proposals, including those suggesting partnerships, as it is poised to embark on new businesses. Taking these circumstances into account, FamilyMart need to prudently examine these proposals and push ahead with their businesses, with an eye to securing their future growth.

3. Medium-Term Management Plan and Shareholder Returns

Q. Regarding the previously announced shareholder return policy, what is the trigger for executing share buybacks?

A. Our medium- to long-term shareholder return policy takes EPS into consideration, and it not only lays out steadily increasing profit throughout the course of a medium-term management plan as a prerequisite, it highlights the importance of also raising shareholder returns per share. In line with our growth strategies, we plan share buybacks as a way to raise EPS and thereby increase shareholder returns per share. However, with regard to our cash allocation policy, which we have held over from the previous medium-term management plan, we must be mindful to maintain positive free cash flows after deducting shareholder returns in order to maintain our credit rating, which was just upgraded, while understanding that stakeholders vary a great deal. Meanwhile, when the stock price decreases, it could be the timing for buybacks. Also, buybacks are a way to eliminate crossholdings with financial institutions. We will consider multiple factors.

Q. ITOCHU aims to maintain an ROE of 13% over the medium to long term, but how will the Company improve its asset efficiency?

A. The reason for upward revision of ROE forecast for the current fiscal year to 17.6% is due to profit growth, and maintaining 14% to 16% during the medium-term management plan is based on our intention to expand shareholders' equity. To maintain ROE at this level, we will put more emphasis on raising the ROA of individual segments than adjusting leverage. The ALM Committee and other organizations are conducting analyses at the segment and project levels to see if there are any low-efficiency assets that need to be replaced. To maintain high standards of efficiency, we strive to ensure optimal asset allocation throughout the Company and for each Division Company. This mindset is now shared throughout ITOCHU, as we have stated repeatedly for three years, so we want to maintain higher ROA, our strength, of close to 5% going forward.

4. Investment Policy and Growth Strategies

Q. The profit forecast for the current fiscal year is ¥500.0 billion. From the next fiscal year onward, what measures will ITOCHU take to achieve further growth?

A. How to maintain a ¥500.0 billion level of profit into fiscal 2020 and beyond is a major concern. Given the uncertainty surrounding the business environment, we think it is highly important that we first reestablish our footing by doubling down on our "earn, cut, prevent" principles. And, to achieve further profit growth, we think upgrading our current businesses/assets and reinvented business are the keys.

Q. What is the investment environment like and what are your investment policies going forward?

A. Assuming a large-scale investment, the current business environment is quite uncertain. Yet, we shall not make a sweeping judgment about whether the investment environment is good or bad but shall evaluate potential investees one by one. The medium-term management plan was devised to reflect the concept that it would be difficult to achieve future growth relying on conventional investments. We have already announced several investments that could upgrade existing businesses. Over the last 12 months, we have invested around ¥15.0 billion on the projects aiming at the next generation, and will continue to do so going forward. We regard this trend as important, but at the same time we will make a close investigation so as to prevent over-investment. From a cash flow point of view, we are thinking about investments in terms of the overall balance; therefore, making an extremely large investment is not our prerequisite.

Q. What specific measures will you take in the non-resource sector to sustain net profit at ¥500 billion going forward?

A. We will take such measures as leveraging agritech in the Dole business and, in the POCKETCARD-based finance business, we will add fintech knowhow, such as that of the payment start-up Paidy, to transform our conventional card business into something new.

Q. You've stated that you aim to reinvent all your businesses; what kind of initiatives are you thinking of for the Textile segment?

A. The Textile Company's strength is the fact that we own supply chains and brands. In our existing businesses, we will adopt e-commerce and make supply chains more transparent and efficient by using digital technologies.

5. Other Topics

Q. What is your policy for resource businesses? Also, as interest in ESG considerations increases, what are your thoughts about thermal coal?

A. We are not currently planning to aggressively increase our interests in thermal coal, but, we have a responsibility as a supplier and cannot simply pull out of the business immediately. We hope to seize any good opportunities related to coking coal that arise. We are also proactively making ESG investments, such as our recent investment in TBM, which manufactures and sells products made from a limestone-based plastics alternative.

Q. There are concerns in the market about China's economic outlook. What are your thoughts?

A. Although big changes are occurring in heavy industries, in food products and other areas of the consumer sector, what is really changing is the sales methods, not the actual "things" being sold. In China, many new stores that want to sell Japanese products are appearing, and so demand is extremely high. Also, among the wealthy in China, who are our targets in the consumer sector, we have not seen any signs of unease about the economic outlook; rather, they seem to be increasingly positive.

Q. How is ITOCHU's relationship with DESCENTE?

A. DESCENTE has fallen into crisis twice in the past, and both times ITOCHU and other companies bailed it out. We think that the company needs to rebuild its business in Japan while performance in South Korea remains strong, but ITOCHU, DESCENTE's top shareholder, has been unable to effectively take part in its management. We are also concerned about their lack of governance, a situation that was revealed when it turned out that the board member dispatched from ITOCHU was the only member who did not get any prior explanation of its business alliance with Wacoal.

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