FY2017 3Q Online Financial Results Conference for Analysts: Q&A Summary

Date: February 3, 2017 (Fri.) 17:00 to 18:00

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1. Outlook for Fiscal 2017 Full-Year Results and Beyond

Q: The Company's financial results for the first nine months of fiscal 2017 were firm, with great progress being made. Moreover, there are no substantial factors raising concerns for the fourth quarter. Why didn't you upwardly revise your full-year forecasts?

A: Our business model is centered on steadily accumulating the profits of 306 operating companies. Our operating results would thus not be substantially affected by any single event. We therefore consider nurturing profit at each company to be of more pressing importance than upwardly revising our forecasts for quarterly results. Although the previous fiscal year's shortfall was the exception to the rule, ITOCHU has long maintained a policy of fully realizing its publically announced business plans. That's why we aren't inclined to revise our forecasts upward at this moment; we will not do so unless we are certain of actual results. Nevertheless, we believe that hitting our current net profit target of ¥350 billion is highly likely. We are looking forward to seeing how much further profit will rise during the fourth quarter.

Q: Can you outline the factors that will contribute to profit growth in the next fiscal year?

A: The Food Company will remain a strong profit driver in the next fiscal year. However, although the Dole business recovered somewhat in the fiscal year under review, it's not as robust as estimated at the time of investment. We expect this business to achieve continued profit growth in the next fiscal year. NIPPON ACCESS is expected to achieve a record-high profit, and we believe it has further growth potential. HYLIFE and Prima Meat Packers will be key profit contributors, as well. Moreover, we expect that the General Products & Realty Company and the ICT & Financial Business Company will be a strong profit driver, too. Specifically, ITOCHU Techno-Solutions (CTC) is expected to achieve profit growth thanks to the demand associated with capital expenditure in the smartphone, AI and IoT-related industries. This built on the record-high profit that CTC posted in the third quarter. In the financial field, we have taken steps to expand into such promising areas as FinTech. On the other hand, the Machinery Company was surrounded by harsh conditions due to the appreciation of the yen. We presently have some projects under discussion in this field and are hoping to see results going forward. Needless to say, we anticipate that business and capital alliances with the CP Group and the CITIC Group will produce synergies.

2. Free Cash Flows (FCF) and Shareholder Returns

Q: After the deduction of dividends, core FCF totaled nearly ¥140 billion for the first through third quarters. What is your approach to distributing cash surpluses?

A: We repay interest-bearing debt in line with basic policies of the medium-term management plan. These are designed to strengthen our financial position, placing utmost importance on the control of cash and deposits. Accordingly, when considering such distribution we take into account the need to achieve a balance between such factors as the level of our liquidity reserves, debt repayment schedules and NET DER. After deducting dividends, FCF will be appropriated for the repayment of debt. If there is FCF in excess, we will take a flexible approach to utilizing it. For example, we would consider purchasing treasury stock depending on stock prices. In fiscal 2018 and beyond, we will discuss how we can better reward our shareholders.

Q: As for dividend, what if full-year net profit exceeds ¥350 billion?

A: Our medium-term management plan's dividend policy remains unchanged. Dividends will increase in step with growth in net profit. If operating results permit, we will pay out more than the ¥55 minimum dividend guarantee set in accordance with our formula. However, as we have not revised our operating results forecasts, our dividend forecast remains unchanged.

Q: Could you provide us with the background to your actual FCF result, which looks prudent? How do you control investments? Are you going to maintain this policy beyond the next fiscal year?

A: In line with our current medium-term management plan, we are strongly committed to maintaining a policy of abstaining from new investments amounting to more than the total of actual operating cash flow (CF) and cash generated by withdrawal from investment projects. This policy also applies to collaborative projects with CITIC. No matter how few investment projects there are, we never relax this standard. Hurdle rates set specifically for each project must be cleared before those investments are greenlighted. We would not change this policy going forward. Meanwhile, we believe that executing investments with CITIC on a Companywide basis is key to creating synergies from the alliance. To that end, to secure sufficient funds for such investments, it is possible to accumulate a portion of the operating cash flow generated by each division company. However, we have not been considering taking on any major projects, such as a ¥100 billion investment. Looking ahead, we will maintain a strict control of FCF.

3. Resource Sector

Q: What is your analysis of factors contributing to the results of ITOCHU Minerals & Energy of Australia (IMEA)?

A: In coal-related assets, we recognized a one-time loss. Before our partners had done so, we had already set aside an allowance for this loss. With the impact of the hike in the hard coking coal price remaining insignificant, IMEA's overall operating results included profit growth of ¥9.1 billion. Of this, IMEA's coal business recorded a rise of ¥4 billion, which included ¥3 billion attributable to price-related factors. The iron ore business recorded growth of ¥5.3 billion, in part reflecting a ¥6.5 billion boost attributable to price-related factors.

Q: The business environment surrounding Drummond seems to be improving. Could you explain its profit status?

A: Although the acquisition price was a bit on the high side, Drummond has been a competitive project. Currently, this company is capable of shipping 3.5 million tons annually. Although we have yet to confirm whether or not it will be paying dividends at the end of fiscal year under review, we believe that it will be able to do so for the next fiscal year provided that coal prices remains stable. In fact, conditions surrounding this business have been improving.

4. Others

Q: NET DER has improved. Have you discussed the appropriate level of NET DER internally?

A: After discussing various factors, when the current medium-term management plan was established we set our NET DER target at 1.0 times. In line with the plan's policies aimed at strengthening our financial position, we have promoted CF management, thus generating considerable FCF. Accordingly, we anticipate that actual NET DER may even fall short of 1.0 times. On the other hand, we believe it is important to accumulate shareholders' equity and maintain robust ROE. Taking foreign currency translation adjustments into account, we will secure adequate shareholders' equity while keeping ROE at 13% or greater, a level of ROE that is typical of major global companies. We are confident that our robust ROE will enable us to differentiate ourselves from competitors. Our NET DER target will be subject to ongoing internal discussions that give due consideration to the balance between this indicator and the size of shareholders' equity.

Q: The ratio of Group companies reporting profits increased 3% to 83%. How did you decrease the ratio of subsidiaries reporting net losses?

A: We established extremely stringent exit criteria. Based on these criteria, we have undertaken the quarterly monitoring of companies reporting losses. We strictly applied these exit criteria from the past. Thanks to these efforts, the ratio of Group companies reporting profits rose to more than 80% from the previous level of around 70% over the past 10 years.

Q: Please tell us about internal discussions regarding upcoming changes in members of the board such as an appointment of additional outside directors? How would you assess the effectiveness of your management structure?

A: Management decisions at a trading company require knowledge of a wide range of business fields. Specifically, remaining apprised of what frontline salespersons say is essential. We therefore consider that simply increasing the number of outside directors while decreasing the number of in-house directors might raise other concerns. Going forward, we will review our rules for Board of Director operations while the discussion topics at the board meeting has changed into such as the formulation of medium- to long-term strategies and the assessment of the operating environment. We are confident that the effectiveness of our policy of separating business execution and management supervision will become more evident as we progress in these discussions.

Q: Could you tell us about personnel exchange with CP and CITIC?

A: ITOCHU and these two partners signed personnel exchange agreements in fiscal 2017. Plans call for initiating the exchange of mid-level employees in March 2017. We will continue this initiative while increasing the number of employees engaged in exchange programs.