FYE 2023 Q3 Financial Results Online Analyst Conference: Q&A Summary

Date: February 3, 2023 (Fri.) 14:45 to 15:45
Respondents: Tsuyoshi Hachimura, Chief Financial Officer
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1. Balancing Three Factors (Growth Investments, Shareholder Returns and Control of Interest-Bearing Debt) while Maintaining a High ROE

Q: Under the current medium-term management plan, core free cash flows after deducting shareholder returns have already turned profitable at nearly ¥800.0 billion at the closure of the first nine months of the fiscal year ending March 31, 2023. Given this, we would like to confirm your future policy for cash allocations aimed at further enhancing ITOCHU's corporate value. In addition, the total payout ratio for FYE 2023, which factors in the additional acquisition of treasury stock totaling ¥25.0 billion, amounts to 33%. Please describe your targets and other thoughts on the total payout ratio for FYE 2024 and later.

A: As we are still in the second year of the current medium-term management plan, we would like to, for the moment, refrain from providing more detailed explanations than what we have already stated regarding our shareholder return policy stipulated under said plan. The points of this policy are "to execute share buybacks actively and continuously" and "commitment to achieving a dividend payout ratio of 30% by FYE 2024." Let me explain the precise meaning of the former point. To date, ITOCHU has striven to enhance the content of shareholder returns via share buybacks in a manner that carefully assesses the status of surplus funds. We have done so whenever the volume of dividends is considered insufficient or inferior relative to those paid by other trading companies despite our fundamental policy of maintaining progressive dividends. As a result, we have executed share buybacks for the seventh consecutive year. Instead of setting a quantitative target for the total payout ratio, we continuously take an active approach that accounts for such factors as the level of dividends in comparison with other general trading companies. Going forward, we will review cash allocations on a quarterly basis based on the assessment of the business environment even as we maintain the aforementioned approach to robustly implement share buybacks. On the other hand, net investment cash flows nearly amounted to negative ¥400.0 billion over the course of the first nine months. For the fourth quarter and beyond, we will ensure that core free cash flows after deducting shareholder returns remain positive, and our policy is to allocate funds from these cash flows to growth investments in a balanced manner instead of excessively focusing our resources on shareholder returns. Furthermore, although some people may consider our current level of shareholders' equity, which is in excess of ¥4,700.0 billion, to be sufficient, as much as possible, we intend to further augment shareholders' equity. This is necessary as the outlook for the current operating environment remains extremely uncertain and thus calls for solidifying our financial base. While we have no immediate plan to revise our shareholder return policy in FYE 2024 and beyond, we are aware that a pillar of the next medium-term management plan could be updating our cash allocation policy. That being said, our traditional policy of carefully assessing the status of surplus on a quarterly basis and reviewing cash allocations will continue unchanged. Looking ahead, we will strive to live up to expectations of the market by steadily building our track record in shareholder returns, including share buybacks.

Q: ITOCHU's strict insistence on positive core free cash flows after deducting shareholder returns may result in declines in NET DER and ROE. In this regard, could you describe what, if anything, is currently being discussed by ITOCHU management regarding the appropriate levels of leverage and ROE for the next medium-term management plan and beyond, along with relevant issues to be addressed?

A: Determining the appropriate levels of leverage and ROE has been an issue we've been confronting since I became CFO in 2015. Our ongoing awareness of this problem is shared throughout the Company. The *ITO Report*, authored by Hitotsubashi University Professor Kunio Ito, suggests that the target level of ROE should be at least 8%. Nevertheless, with the cost of capital amounting to 8%, ITOCHU has striven to achieve an ROE far exceeding the aforementioned target through its operations, taking advantage of high-efficiency management, which constitutes our distinctive strength. Moreover, we consider that our latest minimum ROE target of 13% under the current medium-term management plan is still low in light of growing ROE achieved by other general trading companies and in comparison with other global corporations. In the course of first-half management meetings, we conducted provisional calculations regarding the optimal capital composition and ROE improvement measures in light of our future goal of achieving consolidated net profit of ¥1 trillion, employing a variety of assumptions. By doing so, all members of management were able to develop a shared understanding of issues to be tackled. ROE is a financial indicator that typically draws immense market attention. Accordingly, if we were to be conscious of the global standard, I personally believe that ITOCHU's ROE target must be at least 15%. For us to achieve consolidated net profit of ¥1 trillion in the future and maintain a high level of ROE, we need first to maintain positive core free cash flows after deducting shareholder returns, and then execute proactive growth investments. We have multiple potential candidates in our pipeline for growth investments and are currently assessing their potential in a careful manner to determine whether they can serve as our growth drivers over the medium to long term. In FYE 2023, we have invested more than ¥510.0 billion over the course of the first nine months. Going forward, we will focus on steadily investing in high-quality candidates, even if the size of each might be small, so that we can achieve stable growth in investment returns. We will do this instead of targeting major investment projects like those requiring hundreds of billions of yen. Currently, we have yet to exactly specify long-term quantitative targets for the appropriate levels of leverage and ROE, but we do intend to maintain a high ROE while proactively implementing growth investments. To this end, we deem it essential to maintain financial and capital strategies designed to balance three factors, namely, growth investments, shareholder returns, and control of interest-bearing debt. It is our hope that our investors appreciate these endeavors.

