FY2020 Q4 Financial Results Analyst Conference: Q&A Summary

Date: May 8, 2020 (Fri.) 16:00 to 17:00
Respondents: Yoshihisa Suzuki, President & Chief Operating Officer
Tsuyoshi Hachimura, Chief Financial Officer

1. P/L Related, Shareholder Returns, and the Impact of the Novel Coronavirus Pandemic

Q: In line with its Medium- to Long-Term Shareholder Returns Policy, ITOCHU clarified that it targets a dividend payout ratio up to approximately 30%. On the other hand, ITOCHU forecasts that it will attain a dividend payout ratio of approximately 33% under its FY2021 business plan. Please explain ITOCHU's current stance on shareholder returns.

A: As part of initiatives under our Medium- to Long-Term Shareholder Returns Policy, we have accelerated our schedule for share repurchases while placing the utmost focus on incrementally increasing cash dividends. Although we have positioned FY2021 as a year in which we place special emphasis on solidifying our foundation, we have also prioritized increasing cash dividends rather than achieving the targeted dividend payout ratio. After carefully examining the amount of surplus that can be distributed as shareholder returns for FY2021, we have decided to pay full-year dividends of ¥88 per share, up ¥3 from FY2020.

With regard to share repurchases, we have been adhering to a goal of acquiring approximately 100,000,000 shares of treasury stock over the medium- to long-term and, to this end, steadily completed the first and second rounds of share repurchases ahead of schedule. We also passed a resolution at a Board of Directors meeting in June 2019 to launch the third and final round of share repurchases aimed at acquiring up to 40,000,000 shares or expending up to ¥70.0 billion. To comply with insider trading regulations, a securities firm will carry out these repurchases under a discretionary agency contract. At the same time, we strive to remain flexible in repurchases and, to this end, place multiple repurchase orders so the firm can conduct repurchases in phases. Due to ITOCHU's robust share price, which hit record highs on multiple occasions in FY2020, and such regulations as those prohibiting the placement of repurchase orders in possession of insider information, we have not yet been able to acquire as many shares as expected although we have little time left before the expiration of the repurchase period. However, in line with our policy of swiftly executing measures that we publicly announce to the market, we will prioritize the increase of cash dividends in FY2021 while first progressing the share buybacks of ¥70.0 billion, as part of our efforts to enhance shareholder returns with an eye to securing medium- to long-term growth in EPS.

A great number of companies now have the policy to increase cash on hand for liquidity. On the other hand, we see a number of investee candidates in the fields of our strength, which are becoming attractive in terms of valuation. With this in mind, we intend to keep ourselves flexible in respect to investment activities as we look forward to securing opportunities that may arise following the containment of the novel coronavirus. Our medium- to long-term policy of securing positive Core Free Cash Flows (FCF) after deducting shareholder returns remains unchanged. Simultaneously, our balance sheet management approach is, as it was in FY2020, focused on employing longer perspectives than a single fiscal year. We aim to maintain ITOCHU's rating at "A" or higher. To this end, we will stay conscious of investment trends and changes in the operating environment.

Q: What are your policies for your shareholder returns initiatives including the next medium-term management plan for FY2022 and beyond, aiming at raising EPS and achieving even higher ROE?

A: It is currently nearly impossible to assess the future impact of the novel coronavirus pandemic on our business activities. Accordingly, we are not yet in a position to announce our commitments with regard to what we aim to achieve under the next medium-term management plan. However, we can presently declare our determination to achieve EPS growth, mainly by securing future profit growth, rather than by simply repurchasing treasury stock. We must therefore undertake growth investment going forward. While we still retain flexibility in our funds despite the pandemic's impact on the economic environment, we must be conscious of maintaining "A" ratings or higher and, to this end, employ a balanced approach. It is also important to control our shareholders' equity ratio and risk asset ratio. We must take these factors into account to optimize our policy for ROE. Honestly, we think that maintaining our ROE at 17%, unchanged from FY2020, could prove difficult, but we are strongly determined to maintain ROE at 13% or higher in the medium- to long-term.

Q: To date, ITOCHU has made progress in its efforts to improve efficiency by practicing the "earn, cut, prevent" principles. Having embarked on FY2021, ITOCHU announced its intention to double down on these principles. What positive effects do you expect via the thoroughgoing practice of these principles?

