

FY2019 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: May 8, 2019 (Wed.) 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 Digital & Information Officer; Hiroyuki Naka, General Manager, Corporate Planning & Administration Division; Tatsuya Izumi, General Manager, General Accounting Control Division

1. Profit/Loss Related (FY2019 Results, FY2020 Plan)

Q. Can you provide details on the ¥30.0 billion buffer and the ¥42.0 billion one-off profit included in the ¥500.0 billion consolidated net profit plan for fiscal 2020?

A. The fiscal 2020 consolidated net profit plan is actually ¥530.0 billion on a gross basis. The ¥42.0 billion in one-off profit includes profit from, for example, asset replacement by the General Products & Realty Company, etc. As we progress through fiscal 2020, if the ¥30.0 billion buffer becomes unnecessary, we could certainly end higher. Regarding the buffer, while we understand that there are various opinions, we recognize that the planned figures we announced for consolidated profit is a commitment and we have made our stance clear to the market that it is unacceptable to blame failure to meet targets on uncertainty in the business environment. For example, as for the original fiscal 2019 plan, we announced consolidated net profit of ¥450.0 billion, including a buffer of ¥30.0 billion. However, at the end of the first half of last fiscal year, it became clear that we could expect to surpass the target and the buffer became unnecessary, so we revised the figure upward to ¥500.0 billion. In addition, with the announcement of the fiscal 2020 plan, we considered setting the number at ¥500.0 billion not including uncertain factors of one-off profit or a buffer, but we concluded that it is more appropriate to disclose information that conveys the thought process to determine our plan. Net profit from all segments on gross basis was ¥530.0 billion and, as uncertainty is inevitable at this profit scale, we set a buffer of ¥30.0 billion.

Q. Please explain the fiscal 2019 one-off loss and the possibility of additional losses going forward in the North American IPP business.

A. The North American IPP project, where we recognized loss in fiscal 2019 is on the East Coast and the only project that does not have electric power sales contracts in our portfolio. It was a trial of new business but it did not go well, so we have recorded loss at a level that should avoid any additional future losses. We do not have any other IPP projects without electric power sales contracts, and we do not intend to take on any similar projects at this point in time.

Q. As iron ore price soars, if price volatility risks are hedged, I assume the likelihood of achieving targets will increase under the consolidated net profit plan of the Metals & Minerals Company. What do you think about the outlook for market prices and policies for responding to price volatility?

A. The Australian iron ore business faces currency exchange risk with the Australian dollar and iron ore price volatility risk. As for iron ore price, in response to progress over a 12-month period, we hedge appropriately with futures so that our biases do not get too big. The hedge ratio is not disclosed, but while we conduct hedges for a certain portion, we do not conduct hedges for the total amount. As

for currency exchange, right now the Australian dollar is weak. We are monitoring trends at our operation base in Perth and acquire forward exchange contracts in consultation with financial institutions. Our assumption is that iron ore price will gradually fall. The reasons that the net profit of the IMEA iron ore business is expected to increase year on year are due to the absence of one-off losses recognized in fiscal 2019 on account of the cyclone, a railroad derailment accident, and the change to an equity interest structure. Currently, supply and demand are very tight due to the collapse of the Vale Dam, but other suppliers are enhancing their systems to boost production. Chinese demand can be a wildcard and it was conceivable to forecast an upturn, but at this time, we have a very uncertain outlook. Taking into account that the volume of port inventories is not insignificant, we forecast a downturn.

Q. The scale of the pulp business now exceeds ¥20.0 billion. What are the assumptions in the fiscal 2020 plan and what do you think of the business environment over the next two or three years, including pulp market conditions?

A. I am not able to disclose specifics, but although there was a temporary drop in market prices for both hardwood and softwood pulps, which had been strong until 3Q of fiscal 2019, they are currently trending upward toward a recovery. However, the plan assumes prices will be around 10% lower than in fiscal 2019. METSA FIBRE is a particularly good project out of the large-scale investments made since fiscal 2011, and trades have been growing after a production increase in fiscal 2019. Production is still planned to increase going forward, so we think this field will still grow as we adeptly respond to the production increase. We are engaged in trade of, not just investments in, hardwood and softwood pulps, and there is no change in its position as a core business of the General Products & Realty Company.

