FY2021 Q1 Financial Results Online Analyst Conference: Q&A Summary

Date: August 5, 2020 (Wed.) 16:00 to 17:15
Respondents: Tsuyoshi Hachimura, Chief Financial Officer
Tatsuya Izumi, General Manager of General Accounting Control Division

1. P/L Related (First Quarter Results and Full-Year Performance Forecasts)

Q: Please explain the operational status of each Company in light of the fallout from the COVID-19 pandemic as well as its future outlook.

A: In a portion of the consumer sector, we have seen the resumption of economic activities which has, in turn, contributed to an upturn in customer traffic since June. With this in mind, we expect the overall consumer sector to somewhat regain vitality in the second half. On the other hand, the apparel sector, which is handled by the Textile Company, may confront serious repercussions throughout the fiscal year due to changes in consumer behavior despite the relaxation of pandemic-related restrictions. In the Machinery Company, performance remains sluggish in automobile exports and the overseas dealer business. Although it expects to see an improvement thanks to cost reduction initiatives undertaken by YANASE, domestic businesses are also facing an extremely harsh business environment. Moreover, while FamilyMart stores have seen a rise in spending per customer after the state of emergency was lifted, they have yet to see an uptick in customer traffic and daily sales. We suspect that the performance of FamilyMart is hindered by structural problems, such as those related to lineups and costs, in addition to store location issues. Besides, we need to be aware of the possibility that, even if FamilyMart met its announced target of ¥60.0 billion buoyed by such factors as one-off gains, earnings attributable to ITOCHU after consolidation adjustments may not be as robust as they are on a FamilyMart standalone basis. However, the Group companies in Metals & Minerals, Chemicals, and ICT segments performed solidly and have been able to counter the negative impact of the pandemic. Despite these factors, we believe that we don’t need to revise the breakdown of our initial plan of ¥400.0 billion.

Q: You have named ITOCHU’s cost reduction initiatives as one of the factors contributing to its robust results for the first quarter. Please describe the details of such initiatives.

A: All Group companies have reviewed expenses, including travel and social expenses, in a steadfast and meticulous manner to secure profitability or expand earnings. These efforts helped us yield solid results. Moreover, government-led emergency economic measures executed in some countries benefitted our performance somewhat.

Q: Please provide the outline of ITOCHU’s profit plan for the first quarter. In addition, do you expect ITOCHU’s cost reduction efforts will provide ongoing support for performance in the second quarter and beyond as these efforts served as a major positive factor affecting first quarter results?

A: Although we planned for first quarter earnings of around ¥70.0 billion, the actual results amounted to ¥104.8 billion. At the time our FY2021 business plan was formulated, we assumed that ITOCHU’s operating results for the first quarter would be significantly affected by the pandemic. At the same time, we assumed that in the second quarter, the impact of the pandemic would become somewhat milder and, in the second half, we would be positioned to perform an assessment of the approximate magnitude of the pandemic’s impact; however, economic activities will not soon regain the vitality last seen in FY2020. In light of these assumptions, we forecasted that we would not see a significant upturn in profit until the second half. Considering this projection, our performance in the first quarter has been pretty stable. Taking a look at how cost reductions contributed to our performance, we are not currently positioned to quantitatively asses the effect of such initiatives. For example, the ultimate amount of the reduction in travel expenses may be significantly affected by the status of movement and travel bans enforced in each country. In sum, the effect of cost reductions is contingent upon circumstances related to the COVID-19 pandemic. Nevertheless, we are determined to continuously implement cost reductions to achieve our target of ¥400.0 billion.

Q: Q1 operating results included ¥5.3 billion profit for the Machinery Company. Taking into account that there are no seasonal factors in the segment, this is less than robust as it aims to achieve its full-year target of ¥48.0 billion. What are your plans for achieving recovery amid such harsh circumstances?

A: As for Machinery, some Group companies, including Tokyo Century and the Indonesia-based geothermal power generation business, recorded an increase in profit. However, none of the Group companies subject to financial disclosure performed remarkably, suggesting an extremely harsh result for the first quarter. Currently, we consider profit of ¥48.0 billion to be a challenging target. YANASE is facing similarly harsh conditions. However, its efforts to accumulate profit are ongoing in July and beyond, with the aim of achieving an annual profit target of ¥3.3 billion via, for example, cost reductions.

Q: For the first quarter, the Food Company's progress ratio is stagnant at 16% against its annual plan. Please share your evaluation of its Q1 results and future outlook.

A: We expect NIPPON ACCESS to achieve improvement in the second half, despite a decline in transactions with FamilyMart, due to expected growth in shopping demand at supermarkets and drugstores reflecting the growing number of individuals willing to stay home. We also believe that Prima Meat Packers and HyLife will be able to remain strong going forward. As for Dole, we have explained every year that either its Asian fresh produce business or its packaged food business performs robustly while the other is stagnant. In the first quarter, precut pineapples didn't sell well due to the impact of COVID-19 as these products require processing with hands. Sales of bananas were likewise less than robust despite steady production. On the other hand, canned products and fruit balls performed relatively better thanks to demand among American consumers who have embraced a "stay home" lifestyle. In addition, our U.S.-based grain handling operations are a type of business that significantly contributes to profit in the fourth quarter. Although their first quarter progress ratio therefore seems poor, this is in line with our estimation. In sum, the success of the Food Company's profit plan hinges on the status of NIPPON ACCESS and other businesses closely related to FamilyMart as well as that of Dole.

Q: What factors are behind the year-on-year improvement in "Others, Adjustments & Eliminations?"

