FY2021 Q2 Financial Results Online 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 4, 2020 (Wed.) 16:30 to 17:30
Respondents: Tsuyoshi Hachimura, Chief Financial Officer
Tatsuya Izumi, General Manager of General Accounting Control Division

1. P/L Related (Second Quarter Results, Performance Forecasts, and the Next Medium-Term Management Plan)

Q: Which sectors and businesses saw growth in core profitability compared with the first quarter?

A: The following sectors and businesses saw such growth. The Textile Company recovered overall. In the Machinery Company, MULTIQUIP recovered as the U.S. economy improved and YANASE made large contributions through cost reductions and store reopenings. In the Metals & Minerals Company, the price of iron ore remained steady. In the Energy & Chemicals Company, transactions involving synthetic resin trading, hygiene products, and daily consumables held firm. In the Food Company, the performance of NIPPON ACCESS, which had a rise in chilled distribution over the summer, and trade in ITOCHU remained stable. In the General Products & Realty Company, ETEL's performance remained firm after the lockdown in the United Kingdom was lifted. In the ICT & Financial Business Company, the number of customers recovered due in part to online sales in HOKEN NO MADOGUCHI in addition to growth in CONEXIO and BELLSYSTEM24 sales. In the 8th Company, FamilyMart's daily sales recovered compared to the first quarter. Each Group company grew stably, supported by its business acumen and ongoing cost-cutting efforts. Furthermore, China-related profit in the first half grew ¥1.0 billion year on year to around ¥86.0 billion, accounting for about a third of consolidated net profit. Although CITIC's profits declined, and the company has been recording contributions from higher pork prices in Vietnam and higher iron ore prices in addition to chemical trading in China. However, we believe that the company as a whole is not overly dependent on China.

Q: Will the consolidated net profit target under the next medium-term management plan be formulated based on the pre-COVID-19 expectation of around ¥500.0 billion?

A: We have not officially started drawing up the next medium-term management plan. Specific content will be formulated based on frank discussions with the aim of making a public announcement in May of next year. Results for the first half of the current year revealed an upward swing due to steady progress that it may seem to be possible to achieve consolidated net profit of ¥500.0 billion for the full year. In the second half, taking seriously concerns about the future, we have conservatively left the plan as it is, but today's share price reaction was unfortunate. In FY2019 and FY2020, we achieved ¥500.0 billion in consolidated net profit and laid out a policy of sustainably enhancing EPS. However, as we explained, due to the extraordinary factor of COVID-19, this policy has been put on hold for FY2021. This one-year pause is based on the premise that profitability will return next fiscal year, but before announcing the plan we should think carefully about what factors could contribute to our future earnings base in addition to the transformation of the business model that we are currently undertaking. It is still very early to start discussing expected consolidated net profit in the next fiscal year and onward. When we announced the initial plan for the current year of ¥400.0 billion, some market opinions thought it might be too optimistic, but that in no way means we are content to aim only for ¥400.0 billion.

2. Investment Related and Shareholder Returns

Q: The market is concerned about CITIC's falling share price, but what do you think about the risk associated with impairment loss?

A: For the first-half results, based on an assessment looking for indications of impairment, we measured the recoverable amount. Having checked with an auditor, we determined an impairment loss was unnecessary. The recoverable amount was not simply the disposal value based on share price, it was comprehensively determined with consideration given to the value in use which accounts for a temporary worsening in cash flow due to the impact of COVID-19. Currently, we do not think there will be a significant change from the end of September. Our investment in CITIC is part of our medium- to long-term strategy in China and Asia, which is central to our growth strategy. Neither the investment's role or value, nor our view of the Chinese economy, have changed. Although the banking sector is often considered old-fashioned, banking is playing a very large role in the business expansion of CITIC, as can be understood from the example of Japan's period of rapid economic growth. Although the current low share price is regrettable, the average annual growth rate of CITIC since ITOCHU invested is more than 4% in Hong Kong dollars and more than 6% in Chinese yuan. The necessity of an impairment loss should not be determined only by the current share price level. CITIC's top management has changed over, making it a new organization. We have repeatedly stressed the importance of enhancing the share price to the new chairman, and he has a high level of awareness about the share price. Although we cannot disclose the details of our conversation, CITIC is also focused on measures to enhance share price and is moving ahead with actions.