Q: In FYE 2023, ITOCHU seems to have been more active in investment compared with other general trading companies. On the other hand, the Company's investment outlets now mainly consist of those in Japan and the United States, both of which entail no significant country risk. Taking this into account, we are concerned about a possible decline in expected return. Please describe your thoughts on expected return from investment projects currently under way.
A: ITOCHU has made it a rule to annually review country risk premiums in the course of setting differing hurdle rates for approximately 70 industries. Thus, emerging nations and other countries with high risks are naturally assigned high hurdle rates. This makes it difficult for us to invest in these countries, even in the resource sector. We of course have no intention to undertake new investment by lowering the level of expected return. Our goal is to prudently develop comprehensive maneuvers that enable us to achieve profit. Examples of these maneuvers include our investment in Hitachi Construction Machinery. We not only invest our funds in this company but also engage in trading, finance lease and other peripheral businesses. This approach makes it possible to raise expected return while minimizing risks. Although we will consider undertaking a good amount of investment in the fourth quarter, we are confident that we can also maintain positive core cash flows for FYE 2023 after deducting shareholder returns. Thus, when we embark into FYE 2024, the final year of the current medium-term management plan, we will see a robust volume of cash surplus being accumulated. Accordingly, we will continue to proactively consider investments if good candidates exist. However, we do not intend to engage in major investment projects requiring hundreds of billions of yen. As we have always done, we will steadily expand our portfolio of small-size yet high-quality investees, with the aim of enjoying stable growth in earnings power. This is our fundamental policy.

2. Recognition of Economic Conditions and Status of Each Segment
Q: Although the performance of the ICT & Financial Business Company and the Food Company remains weak, could you share your thoughts on the timing of recovery in these operations? Also, the

economic phase is now believed to have switched to a downturn. In this light, please describe the countermeasures, if any, being undertaken by ITOCHU, especially from the perspective of practicing "prevent" and "cut" principles.
A: The ICT & Financial Business Company recorded remeasurement losses for fund-held investments. Moreover, the performance of its Mobile-phone-related business and CTC has been less than expected. Accordingly, progress made thus far by this company seems to be somewhat sluggish. However, we are still convinced that the ICT & Financial Business Company will be able to achieve a net profit of ¥64.0 billion in line with full-year forecasts. Fund-held investments involving venture capital inevitably involve a certain level of volatility. Startup investment of this kind is, however, extremely important in terms of developing diverse value chains in relevant fields and, therefore, should be executed even when doing so diminishes immediate profitability to some extent. The ICT & Financial Business Company has already built an earnings base capable of supplementing shortcomings arising from this sort of volatility. Although the company achieved steady growth to date, we will undertake ongoing asset replacement for this company while enabling CTC and other operations under its supervision to expand even more broadly into multifaceted, linked businesses. This policy is unchanged. Through these and other measures, we aim to achieve earlier recovery in the level of its consolidated net profit to ¥100.0 billion. Since ICT is an area of radical changes, we can easily lag behind our peers if we fail to take action in a timely manner. This could possibly turn our strengths into weaknesses. Therefore, we will not be overly obsessed with achieving immediate growth and progress. Instead, our policy is to carefully screen potential candidates and take proactive action once high-quality deals are identified. With regard to the Food Company, we believe Dole and HYLIFE failed to take timely action. Deterioration in Dole's performance is mainly attributable to the sluggishness of its packaged food business in the United States. Although we had implemented some countermeasures by the end of the first half, market conditions became worse than ever before in the third quarter. In response, we upwardly revised sales prices in step with rising costs in high-demand seasons like Thanksgiving and the holiday season. However, these measures did not work well as they were based on a misjudgment of evolving market trends in consumer purchasing behavior, including the shift toward low-price and private brand offerings. In sum, we failed to implement well-timed countermeasures against supply chain disruption, rising logistics costs and other negative factors that emerged by the end of the first half. This reflection applies to both upward price revisions as well as advertising and sales promotion activities aimed at maintaining and expanding our market share. Already, we have effectively replaced the leadership of the packaged food business, with an individual from ITOCHU exercising direct supervision over its management from this year. However, the company needs to sell down remaining inventories over the course of the fourth quarter despite the high cost of goods. Taking these factors into account, we can hardly assume that Dole's packaged food business will recover quickly. Meanwhile, the fresh produce business in Asia has been affected by heavy rains in the Philippines, which, in turn, caused local production volume to fall short of estimates. In addition to these factors, surging prices of fertilizers and other items resulted in high cost of sales. However, as the production volume of the fresh produce business begins to recover, we expect that Dole's overall performance will gradually recover in the fourth quarter through FYE 2024. On the other hand, HYLIFE has been struggling with the impact of a drastic decline in prices of pork for China, along with the rapid depreciation of the yen and resulting deterioration in the price competitiveness of Canada-made HYLIFE pork marketed in Japan as premium pork. HYLIFE has yet to successfully raise sales prices in step with surging costs. Although the depreciation of the yen has now settled somewhat, it will take some time until HYLIFE's performance recovery. With this in mind, preparations are under way since the third quarter to undertake exhaustive capital policy reforms. Unfortunately, developing these countermeasures at HYLIFE will require a certain period of time. Despite these circumstances, however, the Food Company's positioning as ITOCHU's core operation is unchanged. Therefore, we will take advantage of our robust performance in food raw material and food marketing and distribution fields while also endeavoring to get our overseas operations on a recovery track as early as possible. Our goal of achieving greater core profit through these endeavors is unchanged. We will

