FYE 2022 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.

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Respondents: Tsuyoshi Hachimura, Chief Financial Officer
Kazuaki Yamaguchi, Deputy CFO, General Manager of the General Accounting Control Division

1. P/L Related and Shareholder Returns

Q: Despite revising the core profit forecast for FYE 2022 from around ¥626.0 billion upward to around ¥686.0 billion, why did you leave the dividend forecast as is?

A: Through the dialogues we have held to date, we are well aware of and understand the concerns of the market. We have steadily enhanced shareholder returns while balancing growth investments, shareholder returns, and control of interest-bearing debt. On the other hand, the current profit level is significantly affected by soaring prices akin to a resource bubble that we do not think will last long, so we need to think about what an appropriate dividend level would be. Although we revised consolidated net profit for FYE 2022 upward to ¥820.0 billion, our policy is to consider shareholder returns in light of investments expected in the fourth quarter, cash remaining at the end of the fourth quarter, and the FYE 2023 management plan. The current medium-term management plan assumes that we are at the stage where we will establish an earning base of ¥600.0 billion in consolidated net profit. When we announced the results for the first half of FYE 2022, we already committed to both a dividend payout ratio of 30% and a minimum dividend of ¥130 per share in FYE 2024. Our policy going forward is to consider cash allocation after carefully assessing cash availability. Regarding FYE 2022 shareholder returns, based on the consolidated net profit forecast of ¥750.0 billion when announcing the first half results, we immediately raised dividends to ¥110 per share and then announced ¥60.0 billion in share buybacks, steadily promoting these two initiatives with the awareness of a total payout ratio of 30%. Of course, we do not think the current level of shareholder returns is adequate. Regarding the lower dividend payout ratio following the upward revision to the consolidated net profit forecast, we will consider total shareholder returns going forward, including share buybacks.

Q: I commend you on actively and continuously conducting share buybacks for six consecutive years. As the current PBR has exceeded 1.0x and the share price has increased, what is your policy on share price levels in consideration of share buybacks?

A: We were unable to conduct a portion of the share buybacks, which reset in June 2021. This was due to the unexpected rise in share price, which set multiple record highs since listing, and from an insider trading-free perspective due to investment consideration during the buyback period. We are always keenly aware of the level of shareholder returns and our performance relative to competitors. Although the rise in share prices due to share buybacks is important, we are aware of the market impression of shareholder returns and consider total payout ratio so that returns do not diminish. In addition, it is natural that the PBR exceeds 1.0x, and, in light of growth expectations going forward, we think the current share price levels should be even higher.

Q: What is your forecast for consolidated net profit in FYE 2023 and FYE 2024 based on the current business environment?

A: When we announced the first half results, we assumed that the soaring resource prices would come back down in the second half of FYE 2022, but we now think that they could continue into the middle of FYE 2023. In the non-resource sector, each Group company is steadily increasing profit, and we feel that the strong resilience of Group companies to economic volatility has enhanced our core profit strength. Accordingly, regarding consolidated net profit in FYE 2023 and FYE 2024, we can take into consideration that non-resource sector core profit is stronger than expected at the time of the first half. However, consolidated net profit could change significantly depending on resource prices going forward, and during the period of the current medium-term management plan, we first focus on establishing an earnings base of ¥600.0 billion in consolidated net profit. Regarding the level of consolidated net profit in FYE 2023, we will address that when announcing the next management plan.

Q: I understand that the increase in profit in the non-resource sector in FYE 2022 is the result of various measures taken to date, but what is your assessment of the rising trend in core profit in FYE 2023?

A: Although the non-resource sector is also affected by economic trends, the consumer-related sector where ITOCHU has its strengths, including clothing, food, and residences, is resilient to economic volatility and has expanded core profit by working on structural reforms in each business, such as improving the expense-to-profit ratio. This has led to the share of Group companies reporting profits to exceed 87%, and we forecast this will exceed 90% in FYE 2022. While we cannot ignore the effect of resource price volatility on core profit, we expect the current price level to continue into the middle of FYE 2023, and it might not have a significant effect. A drop in resource prices in the second half of FYE 2023 would cause a decline in core profit, but we think the core profit of the non-resource sector would be able to offer some level of support.

Q: What is the impact of COVID-19 on core profit in FYE 2023?

A: The negative impact of COVID-19 on the first three quarters of FYE 2022 was around ¥30.0 billion, an improvement of ¥17.0 billion from the same period in the previous fiscal year. However, the negative impact on the forecast for FYE 2022 was revised to ¥35.0 billion, ¥3.0 billion worse than when we announced the results for the first half. Although the impact on the European tire business was minor, due to the spread of variants, the impact has been protracted on the aircraft-related business and in-person businesses, such as the convenience store business and HOKEN NO MADOGUCHI GROUP. The negative impact was around ¥14.0 billion for the convenience store business and around ¥7.5 billion for the apparel and aircraft related businesses individually, and we also forecast effects on other businesses such as food and financial. We need to pay attention to the impact of variants, but we expect an easing of negative impacts in FYE 2023 due to further progress on vaccinations.

