FY2018 Financial Results and FY2019-2021 New Medium-Term Management Plan Presentation: Q&A Summary

This document is an English translation of a statement written initially in Japanese. The Japanese original should be considered as the primary version.

Date and time: May 8, 2018 (Tue.) 10:00 to 11:30

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. New Medium-Term Management Plan

Q: At the time of announcement of previous medium-term management plan, ITOCHU aimed to build a solid earnings base capable of generating ¥400.0 billion in annual consolidated net profit and set minimum guaranteed annual dividends over a three-fiscal year period. In contrast, the new medium-term management plan lacks such detail for the three-fiscal year period. Rather, it is noncommittal with regard to future performance. Why is that? Also, can you tell us what ITOCHU aims to achieve via this "Reinvented Business" basic policy? Why, for example, make FamilyMart UNY Holdings a subsidiary and partner with Rakuten?

A: The performance of general trading companies is often affected by immediate economic conditions, which may cause results to deviate, sometimes extremely, from forecasts. General trading companies therefore have made it a habit to carry out revisions of forecasts—upward or downward—based on the current economic situation.

Considering that, this time we have abstained from including clear numerical targets in this presentation of the three-year medium-term management plan, except those for fiscal 2019. We ask for your understanding of our steady track record of year-on-year profit and stock price growth, as well as enhancing overall corporate value.

Our previous medium-term management plans were formulated on the premise that our continued success largely depended on existing businesses. Under the new plan, however, showing the details of the future plans we are looking at might be detrimental to performance as the entire trading industry has entered an unprecedented new stage, and our competitors are, of course, working just as hard to outmaneuver us.

Counterparties to negotiate potential partnership are totally different from our existing business partners. Thus, we are being extremely vigilant against information leakage. In such situations, any tips about our future moves can rapidly go viral. As for the "Reinvented Business," we aren't quite ready yet to disclose many details. We decided to make FamilyMart UNY Holdings a subsidiary as we believe that it will prove to be an important asset in terms of expanding the ITOCHU Group value chain and enhancing corporate value. As for the partnership with Rakuten, a feasibility study is now under way at the Textile Company to develop a new business associated with apparel brands. However, we haven't yet decided to launch anything new. This topic is just one of numerous initiatives undertaken by each Division Company and is not representative of Group-wide strategies.

Q: Core profit doubled from ¥200.0 billion. However, why did ITOCHU retain its old dividend formula which was adopted seven years ago?

A: The uncertain business environment makes it more difficult to calculate the quantitative impact on performance. Considering this, we basically carried the previous financial strategy forward. Of course, we understand that the dividend payout ratio is a matter of great concern. On the other hand, we have succeeded in steadily raising dividends over the last three years, with minimum payment guarantees being set. We are confident that these efforts are well accepted by the market and helped us earn the market's trust.

We are also aware that tying your payout ratio to performance will result in reduction of dividends when profit goes down or falls short of target. We don't think this is the best way to reward our shareholders. Therefore, we remain committed to a policy of setting a minimum dividend guarantee that also leaves room for upward revisions based on performance. We believe that this is more attractive to shareholders.

The previous medium-term management plan included minimum dividend amounts for a period of three fiscal years. Although we found it difficult to quantitatively assess our performance in the second and third years of the new plan, we set fiscal 2019 minimum annual dividends at ¥74 per share. In addition, albeit qualitatively based, we clearly stated the target of record–high dividends each year. This means we guarantee minimum dividends and, whenever possible, will increase the payout.

Take into consideration the fact that ITOCHU has always accomplished its commitments; please take this as a promise to raise the dividend payout each year. We also stated more clearly than before our aim to flexibly carry out share buybacks to enhance shareholder returns while paying attention to surplus cash and stock price trends.

Q: The material describing the new medium-term management plan highlights some specifics regarding the “Reinvented Business” on page 11. Can you give us a bit more detail about how ITOCHU is going to differentiate itself from competitors?

A: Of course, let’s take the optimization of value chain for example. Needless to say, FamilyMart UNY Holdings will play a key role in this initiative and support ITOCHU’s distinctive strengths. Meanwhile, utilization of Agri-Tech from manufacturing to sales will be the key to enhance the Dole business value chain.

