Business Investment

Business Investment Process

Along with strategic business alliances, business investment is an important means of creating and expanding businesses. To actively promote strategic investments in areas of strength in a timely manner, we choose the optimal structure from a wide range of methods, such as establishing a wholly owned subsidiary, implementing joint investment with partners, and participating in management through M&As or converting to a consolidated subsidiary. As our investments have become larger and our growth investments have accumulated in recent years, we have been identifying various risks and thoroughly scrutinizing the appropriateness of business plans and acquisition prices, while our administrative divisions have been utilizing their expertise and cumulative know-how to conduct even more stringent inspections. After executing each investment, we work to maximize the investee's corporate value and to expand trading profits and dividends received by fully utilizing our Groupwide capabilities and conducting hands-on management. Also, to enhance business earnings and exit quickly from low-efficiency assets, we are further strengthening monitoring procedures centered on instituting more rigorous exit conditions and thoroughly implementing periodic business investment reviews. In addition, through cross-divisional internal training across Division Companies, we share the lessons learned from reviewing past investment failures, thereby endeavoring to enhance the success rates of future investments.

Investment Decisions

Decision-Making Process

We have established a multilayered decision-making process that achieves quick decision-making by giving a certain level of discretion to the Division Companies while striving to pursue investment return and curb investment risk.

Division Companies

- Applicants (responsible divisions)
- ↓
- Administrative divisions
- ↓ …Opinion based on risk analysis
- Division Company Management Committee (DMC) — Deliberation
- ↓
- Division Company President — Decision

Related administrative divisions express their opinions from various specialized perspectives regarding the application made by the applicants. Following careful discussion at the DMC, the Division Company President makes a final decision.

- ↓ Investment Consultative Committee*

If the project needs further consideration and screening in terms of profitability and strategy, the project is discussed at the Investment Consultative Committee prior to the HMC.

* The Investment Consultative Committee is chaired by the CFO, its vice-chairperson is the CSO, and its core members are the CAO, the CDO·CIO, and the General Managers of the Corporate Planning & Administration, Legal, General Accounting Control, Finance, and Global Risk Management divisions. Meetings are also attended by one full-time Audit & Supervisory Board Member.

- ↓ Headquarters Management Committee (HMC)

Projects that exceed the Division Company President's authority must be approved by the HMC.

- ↓ Board of Directors

Of the projects approved by the HMC, projects of quantitative and qualitative significance must be approved by the Board of Directors.

Points for Making Decisions

Investment Purpose and Formulation of Growth Strategies	Verification of Business Plan Appropriateness	Compliance with Investment Criteria	Risk Analysis	Verification of Internal Control Status	Setting Exit Conditions

Thoroughly Verifying Appropriateness of Business Plan
- Scrutinizing business plans before making a new investment (including sensitivity analysis)
- Concrete countermeasures for downward divergence from original plan (including setting of exit measures)

Investment Criteria
- Investment efficiency based on Net Present Value (NPV) calculated from investee's free cash flows: When calculating NPV, about 70 hurdle rates (by country) are used according to industry, taken into consideration of the Company's cost of capital (8%).
- Cash inflows into ITOCHU, such as dividends received and earnings from trade activities
- Scale of investee's earnings

ESG Risk Evaluation
- Evaluate in advance the impact on the environment, society, etc., as well as the corporate governance status of the investment target using an ESG checklist composed of 28 items
- Conduct multifaceted ESG assessments, including on-site surveys, to prevent environmental pollution and other problems among Group companies even following investment

Setting Exit Conditions
- Setting clear and feasible exit measures before making investment

Clear exit conditions:
Setting quantitative exit conditions that, in principle, call for exiting from the investment if conditions are met

Feasible exit measures:
Obtaining advance agreement with partners on exit conditions, etc.