Q: Regarding the Metals & Minerals Company, it seems that coal-related business is not as profitable as that of other general trading companies, but Marubeni-Itochu Steel is conversely performing strongly. What is the reason for the different results?

A: In addition to ITOCHU moving ahead with a complete withdrawal from thermal coal under its current medium-term management plan, compared to other general trading companies, we have relatively less exposure to coking coal assets. In addition to the strong performance of the North American thin plate building materials business, which is one of the strengths of Marubeni-Itochu Steel, the overall business of steel sheets, etc., due to the rise in the steel material market, was favorable.

2. Growth Investments, Etc.

Q: Regarding fields in which you expect growth over the medium- to long-term, are there any excellent growth investment projects?

A: Under the current medium-term management plan, we outline a policy of aiming for profit growth through a market-oriented perspective and the SDGs. A market-oriented perspective refers to carefully identifying customer needs (not just in the consumer sector but also the midstream and upstream areas of the value chain), transforming our business model, and taking initiative. In the ICT & Financial Business Company, we want to strongly develop the financial field in addition to the IT industry field where ITOCHU specializes. Investment in these fields, including small projects, is expected to lead to growth going forward as we carry out a certain number of investments by the third quarter of FYE 2022. In the convenience store business centered on FamilyMart in The 8th Company, we are investing in relevant fields as a business where we expect new development. FamilyMart is searching for a new business model through DX, and its initiatives to increase the attractiveness of its existing products and stores are beginning to bear fruit. In addition, we are making store operations more efficient to enhance support for partner stores and reduce distribution costs. As the domestic market reaches saturation, we will add new functions, such as digital signage (advertisements in stores) and unmanned stores. In the Machinery Company, we decided on investment in Hitachi Construction Machinery, and ITOCHU will develop business as a business partner in downstream fields in the value chain to continue to meet customer needs. The Food Company also has various business opportunities that will lead to stable growth. The General Products & Realty Company's North American construction materials-related business has already grown to nearly ¥20.0 billion in profit.

The core of the business, MASTER-HALCO, has grown by acquiring peripheral businesses. The General Products & Realty Company has provided a successful example of a business model that has steadily grown from a small business, and we can expect further growth as a field where asset replacement is possible. We do not think that all fields can survive with their existing business models, and our mission will be to search for new business opportunities from a market-oriented perspective. As for promising projects in transforming business models, we will continue actively considering projects if they exceed the investment criteria hurdle rate.

Q: It seems like ITOCHU has built up investments centering on the consumer sector, but the investments in Nishimatsu Construction and Hitachi Construction Machinery feel like a somewhat different field than the existing investment strategies. What are your investment strategies going forward?

A: We are continuously considering investments in the consumer sector, but there have not yet emerged any excellent projects that have cleared the investment criteria hurdle rate. Growth investments are not limited to the consumer sector. Any that clear the hurdle rate will be considered, regardless of the field. In addition to the fact that there are not many investment opportunities like those presented by Nishimatsu Construction and Hitachi Construction Machinery, we reached the investment decision in consideration of the large future business opportunities and the expected role of ITOCHU as a business partner. These investments in the two companies are as a minority shareholder and do not mean that trade between the companies or profit will rapidly increase. We aim to undertake businesses together that are expected to expand moving forward while meeting downstream demand. The significance of the investment in Hitachi Construction Machinery is not the existing agency function for general trading companies but rather in the expanding business as a business partner and expected contribution in the downstream field. Hitachi Construction Machinery has installed an operation monitoring system called ConSite for its construction machinery, focuses on expanding such downstream businesses as parts and maintenance, and outlines rebuilding its North American sales network as an important strategy. With these initiatives with Hitachi Construction Machinery, ITOCHU will not just maintain its existing intermediary position in trade and rather focus on expanding profits for its downstream businesses and North American business from a market-oriented perspective utilizing ITOCHU’s logistics, finance functions, and sales network. Because ITOCHU has various networks and its strengths lie in its domestic businesses, we are currently considering this kind of reorganization in Hitachi Construction Machinery as a large-scale investment going forward. However, even after a large-scale investment, we have not changed our aim of maintaining positive core free cash flows after deducting shareholder returns. With the investment in Nishimatsu Construction, ITOCHU and the company will work together on the policy of focusing on domestic residences, infrastructure, and environment-related business, where growth is expected.