Q: What is the difference between assumptions made when forming the strategic business and capital alliance with CITIC, and what is the medium- to long-term outlook?

A: Collaboration has taken longer than was originally expected, but we are moving ahead with medium- to long-term initiatives while sharing information in various sectors. With CITIC's new management team we are considering cooperation, beginning with the retail sector, which has been at the forefront of such considerations from the start. We think that a time will definitely come when we can leverage CITIC's network and capital strength, and, although that time has been delayed, it does not mean that our future outlook has changed. To reiterate, regarding the market's concerns about CITIC's risk associated with impairment loss, ITOCHU's perspective has not changed regarding its CITIC-related businesses and CITIC itself. We would like you to take some comfort in that fact. Business expansion in China, including cooperation with CITIC, will be reflected in discussions of the next medium-term management plan.

Q: Besides CITIC, is there anything else you are worried about in the second half?

A: Currently, there are no worries about impairment losses etc. on specific projects in the second half. As for CITIC, although we are concerned about the low share price, we would like to mention that there is no goodwill for that investment. On the other hand, the ratio of Group companies reporting profits in the first half was 76.5%, and we are deeply concerned that around one in four companies are in the red. We are keeping an eye out to see if there are any companies whose business models have become obsolete due to changes in the business environment, and we are taking measures to make our businesses profitable.

Q: Around when do you plan on giving a public explanation about FamilyMart's corporate value enhancement measures and business direction?

A: FamilyMart clearly plays an important role in our growth strategies, and first we need to wrap up all delisting processes. Under the next medium-term management plan, which will be thoroughly discussed going forward, we will likely explain the details of our growth strategies that focus on FamilyMart. To enhance core profitability, it will be important to first raise the attractiveness of the stores and product development capabilities so that FamilyMart can differentiate itself and customers will want to visit the stores. FamilyMart invited Mr. Adachi to be the Chief Marketing Officer and is considering new initiatives. In addition, as we explained when announcing the tender offer bid (TOB), we need to: 1) optimize the Group overall, including logistics, 2) respond to DX through the advertising business, consumer trend analysis, and AI usage, and 3) expand overseas, including through efforts with PPIH in Taiwan, despite the ongoing trial with Ting Hsin in China. The share consolidation was well received by minority shareholders, and it was approved by 94.89% at the extraordinary shareholders meeting. FamilyMart shares will be retired from the market on November 12, and we predict that we will receive court approval in late December for the transfer of fractional shares. After that, we believe we can engage in more thorough discussions with the management of FamilyMart regarding various measures.

Q: What is your policy on share buybacks going forward in light of the level of share price and the policy on maintaining a high ROE?

A: As for share buybacks, to ensure there is no insider trading, we have entrusted a securities company to dynamically and flexibly place orders. Accordingly, the acquisition prices in July and October do not indicate our expected share price levels. Although the share buybacks resolved by the Board in June 2019 were conducted under the same policy and method, as the share price set 22 record highs after listing, in the end there was no effect on the acquisition. At present, under our policy of conducting share buybacks with an upper limit of 35 million shares / ¥70.0 billion, if we determine that the share price is low relative to the overall market, we will conduct the buybacks dynamically and stably, in line with the rules. As for ROE, although we have not disclosed the level for the current fiscal year, our policy is to maintain it at 13% or higher over the medium to long term. To enhance ROE, which is in a better position than that of other general trading companies, we are focusing on expanding the R component (consolidated net profit). Lowering E (equity) through share buybacks is not an ideal approach. We are also aware of market capitalization and will continue our commitment to conducting buybacks and enhancing ROE while maintaining balance.

Q: Regarding shareholder returns, what is your stance on increasing dividends?

A: We must first achieve our commitments of ¥400.0 billion in consolidated net profit and dividends of ¥88 per share. Working from there, we consider sustainably carrying out a progressive dividend policy to be an important measure to enhance corporate value. Despite the uncertain business environment, as CFO, I would like to focus on maintaining steady dividend increases under the next medium-term management plan without making significant changes to our basic financial policy.