Toyota Tsusho Corporation
Earnings Briefing for Second Quarter of Fiscal Year Ending March 31, 2018
Condensed Transcript of Q&A Session

Date & time: November 6, 2017 (Monday) 15:30–16:30
Attendees: Jun Karube, President/CEO
Hiroshi Tominaga, Member of the Board/Managing Executive Officer/CSO/CIO
Hideyuki Iwamoto, Member of the Board/Managing Executive Officer/CFO

What are the factors behind your earnings forecast's 15 billion yen upward revision and what is your outlook for the fiscal second half and beyond?

First-half earnings were better than we had anticipated. By division, the Metals and Global Parts & Logistics Divisions benefited from robust auto production in the North American market. Higher metal prices also contributed to their earnings growth. In Europe (particularly Turkey), heavy parts shipment volumes were another positive factor. We expect the second half to be a little slower. Our second-half outlook for the Metals and Global Parts & Logistics Divisions is on the conservative side. For the Automotive Division, the main factor behind our upward revision was yen depreciation. In the Machinery, Energy & Project Division, Eurus Energy performed well in the first half. Our second-half forecast for the Machinery, Energy & Project Division is restrained, perhaps a bit too conservative. The Chemicals & Electronics Division has been enjoying favorable market conditions, which we expect to persist in the second half and beyond. For the Food & Consumer Services Division, we lowered our earnings forecast but mainly in response to a one-time loss booked in the first half. We expect the Food & Consumer Services Division's second-half earnings to be in line with their norm. For the Africa Division, we raised our forecast modestly, mainly to factor in a weaker yen. However, we feel the African economic environment is in a nascent upturn. We will start preparing forecasts for next fiscal year once we have more clarity on market conditions.

What is your second-half outlook for North American auto production?

Toyota Motor's production has recently continued to hold up well, bolstered mainly by full-size vehicles, but we assume it will not increase in the second half. While a production mix weighted toward full-size models is in fact positive for us, we are cautious in our earnings outlook.

The Automotive Division's second-quarter profits were down from the first quarter. What was the situation by region and what is your outlook for the second half?

One factor behind the earnings deterioration relative to the first quarter is that second-quarter auto sales in Papua New Guinea declined quarter on quarter, partly in response to a general election. On a year-on-year basis, however, they are in a recovery trend. Another factor that weighed on the Automotive Division's second-quarter profits is that a Thai subsidiary increased its allowance for doubtful accounts in the second quarter.

In Russia and Eastern Europe, earnings deterioration in Russia was offset by earnings growth in surrounding countries. For the region as a whole, first-half profits were modestly better than in the year-earlier period. We expect second-half profits to be roughly unchanged from the first half, excluding the impact of yen depreciation.

Why do you expect the electronics business to continue performing well from the second half onward?

I am proud to say we supply the best automotive electronic products (line cards). We develop them in collaboration with parts makers and others from the product development stage onward. The functions we perform, more than just logistics, are recognized throughout the world. Additionally, our earnings power has been increasing amid the rapid shift toward EVs, partly by virtue of price increases due to parts shortages. We expect this trend to continue for as long as migration to EVs continues. In the image processing space in particular, we expect to continue to add value and perform well. We intend to boost earnings by heavily allocating personnel and other management resources to our Next Mobility initiative.

What are the factors behind the upward revision of your forecast for the Africa Division? Will there be additional costs due to reorganization or any other issues?

The upward revision was mainly the result of revision of exchange rate assumptions in the direction of a weaker yen.

In terms of the business environment, auto sales are good in Côte d'Ivoire and Burkina Faso, countries previously within CFAO's geographic domain, but adverse business conditions persist in resource-producing countries, particularly the two Congos. In countries previously within TTC's geographic domain, sales are tracking roughly in line with their year-earlier level. We expect CFAO's overall automotive segment's performance to be more or less unchanged from last fiscal year. In non-automotive businesses, we expect CFAO's overall earnings to be down modestly year on year, partly because the Congolese beverage business has been hit by headwinds in the form of a market downturn and intensification of competition. There are no additional reorganization costs or other issues.

Could you provide an update on the status of your Argentine lithium mining operations and any future development plans?

Production has recently been running smoothly. The mine is currently producing lithium carbonate at an annualized run rate of 12,000 metric tons versus a target production level of 17,000 metric tons. With lithium prices now about four times higher than we initially assumed, the mine is starting to contribute to profits. We own the sales rights also, so we should be able to earn additional profits from trade. From next fiscal year, we plan to look into expanding the mine, contingent on market conditions.