Regarding the “smart distribution system,” NIPPON ACCESS is taking the initiative, employing its network of 550 business bases and more than 10,000 trucks. Going forward, this logistics system also may serve users’ online shopping needs.

Also given the “next-generation mobility society,” the car-sharing business at YANASE is a big topic. And, with regard to next-generation businesses in the energy field, we are planning to employ ITOCHU ENEX’s energy trading platform to develop EV and rechargeable battery-related operations.

Q: What functions is ITOCHU able to provide to partners operating in different industries and venture startups? What do these partners expect ITOCHU to offer?

A: Well, consider Softbank. Although it has distinctive strengths in the IT fields, it is utilizing the functions and assessment capabilities of general trading companies in other fields. What our partners expect us to offer are distinctive functions that go beyond ordinary trading. For example, the recently announced acquisition of FamilyMart UNY Holdings, was based on a determination to seize growth opportunities generated by the advancing integration of online and offline services. It is rather a protective move. Also, in light of its relationship with NIPPON ACCESS, which was already our subsidiary, we concluded that in order to optimize the entire business structure, we’d be better off with FamilyMart UNY Holdings as a subsidiary. Going forward, we are looking to utilize freezing technologies possessed by NIPPON ACCESS to support not only the FamilyMart UNY Holdings business but other businesses as well.

Q: What is your ROE target?

A: Our medium- to long-term policy of achieving 13% or greater remains unchanged from the previous medium-term management plan. As stated on page 14 of the new medium-term management plan presentation, our quantitative plan for fiscal 2019 includes an ROE forecast of 15.9%, up 0.1 of a percentage point year on year. This forecast takes into account the expected impact of the acquisition of FamilyMart UNY Holdings and some asset-replacement. We are pretty confident that we will be able to maintain ROE at more than 13% over the course of the new medium-term management plan as thoroughgoing measures have been undertaken to enhance the efficiency of existing businesses. Moreover, the P/L balance outlook clearly shows a strong likelihood of organic growth thanks to the success of initiatives undertaken by each Company to boost profitability under the previous plan.

Q: Under the new medium-term management plan do you intend to undertake any major investments that would need a negative financial impact in the initial stages?

A: Currently, we have no such plan.

Q: Does your forecast for fiscal 2019 consolidated net profit take into account the impact of the “Reinvented Business” basic policy?

A: No, it’s not reflected in our forecast. Looking ahead, we will take time to work for the profit contribution from “Reinvented Business.”

Q: Page 10 of the material describing the new medium-term management plan outlines three basic policies, one of which, “Reinvented Business,” identifies three key initiatives. Can we rest assured that all of these initiatives will yield results within three years? Or is there any chance that it would materialize even in the first year of the plan?

A: The effect of the “Reinvented Business” basic policy is not specifically reflected in our operating performance forecasts for fiscal 2019. However, profit contribution from ITOCHU group companies is expected increasingly through further enhancing the value chain as a result of making FamilyMart UNY Holdings a subsidiary. However, our current forecasts do not encompass the quantitative impact of this basic policy.

2. Investment-Related Issues

Q: During the fourth quarter of fiscal 2018, ITOCHU made rather large number of investments. Is the Company leaning toward a more aggressive investment policy?

A: When we announced financial results for the third quarter of fiscal 2018, we revealed the robustness of our performance in terms of operating cash flows, we mentioned the possibility of engaging in more vigorous investment in the fourth quarter. However, this was not an indication of a radical shift in investment policy. Our stance remains unchanged; we will make investment and provide shareholders return within core operating cash flows.

As for fiscal 2019, we expect core operating cash flows to total approximately ¥500.0 billion. Of this, around ¥120.0 billion is earmarked for the acquisition of FamilyMart UNY, while roughly ¥120.0 billion is expected to be appropriated for the payment of dividends, with minimum annual dividends set at ¥74 per share. Therefore, we will have approximately ¥260.0 billion cash on hand. We will then estimate the funds necessary for sustainable CAPEX probably somewhere in the ¥100.0 to ¥150.0 billion range. Then, having sustainable CAPEX at, say, ¥125.0 billion, we will be able to consider investing the approximate balance of around ¥135.0 billion in cash in next-generation or existing businesses. However, even as we assiduously work on asset replacement, we will remain extremely prudent in our investment decisions. In addition, we will set aside funds for investing in next-generation businesses and new technologies, with the CSO being in charge of making decisions.

