

FY2019 1H Online Financial Results Analyst Conference 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 2, 2018 (Fri.) 17:00 to 18:00
Respondents: Tsuyoshi Hachimura, Chief Financial Officer;
Mamoru Seki, General Manager, General Accounting Control Division

1. Results for the 1st Half of FY2019 and Forecasts for Full-Year Results (P/L related)

Q: ITOCHU recorded an impairment loss on its investment in CITIC Limited, a company it acquired about three years ago in FY2016. The consolidated book value at the time of acquisition was HK\$13.8 per share; after the impairment it is estimated at around the lower half of HK\$13 per share. Looking ahead, if no progress is made on generating synergies and the stock price stays within the current range, is there not a risk of further impairment losses?

A: When determining impairment losses, stock price is just one of the factors considered. Ultimately, losses are determined by investment recoverability, taking into account a variety of factors. In this instance, it is difficult for us alone to reverse the current stagnation of CITIC's stock price. Although the company's stock price is gradually rising, it is still relatively stagnant due to the impact of discounts on financial sector stocks in the Hong Kong market in addition to the very low liquidity of CITIC's stock.

Right now, CITIC is more aware of the stock price than ever before. CITIC is prioritizing impairments on resource-related assets and finance-related allowances to improve the soundness of its balance sheets. In addition, CITIC is conducting IR activities, which should help raise the stock price. Efforts to raise the stock price are exceedingly important, and on this point we are hopeful for CITIC. We would have no problem if the consolidated book value of CITIC does not rise; in other words, if the undistributed retained earnings of CITIC do not increase. Accordingly, we have been requesting that CITIC further raise its dividend payout ratio, which has since ticked upward. So far, it has climbed from around 20% to nearly 25%, but a baseline of around 30% to 40% would be ideal. As the payout ratio gradually rises, we think the difference between the rate at which CITIC's stock price rises and the rate at which its consolidated book value increases will become smaller. I personally think that we might be able to avoid risks related to stock price volatility.

Moreover, during Prime Minister Abe's visit to China last week, there was a meeting attended by China's Prime Minister Li Keqiang at which the offshore wind power generation project in Germany undertaken by ITOCHU and CITIC, a project that taps into the synergy between both companies, was introduced as an example of collaborative efforts between Japan and China. As for other synergistic projects, although currently we have publicly announced only the aforementioned project and Bosideng International Holdings Limited, the textile related project, there are actually many more in the pipeline. We think we need to continue steadily increasing the number of projects. Although we are not completely satisfied with the progress of synergistic projects to date, we think it should be seen rather positively that we did not rush into new expensive investments without careful consideration. It is important that, from among the many synergistic projects in the pipeline, we see through only those that meet our investment criteria.

Q: Can you tell us about the outlook for the Machinery Company and the progress it has made towards its goals? While the full-year net profit forecast has been unchanged at ¥6.0 billion, first quarter results were somewhat weak, and the level of progress has been low at YANASE in particular despite improving compared to the first quarter. Many companies have been affected by strained trade relations between the United States and China, so I'd like to confirm ITOCHU's

current position.

A: The main factors affecting YANASE were a decrease in new car sales and a worsening margin on used cars, resulting in a ¥0.4 billion loss attributable to ITOCHU in the first half. At the beginning of the year, the full-year forecast was ¥4.7 billion, but we have now lowered it to ¥2.6 billion. YANASE's business model is to maintain a certain level of inventory for sale. However, since its inventory had built up excessively, it focused on optimizing inventory levels in the first half and the efforts were almost complete at the end of September. In addition, because new models are slated for introduction in the second half, we can probably expect an increase in sales volume. Besides YANASE, the U.S.-based I-Power recorded extraordinary gains in the same period of the previous year but still maintained roughly the same level of core profit. Furthermore, this quarter, we disclosed results of MULTIQUIP for the first time. MULTIQUIP is a North American manufacturer and distributor of construction equipment and generators, business fields that are solidly established and thriving within the United States. We do not expect to see a major impact on results from the U.S.-China trade frictions, including the trade fields.

Regarding the first-half performance, in the automotive field, YANASE's showing was poor, but export-related businesses were firm, and other fields were solid overall. Still, achieving the forecast ¥63.0 billion, which would be a record high for the Machinery Company, could be somewhat tough. Balancing that out somewhat, though, is the forecast for the Metals & Minerals Company, which I think will be relatively easily achieved.

