Investor Briefing on FYE 2025 Q2 Financial Results: Q&A Summary

Date: November 6, 2024 (Wed.) 13:45 to 15:00
Respondents: Keita Ishii, President & Chief Operating Officer
Tsuyoshi Hachimura, Chief Financial Officer
Kenji Seto, Chief Strategy Officer
Shuichiro Yamaura, General Manager, General Accounting Control Division

Q: In line with revisions to the annual forecast for core profit, the expected increase from the previous year in core profit has fallen from ¥71.0 billion to ¥31.0 billion. Could you explain the factors behind this ¥40.0 billion decrease and the breakdown of this new ¥31.0 billion increase?

A1: Challenging changes in the external environment have led to notable impacts on commodity markets (including resources and pulp). In addition, businesses such as the coking coal business, where profit generation and recovery have been slow, are being compensated for through the accumulation of growth in existing businesses, primarily in the non-resource sector, extraordinary profits.

A2: Regarding the breakdown of the ¥31.0 billion increase in core profit, around half of it is expected to come from new investments. Key factors include increased contributions from the full acquisition of DESCENTE LTD. and C.I. TAKIRON Corporation, additional investments in the Brazilian iron ore mining business (CM), announced today, which will begin to contribute to profit in Q4, and investments in North American wind power generation in the Machinery Company. From the next fiscal year onward, we can expect annual profit contributions from these operations. In total, I expect profit contributions of ¥30.0 billion or more from various new investments.

Q: Could you please explain again the feasibility of achieving 10% profit growth moving forward?

A: We expect such growth in the ICT & Financial Business Company (especially in ITOCHU Techno-Solutions Corporation (CTC)). We are seeing growth in orders due to expanding the digital value chain, and thus, expect significant profit increases. In addition to the turnaround of the coking coal business, which has been struggling with operations this fiscal year, we expect growth in contributions from additional investments (announced today) in CM, as well as from the full acquisition of DESCENTE LTD. and C.I. TAKIRON Corporation. We are committed to achieving both organic growth and growth through new investments, and this policy has not changed.

Q: I would like to confirm the breakdown of the ¥40.0 billion reduction in core profit from the initial plan of ¥860.0 billion to ¥820.0 billion. In addition, I understand that operational struggles in areas such as the coking coal business are part of the factors behind this revision, but I would like to know what you envision regarding the turnaround for the next fiscal year.

A: The reason for this downward revision to core profit is largely because of the Metals & Minerals Company. Approximately ¥25.0 billion of this reduction was due to the impact of a market downturn, over ¥10.0 billion was due to operational struggles in the coking coal business in both Australia and North America, and the remainder was because of slower-than-expected contributions to profit from new investments. Operational struggles in the coking coal business can be divided into the Fitzroy project in Australia and the NCR project in the U. S. Post-investment production at Fitzroy had been progressing smoothly, but operations worsened this year due to drilling in mining areas with unfavorable geological conditions. We expect to overcome the areas with poor geological conditions within this year and production will return to normal once we move to the next mining area. Regarding NCR, production began last year in December, and we had expected contributions to profit. However, because of the bridge collapse in the Port of Baltimore, shipments were suspended for roughly two and a half months. Afterward, a fire broke out inside a mine tunnel, and the relevant authorities are still investigating the matter. Accordingly, it will take some time for NCR to reach full-scale production. Both cases are temporary deteriorations, I expect both projects to turn around during the next fiscal year and contribution to profit to meet the initial expectations.

Q: Some companies have started to see signs of performance changes in the second quarter. There were particularly noticeable in the construction machinery and automobile-related fields of the machinery businesses. I understand that the Machinery Company is proceeding according to plan, but could you please tell me the changes occurring in this field as well as your expectations moving forward.

A: Regarding automobiles, Chinese EV manufacturers have emerged and taken a certain share of the market away from gasoline passenger vehicles, which general trading companies have traditionally focused on. Japanese automobile manufacturers are similarly facing difficulties in some markets as they lose share, where Chinese EV manufacturers possess superior cost advantage and capture market share. However, the impact on ITOCHU's automobile-sales business is limited as it mainly involves Isuzu commercial vehicles. In addition, we are working with Isuzu on various initiatives, including the spread of EV trucks, and there is potential for new business expansion in the EV commercial vehicle sector moving forward. While Hitachi Construction Machinery Co., Ltd., has passed its peak and is experiencing weakened replacement demand leading to a slight slowdown, we expect recovery moving forward due in part to shipments for new resource development projects. In North America, we are also working with Hitachi Construction Machinery Co., Ltd., and Tokyo Century Corporation in the finance business, which could lead us to benefit from upcoming increase demand for leasing, rentals and maintenance. I believe we have a wide array of opportunities moving forward.

Q: Within the General Products & Realty Company, I get the impression that the North American construction materials-related business and the pulp business are facing difficulties. What are your estimates regarding performance recovery in the second half of this fiscal year and into the next?

A: Regarding the North American construction materials-related business, while housing indicators in the U.S. are weak, the reality is that high home mortgage rates have led to stagnation in home refinancing and purchases of new homes, which ultimately has resulted in a decrease in sales due to a lack of supply for second-hand homes in the market. I believe that demand from those wanting to purchase homes is still very much present. Moving forward, as interest rates in the U.S. decrease, the buying and selling of second-hand homes will increase, and I believe that sales of products ITOCHU offers, such as fences and decks, will also recover.