▶ Page 60 Exit Criteria for Business Investment

Sharing the Lessons Learned

"Unforgettable" Training Based on Cases of Investment Failures
We internally share the lessons learned from analyzing past investment failures with the aim of increasing the strength and rigor of our measures to "prevent" unforeseen impairment losses and other negative consequences. In FYE 2023, we conducted five training sessions with specific examples, in which a large number of employees from business divisions and administrative divisions participated.
(▶ Page 60 The Four Lessons for Investments)

Asset Replacement

Promoting replacement of low-efficiency assets that meet exit criteria for business investment as well as businesses that have lost strategic significance
(▶ Page 64 Asset Replacement That Took Advantage of Changes in the Business Environment (Belong Inc.))

Control of Cash: Continuously focus on our policy to maintain positive core free cash flows after deducting shareholder returns

Measures after Investees Met Exit Criteria for Business Investment

We review our policies for holding business investments annually and carefully confirm the significance of holding them based on comprehensive consideration of the individual circumstances of each investment, industry characteristics, and other factors. We then implement asset replacement with respect to businesses that have low-efficiency, exit early from businesses that are significantly below targets set at the time of investment, and reduce / restructure the operations of loss-making companies.

After the review of policies for holding business investments, administrative divisions periodically monitor the implementation status of exits as well as improvement measures and provide support to ensure the implementation of measures in accordance with the policies.

	Business Investment to Be Exited	Business Investment to Be Held Continuously
Progress Follow-Up	Exit progress is monitored, and each Division Company reports on progress to the CFO monthly.	Improvement measures are advanced. At the periodic review for business investment in the following fiscal year, the progress of improvement plans is checked, and the holding policy is then carefully reanalyzed.

Decision-Making Process

HMC HMC approval is required if a Division Company's policy is continuing to hold a business investment that meets exit criteria for business investment. In conducting HMC deliberations, the ALM Committee* conducts prior deliberations on the appropriateness of the Division Company's retention policy and the possibility of exit implementation.

* The ALM (Asset Liability Management) Committee is chaired by the CFO, and its core members are the General Managers of the Corporate Planning & Administration, General Accounting Control, Finance, and Global Risk Management divisions. Meetings are also attended by one full-time Audit & Supervisory Board Member.

DMC After verifying the appropriateness of improvement plans for low-efficiency business investments that meet exit criteria for business investment, the significance of holding respective business investments is carefully analyzed in the context of the Division Company's strategies, and a decision on holding policy is made by the Division Company's President.

Investees Met Exit Criteria for Business Investment

▶ Page 60

Periodic Monitoring (Including periodic review for business investment)

In addition to conducting a review one year after investment, we conduct periodic review for all business investment annually to review policies from qualitative (strategic significance, etc.) and quantitative (profit scale, investment efficiency, etc.) perspectives. Also, we formulate improvement measures for group companies and affiliates with issues related to deficits or dividend payouts, and we follow up on the progress of such companies throughout the year.

Execution of Investment

Business Divisions / Administrative Divisions

Enhancing corporate value continuously through collaboration between business divisions and administrative divisions

Hands-On Management

After executing business investments, we dispatch personnel from our business divisions and administrative divisions to the frontline operations and key positions of investee companies. Through hands-on management that utilizes the individual capabilities of personnel, we enhance the corporate value of investee companies and create synergies that increase our comprehensive strength.
(▶ Page 68 Polishing and Further Expanding the Earnings Base of the North American Construction Materials Business through a Hands-on Management Style)