2. Shareholder Returns, Investment Policy, and Growth Strategies

Q. The payout ratio over the medium to long term is targeted to be approximately 30%, but what do you think of the timeline to raise the ratio going forward?

A. In the medium to long term shareholder returns policy disclosed in October 2018, we announced that we would gradually raise the payout ratio to approximately 30% over the medium to long term and would conduct share buybacks totaling around 100 million shares. In fiscal 2019, the payout ratio was around 26%, but on total shareholder return ratio was about 40%. We will continue to gradually raise the payout ratio, but at the same time we will consider how much we return profit on total shareholder return basis. As for profit growth, although it might seem like we aren't growing much if you just look at the consolidated net profit plan of ¥500.0 billion, we want to clearly point out that we are growing on an EPS basis.

Q. After completing the buybacks of 100 million shares, can we still expect measures to ensure continual EPS growth despite of the possibility of profit fluctuation, such as additional share buybacks?

A. Previously we explained that there is the possibility that the buybacks of 100 million shares would be partially undertaken in the period of the next medium-term management plan, depending on the investment scale and the dividend payout. At present, it is difficult to explain the policy after this medium-term management plan. In line with the current EPS growth policy, we try to achieve EPS growth, even if we assume the ¥500.0 billion profit level continues, by executing share buybacks. But real EPS growth should mostly track profit growth. In addition, after completing the buybacks of 100

million shares, the number of shares issued and outstanding excluding treasury shares will be around 1.5 billion. Going forward, we aren't currently thinking about lowering it to, for example, around 1.2 billion, and we think it is important to continue raising our market capitalization. Accordingly, after completing the buybacks of 100 million shares, we aim to show growth by boosting profit and to raise the actual dividend payout amount. However, from an EPS growth perspective, if the plan has lower year-on-year profit, we would need to reconsider our shareholder returns policy.

- Q. Can you tell us about the fiscal 2020 investment policy and ITOCHU's eagerness to increase shareholder returns?
- A. In fiscal 2019, new investments totaled ¥500.0 billion, but we continuously have new investments in the pipeline. Everyone on the management team considers investment indispensable to continued profit growth. In fiscal 2020, we have cash to continue making growth investments, and we have asked everyone in the Company to submit an application when they have good projects. In addition, we have formulated an investment plan along with new management plan, and the total amount of potential projects in the pipeline exceeds ¥500.0 billion, the amount of new investments in fiscal 2019. Therefore we expect the total amount of new investments to be at least at the same level as last year, despite final net investment being dependent on exit scale. Regarding shareholder returns, we have already committed to ¥85/share minimum dividends in fiscal 2020 (about ¥130.0 billion) and approximately ¥60.0 billion of share buybacks is remained to be done out of ¥100.0 billion share buyback plan disclosed in February 2019. Accordingly, we expect to use ¥390.0 billion for net investments and additional shareholder returns, the leftover of the fiscal 2020 core operating cash flow plan of ¥580.0 billion after excluding dividends of ¥130.0 billion and share buybacks of ¥60.0 billion. In addition, as a general rule, we will continue to maintain the core free cash flows after deducting shareholder returns positive, but that does not mean we must not exceed the aforementioned ¥390.0 billion, and it is possible that we could use the surplus funds of ¥300.0 billion in core free cash flows after deducting shareholder returns from fiscal 2019. The dividends of ¥85/share are still just a minimum but there still remains share buybacks to be executed to realize the commitment of 100 billion share buybacks in medium to long term. Therefore, as for cash allocation, we will continue to maintain balance. Also, we abolished the previous dividend formula.
- Q. What is the significance of setting a total of ¥100.0 billion for reinventing businesses (next-generation growth investments of ¥70.0 billion and next-generation investments of ¥30.0 billion)? And what is the certainty of this execution? Will conventional investment criteria be used for these investments?
- A. The purpose of next-generation growth investments of ¥70.0 billion is for strategic transformation of start-up investments into business investments and cross-industry integration. Specifically, as each segment aim for further growth, we will switch start-up investments (Paidy, Dishangtie Car Rental, etc.) to business investments going forward so as to nurture these to our core businesses, and also we will grow the existing next-generation investments through striving cross-industry integration across the company. In addition, as for the next-generation investments of ¥30.0 billion, the investment decisions will be left up to the Chief Digital Officer (CDO). We will make start-up investments that will help us reinvent businesses and will invest in next-generation projects that encompass multiple segments in response to cross-industry integrations and structural changes to industries. I am not able to say for certain whether we will use all the investment funds in fiscal 2020, but the execution certainty is high. Regarding start-up investments, we have established criteria