Q: Could you tell us why ITOCHU has switched to a takeover bid (TOB) midway through the acquisition of an additional equity stake in FamilyMart UNY Holdings?

A: Initially, we approached the acquisition of an additional FamilyMart UNY Holdings equity stake in a way that would not affect its position as an equity-method affiliate. With the intention of entrusting retail business professionals with that company’s day-to-day operations, as of February 2018 we were determined not to make it a subsidiary. To that end, we commissioned a securities company, acting as a discretionary agent, to purchase an equity stake from the market. However, amid the radically changing business environment surrounding ITOCHU, the Company’s management came to recognize the significance of acquiring FamilyMart UNY Holdings. In the course of discussing the new medium-term management plan, we became aware of its potential as part of an infrastructure serving a broad range of next-generation businesses. So, in late February we told the FamilyMart UNY Holdings management team our intention to make it into a subsidiary. As publicized by FamilyMart UNY Holdings, business is expected to steadily grow over the next three years. Considering the further growth through the cooperation of FamilyMart UNY Holdings and ITOCHU, the TOB purchase price of ¥11,000 per share is appropriate.

Q: Please share your projections regarding resource prices and policies for resource-related operations for fiscal 2019. Also, can you fill us in on the background for ITOCHU’s acquisition of an interest in Iraq’s West Qurna oil field? Does this acquisition demonstrate a change in the Company’s stance on the resource business?

A: As we have signed a confidential agreement with our partners, the assumed prices of iron ore and coal cannot be disclosed. All we can say is that our estimates are conservative, assuming prices that are lower than the current prices. We also maintain a conservative stance vis-à-vis for crude oil prices, assuming US$55 per barrel, which is lower than the current price. In addition, our policies for the resource business are unchanged.

Regarding our interest in West Qurna, we found it to be a low-risk investment with an extremely high productivity. We acquired it from Shell, and the operator is Exxon Mobil Corporation. Since Oil & Gas operations are depleting assets, we must always be aware of a need for replacement. Therefore, we stay committed to proactively replacing our assets in this field. Simultaneously, while we are determined not to increase our exposures in the resource business, we are aware of the fact that these assets can turn into contributors to profit and cash flows. An oil field in southern Sakhalin, which eventually grew into a significant profit generator, initially started out as an exploration project. With this in mind, we will keep an eye on some of these projects.

Q: Please share the results of reviews you've undertaken for some of the Company's past investment projects. Also, could you tell us about your plans regarding the extent of planned investment in "Reinvented Business" initiatives and how long it may take to generate profit?

A: As one example, having assessed the effect of investment associated with the merger involving C. I. TAKIRON, we concluded that such investment would yield significant synergies comparable to just acquiring another profitably operating company. In light of returns thus far, the additional acquisition of equity stakes in existing profitable businesses is the best investment choice. Our recent investment in FUJI OIL HOLDINGS and FamilyMart UNY Holdings are representative of this kind of success. We also see that additionally acquiring equity stakes supports steady growth in consolidated net profit as do thoroughgoing measures now under way to restructure unprofitable operating companies. Taking these factors into account, the ratio of Group companies reporting profits rose to 91%. For monitoring and reviewing the investments, we not only check with our investment and exit criteria, our management meetings set aside a time dedicated to investment reviews that provide closer inspection. As for "Reinvented Business" initiatives, we have yet to mention the size of investment, but we are convinced that we will need to yield substantial returns and synergies. We aim to nurture a business that more or less serves as a pillar of the Group, so timid investment doesn't make sense. We will, of course take into consideration how soon it can generate returns.

3. Other

Q: Please tell us about the synergies derived from collaboration with CITIC and the general status of operations in China.

A: Tomorrow, we will meet with Mr. Chang Zhenming, Chairman of CITIC, to discuss future collaboration. Accordingly, we ask you to wait a while for a more detailed explanation of relevant initiatives.

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