FYE 2025 Q1 Financial Results Online Analyst Conference: Q&A Summary

Date: August 5, 2024 (Mon.) 16:15 to 17:15
Respondents: Tsuyoshi Hachimura, Chief Financial Officer
Shuichiro Yamaura, General Manager, General Accounting Control Division

Q: Could you explain the background behind and the aim of the tender offer bids (TOBs) for DESCENTE LTD. (DESCENTE) and C.I. TAKIRON Corporation (C.I. TAKIRON)? Regarding DESCENTE in particular, I would like to confirm the post-privatization growth strategy as I have the impression that the ROI, which can be calculated from the increased ownership, is relatively low at around 4%. Also, for new investments going forward based on the current pipeline, is the environment conducive to further investments and can a market-wide drop in share prices be seen as offering a wide range of investment opportunities?

A: As explained previously, regarding the value expected for each segment as we work to achieve the next profit stage from the current plan of ¥880.0 billion in consolidated net profit, The Textile Company occupies a key position with expansion expected from downstream businesses. Top management wants to increase the current consolidated net profit level of ¥30.0 billion from the Textile Company to around ¥50.0 billion. In the sports apparel field, global corporations are growing significantly, and even some domestic companies have grown by tens of billions of yen. DESCENTE has been continuously growing, but given the very strong performance of its Chinese partner ANTA Sports Products Limited, we were initially concerned that perhaps there was only room for growth in China or that management was falling into a similar situation to the time before ITOCHU became deeply involved, where it had been almost entirely reliant on South Korea. In Japan, DESCENTE is taking action as a premium sports brand, but further action is still urgently needed in other areas such as shoes. In line with this recognition, we decided to conduct the current TOB. There had been difficult negotiations on the price, but we discussed the fundamental value differences between the growth enabled by the current management and the significant growth enabled by our management. We reached the current decision after receiving the recommendation of DESCENTE's special committee and confirming the amount stood within the valuation range of our financial advisors. Going forward, we intend to enhance the value of premium brands in Japan and, overseas, bolster efforts not only in the growing Chinese market but also the stagnating South Korean market. We will also strive to expand business in Europe and other regions where other Japanese sports apparel manufacturers have entered. Please understand that we did not focus on DESCENTE's current level of profit as a prerequisite, and the investment decision was made in light of DESCENTE's future growth potential. Through this TOB, we expect a gain on revaluation of existing equity interest following a change in consolidation category and an increase in profit from the approximate 55% increase in ownership. This expectation, however, was not incorporated into the initial management plan or current forecast.

Regarding C.I. TAKIRON, its mainstay businesses of building materials, packaging, and agricultural films are in very challenging fields with the market in Japan on a downward trend and the simultaneous plastic-free trend. The target company specializes in downstream fields even in plastic-related fields and has undertaken structural reforms since the previous fiscal year, when ITOCHU's former executive vice president Yuji Fukuda assumed the role of president. While profit has been on the rise, there is persistent uneasiness in the field when coming up with major growth strategies for the future. In addition, amid rising momentum for restructuring in Japan's chemical industry, during a discussion on what should be done to grow C.I. TAKIRON, we reached a consensus that by conducting unified management with ITOCHU, it will be possible to expand business into overseas markets and be involved in the major industrial reorganization in Japan. Regarding the price, we held discussions with the special committee about not only the current share price but also the fundamental value based on future plans, and were able to obtain opinion in favor from the special committee with the TOB price level which includes a certain premium over the August 2 closing price.

We intend to accelerate initiatives aimed at the upcoming reforms after completing the TOB.

Regarding our approach to the investment environment, when share prices are falling, we assume there will be more business opportunities by firmly holding onto our view of a company's outlook regardless of whether they are listed or unlisted. Within our pipeline, there are already several projects for which investment decisions have been made, including some with relatively small amounts. Although yen depreciation and a rapid drop in share price are not desirable, they could prove a benefit in terms of valuation.

Q: Regarding C.I. TAKIRON in particular, when considering the current TOB, was there no assessment of the possibility of selling instead? I would like to confirm that there is no change in the policy on parent-subsidiary listing.

A: In July 2024, we sold all shares of Japan Foods., LTD. (36.39%), a listed affiliate, in response to the TOB from JAF Holdings Ltd. This sale was decided after concluding that the company's profit would grow more in the near term by accepting the TOB than if ITOCHU continued to hold the shares. In 2022, we similarly sold all shares of our 60.34% stake in CONEXIO Corporation, which was a listed subsidiary, in response to a TOB by Nojima Corporation. When considering whether to conduct the TOB for C.I. TAKIRON, we held internal discussions on whether to increase our stake or sell, and determined that we could accelerate growth by increasing our involvement. I hope you understand that we will privatize the company to increase flexibility in preparation of future growth, including overseas, as well as the restructuring of the chemical industry expected in the near future.

Q: What action will you take in response to the sale of cross-shareholdings owned by financial institutions?