The pulp market is significantly influenced by China, an area of large demand. Amid the weak economic situation in China, the market remains in a state of stagnation. However, pulp inventory levels in China have fallen, and prices in the pulp market are expected to bottom out in the next six months or so, and then trend toward recovery in the next fiscal year.

Q: In the Metals & Minerals Company, the forecast of profits for the second half of the fiscal year is the same as for the first half, so what are the assumptions regarding resource prices?

A: Regarding the price assumptions for iron ore in the second half of the fiscal year, we do not believe it will increase from the values seen in the first half. Although iron ore prices fell to the $70 range (FOB basis) in the second quarter, they have currently rebounded to around $95. With China's production of crude steel remaining stable, we do not expect iron ore prices to substantially fall. Regarding coking coal, while demand increases in line with India's economic growth are expected, alongside many instances of prices rising due to supply-side related factors in the second half of the year, including bad weather and other seasonal changes, we do not forecast a recovery from the current price levels.

Q: I get the impression that there have been many investments in resource interests recently, such as the additional investment in CM. Could you please explain again your thoughts regarding investments in the resource sector?

A1: The additional investment in CM that was announced today was not merely an acquisition of resource interests. This is a strategic initiative aimed at creating a reduced iron value chain that will also contribute to GHG emission reduction. It is a wide-ranging initiative for securing high-grade iron ore that will be necessary for a reduced iron production project in the Middle East. This investment is aimed at more than just expanding our resource investment portfolio.

A2: From the perspective of maintaining influence in key industries as a general trading company, it is important to continue engaging in upstream areas related to iron ore and energy. In light of the trend toward decarbonization, we will proactively engage in acquiring assets that we expect will have future growth while also considering asset replacement. Please understand that this project is part of a series of efforts aligned with our growth strategy to secure resources for low-carbon steel.

Q: Regarding new investments, I hear that the amount has exceeded ¥800.0 billion, including CAPEX and already officially approved projects. As you approach the ¥1 trillion investment limit for FYE 2025, I would like to confirm your stance on investments in the second half of the fiscal year. In addition, I get the impression that the growth rate has been slow due to delays in profit contributions from new investments in the first half of the fiscal year. Moving forward, when the profit contributions from new investments are included, do you expect the growth rate to return to the past track record?

A: Investments in the first half of the fiscal year amounted to approximately ¥240.0 billion. In the second half of the fiscal year, many officially approved investment projects are expected to be executed, including approximately ¥180.0 billion investment in DESCENTE LTD. In addition, there are several projects that are nearly approved as well as additional investment in CM of approximately ¥120.0 billion. When combining these with CAPEX, new investments already reach a level exceeding ¥800.0 billion. Regarding submitted projects that have been rejected, some of these projects have been refined and resubmitted after reconsidering the schemes and improving their likelihood of success, and, as a result, the growth of our investment pipeline is accelerating. Our goal is not merely to reach an investment amount of ¥1 trillion, but to convey our stance to internal and external parties that we are committed to accelerating growth investments. At the same time, as we steer toward growth investments, we rigorously investigate each investment project, evaluating them based on factors such as expected return, expected time for profit contribution, and the likelihood they will generate synergies. Among the investment projects to be executed moving forward, we expect many of them will substantially contribute to profits in FYE 2026 and onward. In addition, we have no policy limiting investments to ¥1 trillion. Based on cash allocation for FYE 2026 and onward, if we determine investments will contribute to improving future performance, it is entirely possible we will engage in new investments in FYE 2025 that push us over ¥1 trillion.

We cannot avoid the fact that a certain number of new investments will contribute to profit at a slower pace than originally anticipated pace. For example, although we expanded the pulp factory at METSA FIBRE Oy, contributions to profits are expected to be slower than anticipated because of market stagnation. ITOCHU will cover delays in profit contributions from new investments by strengthening existing businesses, aiming to achieve overall growth in operating results via expansion in these existing businesses as well as the execution of new investments. However, we are taking action to improve underperforming projects, and with profit contributions coming from future planned projects, we expect the growth rate to return to levels consistent with our past track record shown in the Management Policy.

Q: I understand that future targets regarding synergies are set when investing. What is your perspective regarding the creation of synergies from expanding areas, and how is the timeline for contribution to profits being discussed?

A: When engaging in new investments, we not only evaluate the target company itself but also always thoroughly examine whether we can expect new business opportunities and consider the level of collaboration across Division Companies. Moreover, while additional investments in active resource projects are expected to lead to early profit contributions, creating new business model can be time consuming and it can be hard to determine a timeline for resulting profit contributions. As an example, regarding investment in Pasco, we are considering whether to aim for collaboration with CTC of the ICT Division or the automated driving-related business in the Automobile, Construction Machinery & Industrial Machinery Division, while continuing to look into collaborative opportunities moving forward. With new investments, I would like to proceed with the aim of realizing profit earlier from new value created through coordination with ITOCHU's existing businesses.

Q: Of all Group companies in the first half of FYE 2025, 33 out of 265 were in the red. Although very few Group companies that individually disclose their results are in the red, could you explain the details of the companies that are in the red?

A: Group companies in the red by segment are as follows: two in the Textile Company, four in the Machinery Company, two in the Metals & Minerals Company, four in the Energy & Chemicals Company, two in the Food Company, three in the General Products & Realty Company, fourteen in the ICT & Financial Business Company, and two overseas trading subsidiaries. There were small-scale investments in startup companies in the ICT & Financial Business Company that ended up in the red. We anticipate recovery in companies that have experienced temporary lulls in performance. The majority of the 33 companies are not at a large enough scale to individually disclose performance results.