different from general investments to Non-Affiliated Companies. Previously, the ICT & Financial Business Company mainly handled start-up investments, but from fiscal 2019, we switched our policy to handle it across the company and established systems to support it. The fiscal 2019 start-up investments were under ¥10.0 billion, and in the fiscal 2020 plan, we set aside another ¥10.0 billion. Regarding start-up investment, it is different from general investments to Non-Affiliated Companies as we aim to transform it into business investment in future. Therefore, we will continue to promote it in collaboration with the CFO, the committee chair of the Investment Consultative Committee.

Q. What amount of profit is set in the fiscal 2020 plan from next-generation businesses and what is its expected profit scale in fiscal 2021, the final year of the current medium-term management plan?

A. I will refrain from giving specific amounts, but as for investments which were already conducted to evolve existing businesses, you can rest assured that these have already contributed to earnings by looking at the fact that the profit level in the fiscal 2020 plan is not lower than before. From fiscal 2021 onward, we aim to disclose that information at the appropriate time since we intend to visualize the profit scale going forward.

Q. If we consider further growth from ¥500.0 billion in consolidated net profit and the promotion of collaboration with CITIC and the reinvented business, I assume the big steps will be required. But what timeline are you considering for growth going forward? In addition, it seems ITOCHU is promoting strategic transformation of start-up investments into business investments, but is it conceivable that ITOCHU will take a majority stake of start-up companies?

A. Although consolidated net profit grew to ¥500.0 billion due to the profit growth of existing businesses, reinventing our businesses is the key to further growth. Although it is necessary for us to make new growth investments and simultaneously evolve and expand the earnings scale of existing businesses of the seven Division Companies, it is incredibly important that we first firmly solidify our earnings base of ¥500.0 billion. In fiscal 2012 we achieved earnings of ¥300.0 billion, and it took another few years to reach ¥400.0 billion in fiscal 2018, and then we hit ¥500.0 billion in fiscal 2019. So we will first attempt to firmly solidify our earnings base of ¥500.0 billion and strive for further profit growth. As for turning a profit on next-generation businesses, we will aim to visualize it in fiscal 2021, the third year of our current medium-term management plan. Although we do already have some businesses that contribute to earnings to some degree, we think it is important to show in certain scale, so we aim to disclose it during the period of the current medium-term management plan. The plan is not to make large-scale growth investments. Our current goal is to clarify the profit scale during the period of the current medium-term management plan in light of the current investment plan of ¥100.0 billion. However, as we promote these initiatives, if we do make large-scale growth investments, the profit from those will be added.

Q. Going forward, in what fields and to what scale can we expect one-off profit from asset replacement?

A. We have not defined a specific field for divesting in line with asset replacement. We will individually determine divestment for each low-return or peaked-out business, and the scale of one-off profit will differ.