How realistic are China's EV transition plan? What is your strategy and/or response?

From an economic rationality standpoint, we are somewhat skeptical that China will really transition to EVs as planned. On the front end, generating electricity by fuels with CO2-rich emissions makes no sense. From an infrastructure standpoint as well, we believe China will be hard-pressed to provide sufficient recharging facilities soon enough. We see challenges on the back end also, including recycling arrangements and used EVs' loss of value due to battery degradation. From a common sense standpoint, we were expecting China to take a little longer to transition to EVs.

That said, given the Chinese government's policy of promoting transition to EVs and India's professed commitment to EVs also, we expect both countries to transition to EVs to some extent under their governments' leadership. We intend to capitalize on these developments. We plan to take action in collaboration with automakers, mainly Toyota, to ensure we do not fall behind the competition. Given the breadth of our involvement in EV-related areas, including electronics, we believe we can make big contributions with the human resources and expertise we have cultivated and our collaborations with external partners.

What are the biggest business risks and opportunities within your Next Mobility strategy?

The biggest business risk is decreased use of sheet steel in auto production in connection with vehicle weight reduction. To mitigate this risk, we are researching aluminum, resin and carbon processing and bonding technologies. Another concern is the extent to which the transition to EVs will reduce the number of parts we supply and the impact that this reduction will have.

Conversely, business opportunities include projected growth in the aluminum processing business and lithium demand. Additionally, supplying electronic parts is an important role in the context of migration to EVs and vehicle connectivity. We expect to profit substantially from not only logistics but also value-adds such as kitted parts and embedded software. We believe that horizontally extending our pre-existing business model will give rise to plenty of opportunities in terms of auto sales also.

With respect to non-automotive businesses in Africa, how long do you expect it to take before you see a payoff from horizontal expansion of CFAO and TTC's respective African operations into each other's territories?

Consolidating all African operations into the Africa Division enabled us to intensively conduct sales activities tailored more specifically to Africa. However, energy-related businesses such as geothermal and wind power generation will take at least 4-5 years to expand into new countries. In contrast, we expect the pharmaceutical wholesaling business in which CFAO possesses expertise and its new pharmaceutical manufacturing business in Morocco to take about three years to expand into eastern and southern Africa, but we have not set explicit timelines on a business-by-business basis.

Electric Power projects and CFAO have historically tended to account for the bulk of your investments. How will you allocate investment budgets going forward?

Our relatively large-scale investments have long been concentrated mainly in renewable energy and power projects and African ventures, but we have been investing a certain amount every year in North American automotive operations also. We plan to continue to do so. Going forward, we will likely invest in electronics operations to some extent, but we first need to decide how much to invest, among other matters. We expect to start funding such investments from next fiscal year.

Are you stepping up the pace of your investment in the current fiscal year?

Until last fiscal year, we were internally sending a message of restraint with respect to investment, but we have shifted gears to speed up investments from the current fiscal year. For the time being, however, we aim to keep each division's investments within the bounds of its operating cash flow. In the first half, all divisions actually achieved this aim. I believe their first-half investments tallied to 50 billion yen. We expect to undertake new investments from the second half of the current fiscal year onward. Investments in lithium or other EV-related businesses and/or new African businesses are likely in the second half or next fiscal year. We may invest upwards of 100 billion yen annually. We have enough operating cash flow to do so. We do not envision running a free cash flow deficit.

Do you have any particular investment standards for the Africa strategy and Next Mobility strategy in your Mid-term Business Plan? Do any such investments have a payback period of 10 years or longer?

We do not have special investment standards for Africa or Next Mobility. We have one set of company-wide standards. Our Africa strategy involves initiatives such as horizontally expanding businesses that are starting to succeed, extending automotive operations into after-sales service and expanding the pharmaceutical business into generic drug manufacturing. We do not plan to spend the next 10 years just sowing seeds. In most cases, we should be able to recoup our investments within 7 years.

With Next Mobility, we do not yet have visibility in terms of direction, so we cannot make decisions without considering various patterns. We expect electronic device operations to generate near-term profits, but we do not know how much profits would increase if we were to invest in aluminum processing technologies to meet demand for lighter-weight vehicle bodies in conjunction with migration to EVs. I expect we will spend some money on bonding technologies but not billions of yen.