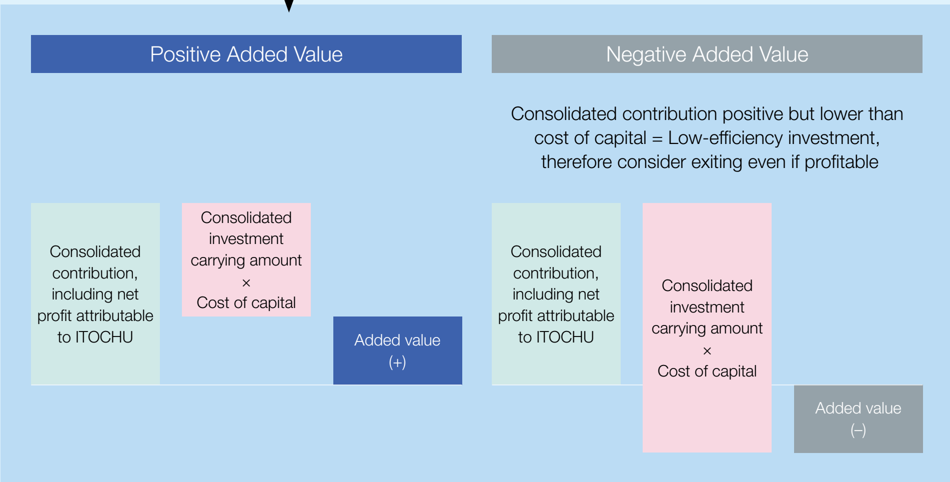
Exit Criteria for Business Investment

(1) Cumulative losses for the last three years

(2) Returns lower than original plans made at the time of investment

(3) Cumulative losses in added value for the last three years
[Consolidated contribution*1 – (Consolidated investment carrying amount x Cost of capital*2)]

*1 Consolidated contribution: The total of net profit and trade merit
*2 Cost of capital: Set according to industry (approximately 70) and country



The Four Lessons for Investments

ITOCHU has compiled the lessons learned from past investment failures as "the Four Lessons for Investments" and repeatedly shares the lesson through training sessions based on cases of investment failures and at various management meetings throughout the whole company. In this way, we ensure that the lessons are kept in mind when investment projects are being considered in frontline operations. "The Four Lessons for Investments" are as follows.

The Four Lessons for Investments (To Rigorously Prevent Below)

(1) Overpaying for investments	• Make investments at a low price to minimize future risk of impairment loss
(2) Investments aimed at seizing profit from investees	• Avoid shortsighted investments in a field or area with limited insight that only target current profit contributions
(3) Overdependence on and overconfidence in partners	• Do not engage in projects where ITOCHU must rely on partners or sales from the specific customers
(4) Lack of hands-on management	• Do not engage in projects where ITOCHU cannot seize management control or take the initiative

