

## **FY2020 1st Half 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: November 6, 2019 (Wed.) 10:00 to 11:30  
Respondents: 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 and Shareholder Returns**

Q: With the macroeconomic environment worsening, please tell us about any areas you are particularly focusing on in the second half of the fiscal year, such as areas that are off course, the Food business which saw slow progress toward the full-year plan, or the situation of the businesses in China.

A: As for the U.S.-China trade frictions, our businesses have not been majorly affected so far, as the domestic demand in China has been firm. The softness in China is in such areas as automobiles and home electronics, and this has caused some weakness in our results. We have a wide range of businesses in the chemicals field, and present conditions in this field are mixed as, for example, home electronics-related businesses have been weak, while semiconductor-related businesses are recovering. There is a sense of gradual weakening overall, and those at the frontlines feel that the slowdown will be more pronounced next year. In North America, the building materials business, for example, is not expected to see a marked impact next year, as the housing market is firm. However, considering such factors as falling interest rates going forward, it is difficult to predict the business environment in 2021 and beyond. The pulp market, due in part to inventory adjustments, is expected to be soft until next year, but it may rebound after that.

Q: Please tell us your market assumptions for the second half of the fiscal year.

A: We have not changed our assumptions since we formulated the FY2020 management plan, so they are slightly conservative. When we drafted the plan, there were concerns that the U.S. FRB would raise interest rates, so we assumed a 3-month LIBOR rate of 3.2%. Since then, however, rates have been lowered. We cannot disclose our assumption about iron ore price, but it is true that higher prices in the first half of the fiscal year contributed to the strong performance of the Metals & Minerals Company. On the supply side of iron ore, in Brazil, mines where operations had been halted following the collapse of Vale's dam are coming back online, and supply from major mines in Australia is strong. Demand, meanwhile, is firm, as in China, infrastructure construction remains strong, despite inventory buildup at ports and a slight downturn in automobile sales. Given these circumstances, we think that iron ore supply will slightly outpace demand, and over time prices will decrease from where they are now. Our sensitivity to coal prices in the second half of the fiscal year is  $\pm$ ¥80 million, so any impact will be minimal, but we assume prices will be near their current level. The crude oil (Brent) price has fallen significantly from a year ago, from US\$75.4/BBL to US\$65.2/BBL, and we do not expect the market environment to shift greatly during the remainder of the fiscal year. Our initial sensitivity was  $\pm$ ¥580 million, but it has decreased to  $\pm$ ¥90 million, in part because hedges related to CIECO Azer have advanced faster than trading. The impact of crude oil price fluctuations going forward will thus be minimal. Pulp prices fell considerably in the first half, due in part to recoil from high prices in the previous fiscal year, and conditions going forward remain unpredictable. The reasons for the price downturn include seasonal factors, namely weak demand for paper in the summer, as well as worsening fundamentals, such as the U.S.-China trade friction, and increased pulp import costs in China due to the depreciation of the yuan. We expect pulp prices to remain severe in the second half of the fiscal year and beyond.

Q: You said that the ¥30.0 billion buffer for unexpected losses is still unused. While the buffer provides reassurance to markets, it may also dampen expectations of strong performance. As you implement commitment-based management, how will you handle market expectations?

A: Although the full-year forecast of ¥500.0 billion is unchanged, that does not mean that we are saying net profit will be no higher than that. As we move into the second half of the fiscal year, there are no major assets of concern, but we regard the management environment with tremendous caution, and we will continue to diligently consider how we should change our forecasts for the full year. At present, what I can say is that we feel bullish regarding the forecast of ¥500.0 billion, and we have not yet used the buffer.

Q: Please tell us your reasons for establishing The 8th Company, your policy for its operations, why its progress toward its full-year target in the first half of the fiscal year was so strong, and your forecast for it in the second half.

A: The 8th Company brings together businesses from across the Group that should be developed with a market-oriented perspective centering on the consumer sector. Consumer-facing group companies, such as FamilyMart, NIPPON ACCESS, ITOCHU LOGISTICS, and POCKET CARD are included in this Company, and (with the exception of FamilyMart) The 8th Company mutually holds interests in those companies with the seven existing Division Companies in order to develop businesses from a more market-oriented perspective. The main reason that The 8th Company showed strong progress toward its annual targets was the favorable performance of FamilyMart. The convenience store business often records strong profit in the first half, due to brisk ice cream and beverage sales in the summer. Extraordinary factors, such as decreased tax expenses due to group internal reorganization, also contributed. The 8th Company's first-half progress was thus as expected. In addition, while the Food Company's progress looks weaker than usual, this is due in part to the transfer of FamilyMart, with its concentration of profit in the first half, to The 8th Company. In the four months since the establishment of The 8th Company, it has received numerous inquiries from new customers and the customers of the existing seven Division Companies. In addition, we are now better able to handle projects and inquiries for which there was previously no clear contact point. Of the nearly 20 projects The 8th Company is currently advancing, about a third are related to FamilyMart. In addition to supporting initiatives to address the challenges that FamilyMart faces (24-hour operations, personnel shortages, food loss, settlements, etc.), by combining such initiatives, we aim to advance new business development (horizontally and with other companies). The remaining two-thirds of the projects are initiatives that are unrelated to FamilyMart and include business projects aimed at meeting consumer needs.

