

FY2021 Q3 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: February 4, 2021 (Thur.) 16:45 to 17:45
Respondents: Tsuyoshi Hachimura, Chief Financial Officer
Tatsuya Izumi, General Manager of General Accounting Control Division

1. P/L Related and Shareholder Returns

Q: Significant progress has been made with regard to the plan, and there are high expectations that core profit will exceed ¥400.0 billion. What is the policy toward shareholder returns?

A: In FY2020, core profit was approximately ¥485.5 billion. Our plan for FY2021, which took effects from the COVID-19 pandemic into consideration, was for ¥400.0 billion in core profit. And for the first three quarters, the progress of core profit was high at around ¥321.5 billion. The price of iron ore is soaring, but, due mainly to effects from COVID-19 and falling pulp prices, we do not think there will be a swift recovery to FY2020 levels. While we do not think that fourth quarter momentum is weak by any means, during internal discussions we remain mindful of the rate of growth perspective from FY2022 onward compared to FY2020. In addition, in FY2021 we will make all out efforts to achieve the triple crown of general trading companies: No. 1 in share price, market capitalization, and consolidated net profit. We will continue to consider the necessity of revising our forecasts upward while moving forward with preparations to enable us to achieve our goal no matter what occurs. Our current plan for an ¥88 dividend is predicated on the FY2021 plan of ¥400.0 billion in consolidated net profit, but we will consider increasing the dividend based on how the situation unfolds moving forward. Although we have not conducted share buybacks in the last three months, we have committed to buying back the approximately 31 million shares (or up to approximately ¥60.0 billion) remaining under the Medium- to Long-Term Shareholder Returns Policy. We will definitely follow through. However, from the perspective of sustainably raising our market capitalization, instead of acquiring the shares all at once regardless of the share price, we judged it would ultimately be more beneficial for all shareholders and investors if we took some time to take a more flexible approach based on the movement in the share price.

Q: The price of iron ore is now soaring. What is the FY2021 forecast of its average trading price adjusted for hedge trades?

A: I cannot speak on the forecasted trading price. While we are moving ahead with hedges for some contracts, that does not mean we have fully hedged. Based on the trading price and profit earned over the first three quarters, if the current price level continues, I think iron ore-related business will continue to perform well in the fourth quarter as well.

Q: Can you talk about the possibility of outperforming the full-year forecast and whether or not there will be future impairment loss risks in the fourth quarter?

A: Regarding our investment in CITIC, which has garnered a lot of market attention, we conducted an impairment test of the CITIC investment at the end of the third quarter, just as we did at the end of second quarter. The test found that value in use increased from the end of the second quarter. The main reasons were that the reserve ratio of bad debts in the financial business improved in the third quarter and CITIC's profit in their current fiscal year (FY2020) is now forecast to increase 3% year on year. The share price is also on a recovery trajectory, and we

currently have determined that there is no risk of an impairment loss. On whether or not there are future risks, although there were no major future risks as of the end of the third quarter, because the business environment still remains uncertain, we will continue to carefully assess fourth quarter trends and determine whether there are investments for which we should eliminate future risks.

Q: Compared to other general trading companies, ITOCHU's increase in profit from the second quarter to the third quarter was small, but how would you evaluate the current business environment?

A: We understand the improved results of other general trading companies in the third quarter and the size of the gap. ITOCHU's results, on the other hand, as the single-quarter change in core profit shows, took place after profitability recovered in the second quarter, growing even further in the third quarter. As such, we are steadily building up profits. Looking at third quarter results by segment, the Textile Company was weak on the whole. As for the Machinery Company, automotive-related business appeared to recover, but the percentage of the business in our portfolio is not as high as that of other general trading companies. In the Metals & Minerals Company, although the price of iron ore is soaring, the company was also impacted by plunging coal prices. In the Energy & Chemicals Company, as the extraordinarily strong energy trade in the second quarter came back down to normal levels, the profit growth of chemicals covered that dip. In the Food Company, while the strength of results differed for each business during the pandemic, profit expanded overall. In the General Products & Realty Company, the drop in pulp prices and the decrease in profit in the U.K. tire business were somewhat mitigated by higher profit in the North American construction materials business and other businesses. In the ICT & Financial Business Company, ICT-related operations remained a tailwind for the business environment, but overall performance stayed flat as it was dragged down by some businesses requiring upfront expenses. In The 8th Company, FamilyMart's business results were down.

2. Outline of the New Medium-Term Management Plan (as related to the SDGs)

Q: What were your intentions behind announcing the "FY2022-2024 Outline of Medium-Term Management Plan" on January 13? What is the direction of the new plan and the status of discussion on it?