A: Amid the current economic environment, businesses are more prone than ever to encounter such problems as bad debts and excessive inventories. Therefore, the practice of the "prevent" principle is a matter of crucial importance. With regard to practicing the "cut" principle, we believe that various expenses, even those that to the present have been regarded as matter of course, should be reviewed with a fresh eye because we may find additional room for cost reduction. From the perspective of the "earn" principle, in light of the aforementioned environment, we must ensure we maintain revenue and profit levels despite the impact of any negative factors.

Q: How did you factor in the impact of the novel coronavirus pandemic in the course of formulating ITOCHU's FY2021 Management Plan?

A: We formulated the FY2021 Management Plan based on the assumptions that the impact of the pandemic would be major in the first quarter, become somewhat milder in the second quarter, and in the second half that we will see prospects for recovery to some extent. We have assumed the negative impact of the pandemic on our net profit in each Division Company, and the sum of those amounts comes to around 10% of our target of ¥400.0 billion. Furthermore, we have set a loss buffer of ¥50.0 billion by adopting an even more conservative approach. In total, we have anticipated a 20% to 25% negative impact on our profit. In addition, we took a conservative approach in setting the assumption of resource-related commodity prices.

Q: The FY2021 plan for the consumer-related sector, especially the Food Company and General Products & Realty Company, seems to be bullish. What are your thoughts behind the plan for these segments?

A: First of all, we would like to refrain from disclosing the breakdown of expected extraordinary gains and losses in FY2021, including those attributable to asset replacement, as these factors involve negotiations. We ask for your understanding in this matter.

As for the Food Company, we expect it to achieve an improvement in Dole, which experienced stagnation in FY2020, as well as profit growth from Hylife and other livestock-related businesses. With regard to the General Products & Realty Company, we are refraining from disclosing our forecasts on sub-segment net profit and operating results for some group companies, as we are not yet adequately positioned to accurately assess the impact of the novel coronavirus pandemic. However, despite the negative impact of the pandemic, we expect to see gradual recovery in such businesses as European Tyre Enterprise Limited and the North American construction materials business. We will also benefit from the absence of the impairment loss in Japan Brazil Paper & Pulp Resources Development Co., Ltd recorded in FY2020.

Q: Can we rest assured that ITOCHU is not encountering fundraising issues despite the impact of the novel coronavirus pandemic on the economic environment?

A: That is correct. We have no problems in raising funds. Moreover, we have a program in place aimed at enabling ITOCHU to extend emergency funds to some of its Group companies.

2. Investment Policy and Growth Strategy Related

Q: While pursuing medium- and long-term growth in corporate value, ITOCHU steadily accumulated Core FCFs after deducting Shareholder Returns during FY2019 and FY2020. This resulted in more than ¥420.0 billion. With an eye to securing opportunities in the post pandemic period, in FY2021, what factors will you focus on in terms of cash allocation?

A: If we meet an investment opportunity that would help us further strengthen our position in the consumer-related sector, where ITOCHU already boasts competitive advantage, we may ultimately greenlight an attractive investment despite the currently disadvantageous investment environment. However, amid the circumstances with the novel coronavirus in FY2021, we will place the utmost priority on maintaining our existing capacity to secure profit. Throughout FY2021, we will therefore take a defensive stance while doubling down on practicing the “cut” and “prevent” principles. That being said, we also believe that a simple insistence on “defense” is a recipe for failure. Aligning our business approach with changing circumstances is another matter of high importance. Today, it is anticipated that the novel coronavirus pandemic will trigger changes in a broad range of fields. Matters affected by these changes are expected to range from people’s lifestyles and medical practices to educational outlets and payment methods. Accordingly, our value chains in the consumer-related sector must adapt to these changes. For example, as part of initiatives to promote a transition from face-to-face marketing to online commerce, we will accelerate the ongoing digitalization of operations related to FamilyMart, NIPPON ACCESS, and other Group companies. In addition, the textile industry is thought to be another sector affected by these changes. As we expect that mainstream apparel marketing outlets will shift from face-to-face sales at physical shops to online sales going forward, we will help EDWIN, JOI’X and other brands be more responsive through online marketing utilizing precedents in China.

3. Other

Q: Recently, CITIC Limited announced a change in president. Could you elaborate on the factors leading to this change and its possible impact on ITOCHU’s strategy related to collaboration with CITIC?

A: We had been aware of a possible change in president, and now CITIC has appointed a highly reliable business leader as successor. He previously served as a vice president of the People’s Bank of China. Our expectations are high for this incoming president. In addition, this change does not affect our strategy with regard to collaboration with CITIC and the Chinese retail business as a whole. Looking ahead, we will push ahead with ongoing collaboration involving two partners, including CITIC and CP, in adherence to the medium- to long-term perspective.