A: I understand that there has been a trend to sell cross-shareholdings by banks, non-life insurance companies, and other financial institutions, which had been stable shareholders, and this trend is accelerating especially among non-life insurance companies due in part to the problem of fraudulent claims and guidance from the Financial Services Agency. These financial institutions alone hold ITOCHU shares. Although we cannot ultimately control the policy of each company, we have always discussed the sale method and timing. Furthermore, there are currently no specific proposals from non-life insurance companies to sell ITOCHU shares. Regarding the sale of cross-shareholdings, we assume there are various methods such as these financial institutions set a specific period and promote market sales over the long term in a way that does not impact on the share price, or share buybacks through off-floor trading using ToSTNeT(Tokyo Stock Exchange Trading NeTwork System). When specific moves are made, based on discussions with market players and investors, we comprehensively assess the situation.

Regarding the share buyback of ¥150.0 billion announced today, we will first diligently move forward with purchases from the market.

Q: What is the first quarter status of and forecast from the second quarter for the Metals & Minerals Company and General Products & Realty Company, which are seen as underperforming compared to the initial management plan?

A: As for the Metals & Minerals Company, in addition to the decrease in Marubeni-Itochu Steel Inc.'s metal pipe and construction materials business in the United States, the results were tripped up by a weaker than expected performance in the operations of the new coking coal projects of Fitzroy in Australia and NCR in the Americas. Fitzroy is currently taking action to address layers with low-quality coal, which is technologically difficult to extract, and results significantly worsened year on year due in part to extraordinary gains in the previous fiscal year. Regarding NCR, after the bridge collapsed at the Port of Baltimore, a roof collapsed at the mine and a fire broke out in a shaft, so we will pay careful attention to the situation moving forward. Another factor in the worsening performance is the year-on-year decrease in the dividend from CSN Mineração S.A. On the other hand, IMEA's iron ore operations are performing strongly due in part to exchange rates.

The results of the General Products & Realty Company were due mainly to the posting of a loss in the first quarter by IFL, which had been expected to see a turnaround, and problems in operations at METSA FIBRE's pulp plant because of an explosion. However, the pulp market itself has bottomed out, and signs have appeared of a path toward profitability. We will pay attention to economic trends and whether the market performs as expected moving forward. Regarding the North American construction materials-related business, Pacific Woodtech Corporation has performed well. ITOCHU's anticipated business expansion is continuing due in part to investments that have already been approved this fiscal year in a roll-up strategy.

Both segments underperformed in the first quarter, and we will need to monitor the situation from the second quarter onward. Regarding the Metals & Minerals Company, although we will need to pay attention to the status of operations at coking coal projects, the performance IMEA's iron ore mining business and non-ferrous-related trading by ITOCHU remains steady, and the business is catching up to the ¥240.0 billion target. As for the General Products & Realty Company, although the progress of the Forest Products, General Merchandise & Logistics Division is somewhat weak, the Division Company overall is progressing steadily on the back of strong condominium sales by ITOCHU Property Development in the Construction & Real Estate Division, as well as firm business related to construction materials.

Q: In the Food Company, it appears that although HYLIFE has achieved profitability, Dole is continuing to struggle. Could you update us on the turnaround status of each business?

A: HYLIFE eliminated its U.S. business, which was in the red in the previous fiscal year, and achieved profitability with just its Canadian business. Until the previous fiscal year, in addition to exports to Japan, which were affected by the yen depreciation, exports to South Korea and China also struggled, but sales to Japan and South Korea have recently recovered and the business is approaching its ideal state. The management team has changed, and it appears to be becoming more profitable. Dole may seem to have only increased its profit around ¥0.1 billion from its first quarter consolidated net profit of ¥0.1 billion in the previous fiscal year, but the packaged foods business is on a recovery track despite the weak performance of the Asian fresh produce business. The hurdles are high, but Dole is working hard to achieve its initial plan of ¥3.8 billion. While it is necessary to further cut production costs for bananas and pineapples, the sales volume of the U.S. packaged foods business is increasing and returning to normal due to stronger sales promotions and other marketing efforts. With the head office functions transferred from Singapore to the Philippines, they are now conducing hands-on management closer to the frontlines, and the effects of this are beginning to appear. However, the impression of high degree of difficulty in achieving the initial plan, and the situation will still need to be monitored into the second half of the year.

In the Food Company, besides the food products business, there are also the upstream provisions and downstream distribution businesses which are progressing steadily. It is on track to achieve its annual plan of ¥75.0 billion with a progress rate of 25%.

Moreover, the Food Company began disclosing information for each Division as a way to expand disclosure from the first quarter of FYE 2025.

Q: Profit from CITIC appears stronger than expected. What are the factors behind that?

A: The Orchid Alliance is performing strong with a progress rate of around 29% for the first quarter of FYE 2025. The fact is that a major factor was foreign exchange effects. The currency used for CITIC's results is the Chinese yuan. Although the Chinese yuan weakened against the U.S. dollar, the effects of yen depreciation against the U.S. dollar were more significant, leading to an increase in profit. As for the performance of CITIC itself, the strength of performance varied even within each business. For example, the comprehensive financial segment includes CITIC Securities, which is currently struggling due in part to fewer IPOs, and the mainstay CITIC Bank, which maintained strong results. CITIC can be said to have a favorable financial result, as CITIC Bank is able to control aspects such as the ratio of non-performing loan ratio and the proportion of loans to real estate corporations better than the Big Four Banks.