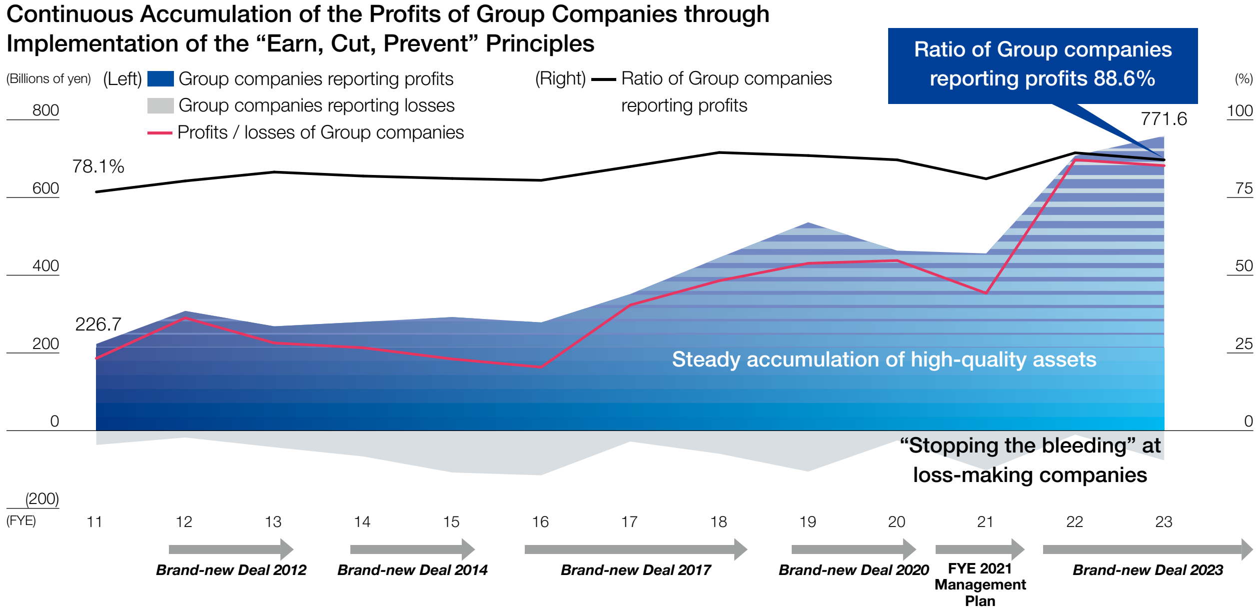
Training sessions based on cases of investment failures aim to understand the essence of past investment failures so that we avoid repeating the mistakes that led to them. The Global Risk Management Division prepares training materials based on interviews with relevant parties regarding the decision-making process at the time of investment and regarding discussions at the DMC*1 and the HMC*2. In FYE 2023, the training sessions included five specific examples, such as points to keep in mind in relation to projects purchased from investment funds or introduced by investment banks and examples of failures in overseas business investment. In the past, only mid-career employees participated in the training sessions. Beginning from FYE 2023, however, the scope was expanded to all employees, and a large number of employees participated in each training session. Through training sessions based on cases of investment failures, we will continue to utilize the lessons learned from the past in investment decisions and monitoring. In this way, we will strengthen and increase the rigor of measures that "prevent" the occurrence of unforeseen impairment losses, thereby heightening the success rate of investments.

*1 Division Company Management Committee
*2 Headquarters Management Committee

Enhancing the Corporate Value of Group Companies

ITOCHU enhances the corporate value of Group companies by rigorously implementing the "earn, cut, prevent" principles and strengthening monitoring, which is based on various types of assessments. For example, we steadily accumulate high-quality assets by conducting qualitative and quantitative verifications that consider synergies in assessing investment efficiency and the strategic significance and earnings scale of business investments. Moreover, in relation to concern over possible future losses, at an early stage, we evaluate investments and take appropriate measures by consistently applying conservative premises both for credit management and evaluations of the recoverability of various types of assets. Thanks to these activities, we have built a robust earnings base that is diversified across a wide range of business areas mainly in the non-resource sector. Even in an uncertain business environment, the ratio of Group companies reporting profits remains at the high level of approximately 90%.

Continuous Accumulation of the Profits of Group Companies through Implementation of the "Earn, Cut, Prevent" Principles



Group Companies Management Awards Program

ITOCHU has a Group Companies Management Awards Program that is aimed at invigorating the Group's management. The following is an overview of the awards for this program.

Best Management of the Year Award	Group companies (with profit from investees of ¥1.0 billion or more) that have achieved outstanding management results and helped enhance ITOCHU's consolidated financial results and the ITOCHU Group's value
Management Award	Group companies (with profit from investees of ¥0.2 billion or more) that have endeavored to improve management through market development, product or technology development, rationalization, and other measures to strengthen management efficiency
Chairman & CEO Special Award	Group companies that have realized noteworthy qualitative achievements

The criteria for selections include quantitative target achievement and year-on-year increase in profit from investees in relation to the "earn" principle as well as year-on-year improvement in the ratio of SG&A expenses to gross trading profit in relation to the "cut" principle, with Group companies required to satisfy multiple criteria.

Each Division Company nominates Group companies that satisfy both qualitative and quantitative criteria, and the final award winners are determined by the HMC. At the awards ceremony, prize money is also granted to the award-winning company to allow executives and employees of the companies to share in their joy and contribute to heighten their motivation.


The 37th Group Companies Management Awards ceremony