Q: While the Energy & Chemicals Company is making solid progress, Japan South Sakha Oil's ¥3.8 billion showing in the first half seems particularly strong. Could you tell us your forecasts for its net profit and the portion of its production volume attributable to ITOCHU? Also, what are the factors behind the increase from the same period of the previous fiscal year in ITOCHU's equity share?

A: ITOCHU invested in Japan South Sakha Oil from the exploration phase, and the company shifted to development and production starting in December 2016. It gradually began to generate profits, so we have decided to disclose its results. ITOCHU holds a 12.3% stake in the company, alongside partners Irkutsk Oil, INPEX, and Japan Oil, Gas and Metals National Corporation (JOGMEC). Production volumes are undisclosed, but we do not expect the project to quickly peak and taper off, but rather to constantly provide a certain level of revenue going forward. As for equity share, it has increased due not only to the contributions of Japan South Sakha Oil but also to the West Qurna Field, WIDP, and other projects.

Q: You increased the forecast of net profit attributable to ITOCHU from ¥450.0 billion to ¥500.0 billion. Of the ¥50.0 billion difference, if ¥20.0 billion is increases in the Metals & Minerals Company and Energy & Chemicals Company, what accounts for the other ¥30.0 billion?

A: We had conservatively forecasted a loss of ¥30.0 billion as a buffer in Others, Adjustments & Eliminations at the beginning of the fiscal year. Given the solid performance in the first half, we have deemed this buffer unnecessary.

2. Cash Flows, Investments and Shareholder Returns

Q: In the first half, excluding the investment in FamilyMart UNY Holdings, overall new investment was not that large. Given that you are planning to sell CEICO UK, which will provide a cash inflow in the second half, it seems that the core free cash flows will be considerably higher than the ¥140.0 billion plus forecast for the year. Please tell us your thoughts on the full-year cash flow forecasts.

A: While growth investments are necessary, over the last three years, we have maintained discipline with regard to investment. Furthermore, the CFO, myself, chairs the Investment Consultative Committee, which has earned a reputation within the Company of being very strict

in its evaluation of potential investments. However, we are currently looking at several promising opportunities. While maintaining positive core free cash flows after shareholder returns, as we have publicly committed to doing, and carefully considering how we will invest going forward, we will maintain a balance between investment and shareholder returns (dividends and share buybacks). Furthermore, with regard to FamilyMart UNY Holdings' acquisition of a 20% stake in Don Quijote Holdings and sale of 60% of UNY's shares, it may look at first glance like the outflows will be larger, but we will also take such steps as collecting on investment loans made to UNY's subsidiary, so we expect the amount of inflow to be about the same. As such, we expect core free cash flows to be strong.

Q: Please tell us about the impact on the consolidated balance sheet of making FamilyMart UNY Holdings a consolidated subsidiary, reorganizing the general merchandise store business, and investing in Don Quijote.

A: As they are listed companies, I will refrain from going into detail. Regarding the balance sheet, in the second half, there will be the investment in Don Quijote, but total assets will decrease in proportion to the sale of UNY shares, and FamilyMart UNY Holdings will make efforts as well, so we expect to see almost no impact on a consolidated basis.

Q: We would like to ask for more detail about your policy regarding core free cash flows. Will you carry out share buybacks if core free cash flows exceed the target for a single fiscal year? ITOCHU's ratings have already improved, but will you still maintain the policy of keeping core free cash flows positive going forward?

A: Under a policy of ensuring positive core free cash flows after shareholder returns for each fiscal year, we are controlling investments. We have explained our cash control measures to the ratings agencies, and our basic policy of balancing three factors, undertaking growth investment, enhancing shareholder returns and repaying interest-bearing debt, remains unchanged. We are not planning any further large-scale investments like CITIC, and we are carefully judging potential investments while advancing the reinvention of our business.

3. Other Topics

Q: What are the assumptions underlying the forecasts for the second half? Why does it state "Yes" in the first page of the statement of Consolidated Financial Results for the first half about a revision to the outlook of consolidated operating results announced most recently?

A: The Business Results Summary contains the assumptions for the forecasts for the full year and the results for the first half. It also describes our sensitivity to market fluctuations in the second half. Regarding the statement of Consolidated Financial Results, we revised revenue and profit items that had not been disclosed at the time of the net profit forecast revision announced October 1, but there has been no change in net profit attributable to ITOCHU.