Q. As for the Textile Company, could you explain the growth strategy going forward, including DESCENTE business?

A. The fiscal 2020 consolidated net profit plan for the Textile Company is ¥33.0 billion (an all-time record high). We are promoting various initiatives to enhance existing businesses, and we expect further growth as we see signs of growth in line with our policy of reinventing businesses. We have made investments in JOOR (a US B-to-B marketplace) and LYCRA, which owns spandex (a stretchy polyurethane fabric), and we promote the solutions business that uses radio frequency identifier (RFID) tags. As for DESCENTE, we earned the trust of many shareholders and completed our tender offer without any problems, and we are very grateful for that. Now it is important that we contemplate how to further raise DESCENTE's corporate value going forward to meet stakeholder expectations. We will expand businesses in China and Japan in order to break away from the earnings structure reliant on South Korean businesses, and form a triple-pillar structure. We are actively taking measure to promote integration and, ahead of formal board member appointments, the new president Shuichi Koseki, the new senior managing executive officer Yozo Kubo, and the new CFO Akira Tsuchihashi have all already begun working at DESCENTE. We have held employee get-togethers and labor-management meetings, and we have got lively and positive opinions. We think we can achieve new growth while promoting integration with employees.

3. Chinese Economy and CITIC

Q. Can you explain your outlook on the Chinese macroeconomic environment going forward and the full-scale entry into the Chinese retail business?

A. Recently, there was a pivot from an excessive deleveraging policy to an economic stimulation policy such as investments in infrastructure, so we think the Chinese economy will remain stable. However, the situation could change dramatically given U.S. President Trump's talk about raising tariffs on China. We will carefully watch the development of U.S.-China trade tensions. We believe there is room for further growth in the retail business in China, but the issue is how to build a base of business, including FamilyMart. We are not currently at a stage where we can disclose specific investments and progress, so we ask for your patience.

Q. Can you give us an overview of the investments in medical care in collaboration with CITIC? And what progress has been made on realizing synergies with CITIC?

A. We invested in a medical fund in which CITIC Capital (a CITIC group company) participates. We plan to participate in medical-related businesses in China and decided to invest jointly in large privately run general hospitals in Beijing. The standard of living in Chinese cities has risen significantly and, as the population ages, we can expect a rise in medical-related demand. In addition, as the Chinese government proceeds with its policy of privatizing medical operations, we forecast demand for Japanese-style operations, services, and medical equipment. Previously, due to China's anticorruption activities, it was difficult to promote collaboration and therefore synergy projects were limited. However, the National Congress of the Communist Party of China enacted a policy of strengthening government-owned companies, and since then, the environment for promoting synergy projects has improved considerably. Currently, we are making progress on many such projects. At present, I am not able to mention specifics, but all segments are considering various projects. I can say that the environment is in place and progress on projects is accelerating.

Q. The share price of CITIC remains mired in resistance, so what do you think about additional impairment loss risks going forward?

A. Although it would be troublesome if the share price does not rise, determining impairment loss is not only based on share price alone. CITIC itself has sufficient future potential and solid financial results, so we are not currently worried about additional impairment losses.

4. Other

Q. What was the background leading to the establishment of an 8th Company? What is the significance and how does this strategy differ from the others?

A. At a management meeting in April 2019, we discussed how we can accelerate new progress. We agreed we needed something different than the existing 7 Division Companies and decided to establish an 8th Company. I think the other competitors have the same awareness of the challenges, but how we actualize it in response to that awareness is different. In our case, we focus on the frontlines and there is no change in our emphasis on the existing 7 Division Company structure, but we are establishing the new 8th Company from a different perspective. We will unite the human resources and assets of the B-to-C businesses scattered throughout the existing 7 Division Companies. By centralizing the B-to-C businesses, we will bring together the customers and related people associated with those businesses. We certainly expect to see something new and different from the existing vertical B-to-B perspective. Details will be announced in June 2019.

Q. What is the impact of change in the IFRS lease accounting standards?

A. Although we forecast an impact of over ¥1.0 trillion for both lease assets and liabilities, going forward, we need to conduct a meticulous analysis. The majority of the impact is due to making FamilyMart UNY Holdings a subsidiary. Accordingly, total assets are expected to increase more from the ¥10.0 trillion in fiscal 2019. There is no impact on net profit.