Q: CITIC made strong progress toward its annual net profit target in the first half of the fiscal year. What do you expect in the second half?

A: While the slowdown of China's macro economy is undeniable, as long as trade frictions do not intensify further, conditions are expected to bottom out, as the government has moved away from the deleveraging policies that had been a drag on the economy since last year, inventory adjustments of smartphones and other IT devices have ended, and the government is implementing economic stimulus measures, such as infrastructure investment expansion, monetary easing, and tax cuts. As for CITIC, its direct trade with the United States is minimal, and we expect only a slight impact on its performance. CITIC recorded a year-on-year increase in profit in the first half. Its financial segment did well, reflecting monetary easing. The rise in iron ore prices helped improve the profitability of Sino Iron, and the special steel business was strong. Overall, the company's performance is very strong. CITIC Limited does not disclose any annual results forecasts, however, so we are unable to comment on expectations for the full year.

Q: As of the end of October, there has been no progress on the share buybacks announced in June. What

are your current thoughts about ITOCHU's share price and the total payout ratio?

A: In October 2018, we announced the Medium- to Long-Term Shareholder Returns Policy. In this policy, we targeted total buybacks of approximately 100 million shares, and we have already repurchased about 65% of said shares, putting us ahead of schedule in terms of the acquisition period of around three years assumed when we announced the policy. In June, we announced buybacks of the remainder, up to 40 million shares for up to ¥70.0 billion, over a one-year period. I think that our share price, which reached its highest value ever in September, has been favorable for shareholders and investors. In the second half of the fiscal year and onward, our policy will be to steadily execute buybacks when conditions are right by carefully monitoring cash flows, as well as being conscious of the balance with dividends and growth investments and the steady increase of EPS.

## **2. Investment Policy and Growth Strategy**

Q: In the first half of the fiscal year, investment seems to have been mainly routine capital expenditure, with no notable major investments. Could you tell us anything about groundwork being laid for future growth, including progress in the retail business in China?

A: Our policy is to achieve growth going forward by first focusing on building a ¥500.0 billion earnings base. One of ITOCHU's strengths is its earning power in the non-resource sector, mainly in consumer-related business. We expect such companies as FamilyMart, NIPPON ACCESS, ITOCHU Techno-Solutions, and POCKET CARD to be our growth drivers for some time. In terms of groundwork for future growth, we are making next-generation investments in such domains as mobility, electricity, and reinforcing consumer value chains.

In mobility, we are paving the way forward with investments in such companies as Singulato Motors (an EV manufacturer) and Dishangtie Car Rental (Shenzhen) (fleet management of electric commercial vehicles) in China, which is at the cutting edge, as well as in Via (ride sharing) and KeepTruckin (a commercial vehicle operation platform) in the United States. We aim to work with automakers to take a leading role going forward.

In electricity, we have made storage batteries one of our main focuses and are working with our partner NF Corporation to market energy storage systems (ESSs). We aim to expand our market share by capturing demand of households with residential solar panels after the end of the feed-in tariff (FIT) system. We are also making investments aimed at constituting a virtual power plant (VPP) business, including investments in 24M Technologies (semisolid lithium-ion batteries) in the United States and PAND, which has a business relationship with BYD Auto in China in battery reuse. By doing so, we are working to develop the electricity value chain into a new earning pillar.

In retail, we are reinforcing our value chains centering on FamilyMart by adding new functions through digital transformation via the combination of functions provided by such companies as POCKET CARD and Paidy in settlements and FreakOut in digital marketing. So far, we have invested in a range of fields within selected domains. Going forward, however, in addition to creating synergies with existing businesses, we are considering increasing our stake in certain investees to make them into group companies as strategic businesses. Through the combination of these, we will generate earnings from next-generation investments.