Q: What is the reason core operating cash flows grew significantly more than the increase in core profit?

A: Core operating cash flows increased ¥66.0 billion year on year, with increases in the Machinery Company, Metals & Minerals Company, ICT & Financial Business Company, and Others. Of the factors behind the improvement in core operating cash flows, those not linked to core profit include an increase in dividends from equity-method affiliates and a decrease in payments for income taxes. Although there are temporary positive factors, core operating cash flows also improved in line with ITOCHU's solid performance, so please understand that we are making good progress toward our annual forecast.

Q: In FYE 2024, the performance of the distribution field remained strong due to the growth of NIPPON ACCESS, INC. in line with FamilyMart's rapid expansion. While the profit of NIPPON ACCESS, INC. and FamilyMart have both increased year on year in the first quarter of FYE 2025, what kind of growth can we expect going forward?

A: FamilyMart provides its own individual disclosures, but the initial plans seem somewhat conservative from ITOCHU's perspective. In addition to enhancing daily net income, the unconventional business related to advertising and media has grown, and the profit scale of Data One Corp. and Gate One Corp. have expanded. Including profit related to convenience wear, these new businesses account for under 10% of total profit. The products are highly regarded, and the number of customers and net sales have increased year on year in the first quarter of FYE 2025. We expect the second quarter, which is the money-making season for convenience stores, to be positively impacted by scorching weather, and progress is proceeding in line with our forecast. As retail business (including FamilyMart) grows, the distribution field (including NIPPON ACCESS, INC. and ITOCHU-SHOKUHIN Co., Ltd.) is also expected to grow steadily.

Q: What is the forecast for the status of orders received and FYE 2025 performance for the ICT field, including ITOCHU Techno-Solutions Corporation (CTC)?

A: CTC's current status of orders received is very strong, and backlogs are at an all-time high. Looking at CTC by segment, the performance of the generative AI platform construction business in the Telecommunication segment has remained strong from the previous fiscal year. In the Regional & Social Infrastructure segment, demand is very strong for cloud investment in governments and municipalities. Projects to establish systems related to constructing semiconductor plants in Japan are performing strongly. In the Financial Services, the number of projects is increasing amid robust capital investment appetite in relevant industries. Regarding value chain initiatives, although the investment amount is not large, we have already invested in multiple projects this fiscal year to strengthen each process, spanning from upstream to downstream, and expect to realize synergy going forward. CTC's current operating profit margin is around 7% to 8%, but system integrators that excel in consulting have operating profit margins in the double digits. To strengthen upstream processes, we are taking such action as capital investment and reskilling of engineers. By privatizing CTC, we are creating a foundation to grow the entire ITOCHU Group while utilizing CTC.

Q: Non-resource core profit increased ¥9.5 billion, and the majority of that (¥7.0 billion) was from foreign exchange effects. If you exclude foreign exchange effects, doesn't that mean the business environment worsened? What is the forecast for the second quarter onward?

A: As described on page five of our disclosure materials, when looking at the growth in non-resource core profit excluding foreign exchange and interest rate effects by segment, the Metals & Minerals Company and Machinery Company saw a year-on-year decline. The non-resource portion of the Metals & Minerals Company consists of profit from trading in such companies as Marubeni-Itochu Steel Inc., and the decrease is attributable to the previously mentioned decrease in the steel pipe business.

Regarding the Machinery Company, while profit decreased year on year due in part to the major maintenance at North American IPP, the North American electric power-related business is proceeding in line with the plan. Regarding Hitachi Construction Machinery Co., Ltd., we have been told that sales in Asia, South America and Europe are not progressing in line with forecasts and profit declined. However, the budget for the Machinery Company was conservatively set, and because the automotive-related businesses are performing strongly, we are not especially concerned about progress going forward.

Regarding the overall forecast for the second quarter onward, we are most concerned that profit will not accumulate as predicted due to a delay in progress on new investments. There are still many projects in our pipeline, but even if new investments do not contribute to profit, we have a buffer of ¥40.0 billion and have not incorporated the initial management plan of the TOBs announced today, so we are not currently worried about achieving ¥880.0 billion. Businesses that we are carefully monitoring include the previously mentioned coking coal project and energy-related projects (including LNG trade and electric power trade). We will also pay attention to the continuity of improvement for turnaround projects from the second quarter moving forward. From a macroeconomic perspective, we do not think that the rapid and significant drop in share prices and yen appreciation that occurred today will continue moving forward, but if this indeed marks a turning point for the economy, there could be negative effects on consumer trends and capital investment. In addition, we are paying attention to rising geopolitical risks posed by the U.S. presidential election and Middle East conditions.

Although there are many businesses requiring attention due in part to the external environment and investment progress, we have not changed our forecast ratio of 3:1 for non-resource to resource business, and we can confirm core profit is growing. So, we are not very concerned about progress in the non-resource sector.