also implement human resource-related measures. In these and other ways, we will aim for steady improvement in profit.

Q: Even as ITOCHU aims to reach a profit stage of ¥800.0 billion, changes in the economic conditions have begun to gradually emerge, such as continued yen appreciation from the end of the second quarter. In which segments can we expect to see profit growth into FYE 2024?
A: Regarding the ¥800.0 billion profit stage for FYE 2024, we recognize there are many harsh views on this, but the Company believes it has entered this stage under the current medium-term management plan. Discussions about the short-term plan for FYE 2024 have already begun and will heat up after the release of third quarter results. Like other general trading companies, we need to make comprehensive plans with a careful eye on the trend of resource prices going forward. As previously stated, the ratio of non-resource sector businesses accounted for 76% of business between the first and third quarters. Our business portfolio for FYE 2024 will remain centered on the non-resource sector. At the same time, it is also true that the Metals & Minerals Company accounted for the largest share of core profit between the first and third quarters, and there were also large contributions to profit in the Energy & Chemicals Company from energy trading transactions and electricity transactions, which are buoyed by high resource prices. Going forward, we need to pay attention to what will happen to profit in the resource sector. Into FYE 2024, each segment will have their strengths and weaknesses, but what we can really look forward to are the Metal & Minerals Company, the Energy & Chemicals Company, and the Machinery Company, which are each currently forecast to exceed ¥100.0 billion in core profit. The Machinery Company is investing in various fields and expects to maintain its solid performance. In addition, although the ICT & Financial Business Company has experienced a temporary slowdown, it achieved ¥100.0 billion in consolidated net profit in FYE 2022, and our expectations remain high. We will continue to invest in this business going forward without letting up. The General Products & Realty Company achieved ¥100.0 billion in consolidated net profit in FYE 2022. The business is steadily expanding core profit while moving forward with asset replacement, and it can be expected to continue to maintain this performance. As for the Food Company, we know that profit growth will be difficult if we were to rely exclusively on the domestic food marketing and distribution field and the food raw material field, where we have not invested so much. Accordingly, we will need to reorganize currently struggling overseas businesses, including Dole and HYLIFE, and figure out how to expand profit going forward. In the 8th Company and Textile Company, the profit scale is relatively small, but these are important business fields that have direct customer contact points, and we will steadily expand the business. In addition, there has been a large impact from COVID-19 on the 8th Company, the Textile Company, and the aircraft-related business of the Machinery Company, but as people return to normal life, there is a lot of room for recovery.

Q: What is ITOCHU's take on the forecast for the Chinese economy?
A: Even economists have differing perspectives and analyses on the forecast for the Chinese economy, it is a very tricky subject. ITOCHU Research Institute, a Group company, has a rather somber stance on the forecast for the Chinese economy, like that of many economists. While the general opinion is that China has passed the peak of COVID-19 infections in the country, there are such downside risks as a resurgence of COVID-19 infections, a slump in exports due to political friction with the United States, and a delay in the recovery of personal consumption and the real estate market. ITOCHU Research Institute also takes the dismal view that China will not meet the estimated government's GDP growth target of around 5%. Of course, ITOCHU is not in a position to build up its Chinese exposure or take a lax view of the current economic conditions, but from the second half of 2023, we think it is entirely possible for China's economy to recover more than expected. At the end of January, the IMF announced its forecast for China's net growth rate in 2023 would be over 5% at 5.2%. If we were to take a positive view, despite a 19% year-on-year decline in U.S. exports of electronic machines to China, including semiconductors subject to export restrictions, the total volume of U.S.-China trade increased. Investment in tangible assets in the manufacturing industry in China is expanding,

especially in high-tech related areas, such as telecommunication devices, electronic machines and steel which is strongly related to the government's infrastructure investments. In addition, the flow of people and goods, which had stalled due to the rise in infections after the zero-COVID policy was rescinded, began recovering from the end of December. Right now, these flows have dipped due to the effects of the Lunar New Year, but a stronger recovery is expected after the holiday period is over. Of course, the Chinese government is taking the economic recovery seriously and has begun implementing various stimulus measures. From this perspective, in 2023, China can be expected to drive growth in the global economy even as economic growth in the United States stumbles somewhat.