A: We plan to announce specific measures of the new plan alongside the FY2021 consolidated financial statements, so you will need to wait a bit longer. With the announcement of the new management structure, we felt the market expected us to show in the very near term the direction ITOCHU is aiming, so we decided to make the announcement. We will continue accelerating the transformation of our business model to adapt to changes in the business environment and consumer needs. At the same time, we will continue to strike a balance between growth investments, shareholder returns, and interest-bearing debt control. Under any environment, we do not think we should significantly change our current financial policy of enhancing stakeholder satisfaction via the aforementioned endeavors. The purpose of the announcement was to clarify again that we will not change our existing financial policy, including maintaining progressive dividends and highly efficient management under the new management plan, and to reassure investors. In addition, to show our sincerity to meet the SDGs, as a specific measure, we intend to incorporate the complete withdrawal from thermal coal interests into our new plan and issue SDG-linked bonds at some point down the road.

Q: Although the policy on completely withdrawing from thermal coal interests was announced,

what is the policy on dealing in coking coal, coal-fired power generation, and crude oil? Given that your exposure to these businesses is small, do you think you should take swift action before they become stranded assets?

A: We fully understand the point that the evaluation of GHG emissions is getting harsher day by day. It is important to consider measures by backcasting from ten years in the future to see, for example, how to achieve net zero GHG emissions. We, however, began by ranking current issues by priority level, and are focused on announcing and steadily carrying out measures that dynamically promote effectiveness. This is an approach ITOCHU has always taken. With the sale of Drummond, we will divest from around 80% of the thermal coal interests we own. Many coking coal mines also produce thermal coal, and, although they may be separated by caloric content, volatility, or caking properties, they are basically the same thing. Accordingly, it is not acceptable to own such mines on the basis that they are coking coal interests, and we believe that we must eventually divest from mines that produce both coking coal and thermal coal. In addition, while some say that coking coal is necessary from a technological standpoint to produce steel, ITOCHU's coking coal exposure is extremely small, and we will therefore take a more restrained stance toward new purchases. Our business that is viewed harshly due to GHG emissions is the thermal coal interests, with Drummond representing its major component, as well as coal-fired power generation, where we only have ownership in a single project in Central Java. Regarding power generation businesses, we aim for renewable energy to exceed 20% by 2030 on an equity interest basis and have already announced that we will not participate in new coal-fired power generation businesses. Top management is holding serious discussions on how we should deal with the Central Java coal-fired power generation business going forward. The project is a public-private partnership that is under construction to sell electricity to Indonesia's state-owned electric power company. Although there are GHG emissions problems, our dilemma is that as a merchant we cannot damage our credibility by backtracking on our promises. It is just one project, but we are aware that the negative effects of owning coal-fired power generation businesses are growing gradually.

Q: In the outline of the new medium-term management plan, ITOCHU highlighted a basic policy of realizing business transformation by shifting to a market-oriented perspective, but as the Company is already taking a market-oriented perspective, what was the point of reaffirming that basic policy? What do you think of The 8th Company's current situation, FamilyMart's current capability, and the recovery timeframe going forward?

A: Under pressure from the pandemic, product-oriented business models are quickly becoming outmoded. We therefore needed to refocus The 8th Company and all other Division Companies on a market-oriented perspective, concerned that otherwise there would be no growth going forward. For this reason, we determined it was necessary to reaffirm our position now. When formulating the new management plan, we are working to conduct the revision of existing businesses including FamilyMart from a market-oriented perspective and, to this end, performing detailed analysis of their quantitative performance.

Q: Regarding decarbonization outlined as a measure under the new plan, aside from Drummond, what is the policy toward coal mines (Maules Creek, Ravensworth North and Oaky Creek)? In addition, regarding initiatives to reinforce environmentally friendly products and circular economy businesses and services, what is the expected scale of assets and profit during the period of the new plan?

A: We are currently considering the specific content of the new plan, so I will refrain from

elaborating on figures. Regarding specific policies for each project, because partners are involved, I cannot speak on that subject, including on whether we are even currently engaging in negotiations. However, we recognize that this is an area we need to address during the period of the new plan. Even if we did divest, we do not think it would have a large impact in term of P/L. Regarding initiatives for the SDGs, going forward we will continue to organize and clarify the initiatives and contributions of each field. We will continue to accurately identify social demands, steadily expand our businesses, and connect that to revenue expansion. Such businesses include renewable energy business (wind, geothermal, solar, and more), storage battery-related businesses (from upstream to downstream), biomass-related business, cement substitute businesses, expansion of water and waste treatment businesses, and polyester and plastic recycling.

Q: Has there been a change in your stance on the cost of equity in the new plan?

A: As the chair of the ALM Committee, I am conducting internal discussions with keen awareness of the need to achieve our ideal for cost of shareholders' equity. We are also analyzing the difference between cost of equity rationally calculated from CAPM and the 8% considered to be the minimum expected level by the market. When the cost of equity is mechanically calculated using prevailing indicators such as the current risk-free rate, the hurdle rate becomes lower for the in-house investment standard. This would result in a gap with the equity return expected by external stakeholders. At the companywide level, we are aware that volatility in the business portfolio can affect the cost of equity, and we are working internally to address it.