A: Main factors contributing to the improvement included increases in profits from C.P. Pokphand and CITIC in addition to a decrease in tax expenses.

2. B/S and Investment Related (including TOB in FamilyMart shares)

Q: Please explain your capital allocation policy that will be in effect following the completion of the TOB targeting FamilyMart share.

A: Considering the current status of our investment pipelines, we have no concerns about our surplus capacity for growth investment as we have ¥420.0 billion at hand thanks to the accumulation of surplus in FY2019 and FY2020. Moreover, we are planning to carry out asset replacement in FY2021. With regard to shareholder returns, we will prioritize implementing our announced plan of repurchasing our own shares totaling ¥70.0 billion. At the same time, we intend to raise the amount of cash dividends per share every year over the medium- to long-term. Accordingly, we will consider upwardly revising our planned dividends of ¥88 per share if ITOCHU's operating results for FY2021 exceed our estimation. Looking at the interest-bearing debt, we do not place high priority on its repayment as the current level of such debt is low.

However, we might consider switching our fundraising methods without expanding the total amount of debt as the ratio of corporate bonds has declined to around 11%.

Q: Please explain the ROI target to be achieved following the TOB in FamilyMart shares.

A: We cannot state a specific ROI target. However, as presented in our timely disclosure material, we had previously concluded that a TOB pricing of 2,600 yen/share would be appropriate when we initiated TOB-related negotiations. This amount was calculated using a business plan proposed by FamilyMart. Then, the COVID-19 pandemic emerged, resulting in structural changes in consumers' purchasing behavior. Taking this change into account, FamilyMart had to revise its plan due to the growing likelihood of a negative impact on its operating results over the medium- to long-term. Based on FamilyMart's revised plan, ITOCHU once again screened the TOB deal in light of ITOCHU's strategies of "further strengthening business foundations," "creating new business models," and "pursuing global expansion," with its Investment Consultative Committee and other bodies exercising rigorous scrutiny, as they always do, into the project. We have thus determined the current TOB pricing of 2,300 yen/share, a maximum pricing that can satisfy our investment criteria. We hope this helps you understand the rationale behind our pricing.

Q: ITOCHU increased its equity stake in Tokyo Century and FUJI OIL HOLDINGS. Please explain the objectives of this move.

A: Both of the companies are among ITOCHU's core Group companies. As the largest shareholder, we aim to extend robust support to their managements to help them navigate a business environment rewritten by the COVID-19 pandemic. That's why we carried out the acquisition of additional equity stakes, but this does not mean that we intend to make them consolidated subsidiaries.

Q: Other than FamilyMart, what are your future policies for maintaining the status of ITOCHU's listed subsidiaries?

A: The ITOCHU Group's listed subsidiaries consist of seven companies, namely, ITOCHU ENEX, C.I. TAKIRON, Prima Meat Packers, ITOCHU-SHOKUHIN, ITOCHU Techno-Solutions, CONEXIO, and FamilyMart. The detailed rationale behind ITOCHU's possession of equity stakes in these subsidiaries, along with its methods for maintaining their management autonomy, are presented in our Corporate Governance Report, which has recently been updated. As this report was issued prior to the announcement of the TOB deal, descriptions regarding FamilyMart are compiled based on the assumption that it will remain a listed company. The background of ITOCHU's decision to delist FamilyMart via TOB is explained in a separate disclosure.

The status of listed companies differs by each entity. For example, ITOCHU ENEX, ITOCHU Techno-Solutions and CONEXIO are all spinout companies originating from ITOCHU business units. Therefore, none of their operations compete against ITOCHU and they have few transactions with ITOCHU. Accordingly, these companies are able to maintain their independent status. With this in mind, ITOCHU takes great care not to abuse its superior position as their parent. At the same time, these subsidiaries strive to maintain autonomy by, for example, increasing the number of outside directors and establishing an advisory committee. On the other hand, as for the entities on which ITOCHU increased its influence through acquisition of listed stocks, for example FamilyMart, we recognize that there is high possibility of conflict of interest within the ITOCHU Group. Therefore we are paying close attention to these circumstances. Currently, our policy is to maintain the listing status of the six subsidiaries named above, excluding FamilyMart. However, we will take a flexible and forward-looking approach when we have to deal with the occurrence of governance-related concerns or policy revisions.

Q: Please explain the current status of investment projects associated with Reinvention of Business and their timeframes for achieving profitability.

A: Although we promoted Reinvention of Business-related investments under the initiative of the Headquarters until the end of FY2020, we decided to task each business division with managing these projects from FY2021 onward. Due in part to the impact from the COVID-19 pandemic, we expect the number of projects and the total amount of investments to decrease. However, ITOCHU has made it a rule to allow each business division to exercise judgement on small-scale investments. In accordance with this rule, we will steadily execute projects that are essential in light of our business strategies. Looking at the status of our main investment projects, for example Paidy, a post-pay platform, have already garnered favorable reviews from its major clients. We will steadily seize business opportunities arising from a growing trend toward the use of non-contact settlement services amid the COVID-19 pandemic. That being said, we also expect that it will take several years until we secure profitability from the investment. Our storage battery-related businesses, on the other hand, have already begun contributing to profit. Looking ahead, we will engage in the further development of these businesses to expand their profitability.

Note: Given the extremely high interest in the market toward the TOB for FamilyMart's shares released by ITOCHU on July 8, 2020, we provided online conference participants with an additional explanation on ITOCHU's point of view.

For more details, please refer to our disclosure titled *Summary of Explanations for "Tender Offer for Shares in FamilyMart Co., Ltd."* posted on our corporate website.