Further enhancing the businesses of the existing seven Division Companies is also crucial. For example, in addition to the businesses of YANASE, the Machinery Company is engaged in geothermal power and energy-from-waste businesses and is working to develop environment-related businesses, including the water business, into future revenue sources. In the resource sector, as previously announced, we have decided not to acquire any new thermal coal mining businesses, but we aim to acquire high-quality resource interests in coking coal and LNG to expand our earnings base. In the Food Company, we have a collection of key group companies, such as Dole, ITOCHU-SHOKUHIN, and Prima Meat Packers. By further enhancing these, we will reinforce the earnings base. As for the retail business in China, it will be a little longer before we can reveal our plans, as we have to coordinate with our partners.

Q: Although you have designated next-generation investment as part of your growth strategy, new investment has been limited, and core free cash flows in the first half of the fiscal year rose all the way up to ¥200.0 billion. In light of the changing global economic outlook, what do you see as the scale of investment going forward?

A: The anticipated size of next-generation investment is, as announced in the FY2020 management plan, approximately ¥100.0 billion. We expect to invest in such areas as mobility, electricity, and reinforcing consumer value chains. The future profitability of new businesses in such areas is often difficult to foresee, and given the uncertainty in the global economy and softness of the IPO market, our investments so far have been small. Going forward, we will carefully examine the business viability of investees, and we may make decisive investments in companies that have the potential to grow into core ITOCHU business, including raising our equity stake in them to make them into group companies. For the time being, we are in a phase of avoiding sporadic, wide-ranging investments; carefully examining our investments so far; and preparing for major action down the line.

Q: You said that the ICT & Financial business will be important, but could you tell us what specific areas you are focusing on? For example, with services like PayPay and Line Pay, several companies are pouring capital into the contest for dominance in settlements. What is ITOCHU's strategy, and how do you intend to compete and achieve differentiation?

A: Strengthening our retail value chains centering on FamilyMart is key. We are working to do so by adding a range of functions, such as digital marketing and new settlement methods. For example, POCKET CARD generates adequate revenue on its own through its core card business, but it is also providing such functions as Famima T Cards for FamilyMart, and it may be able to provide deferred payment and other functions in the future. We are placing priority on allowing companies to steadily turn a profit from their own existing businesses while also adding ICT and financial functions to ITOCHU's value chains. The assets we have are different from those of an internet-based company, so we see such companies not as competitors, but as potential collaborators. In addition to the ICT & Financial business, by combining the functions of the logistics of NIPPON ACCESS, or the ITOCHU Group's brick-and-mortar stores, we hope to achieve further growth in collaboration with internet-based companies.

Q: Does that mean that you are aiming to use the data from these businesses by, for example, collaborating with internet-based companies, and not aiming to claim the dominant position in settlements?

A: POCKET CARD, for example, is not working to secure its own members and expand its own customer base through settlements and loyalty point businesses, like Rakuten. Its role is to complement and expand functions within our portfolio.

Q: You have made progress on next-generation investment, but when do you expect to start seeing returns?

A: The timing depends on the project. Investments in very early-stage start-ups take time to begin generating profits, but the functions that such companies create may indirectly exert a positive effect on existing businesses. On the other hand, late-stage investments may turn a profit within a year or two. Furthermore, there are likely some investments where we can decide to strategically turn them into our business this year and next, with the expectation of receiving profits from the coming fiscal year. We are not investing with the aim of achieving profitability in five years.

### **3. Other**

Q: Please tell us your approach to parent-subsidiary listings. Do you plan to increase the number of listed subsidiaries? Is there a chance of making any into wholly owned subsidiaries?

A: While we believe in the need to build appropriate capital relationships in light of our business

together, there is a need to safeguard the independence of listed subsidiaries. Based on ITOCHU's policy on the governance of its listed subsidiaries announced in October, we will handle each case according to the specific circumstances of the company in question.

Q: After ITOCHU-SHOKUHIN bought shares of Prima Meat Packers, Prima Meat Packers put out a release to the effect that ITOCHU had become its parent company. Please tell us what led to this acquisition, including your strategy in the meat field going forward.

A: This acquisition was part of the strategy of ITOCHU-SHOKUHIN, which is an independent listed company. What I heard is that, while ITOCHU-SHOKUHIN already had strengths in alcoholic beverages and gift-related products, they decided to make the acquisition based on a strategy of working with Prima Meat Packers to move further into delicatessen products, as well. As a result of the acquisition, we expect Prima Meat Packers to become a subsidiary of ITOCHU based on IFRS, following the necessary internal approvals. The related procedures are scheduled to be completed in mid-November, and we will disclose the outcome in our quarterly financial reporting and elsewhere.