Toyota Tsusho Corporation
Earnings Briefing for Second Quarter of Fiscal Year Ending March 31, 2019
Condensed Transcript of Q&A Session

Date & time: November 1, 2018 (Thursday) 9:30–10:30
Attendees: Ichiro Kashitani, President/CEO
Hiroshi Tominaga, Member of the Board/Managing Executive Officer/CSO/CIO
Hideyuki Iwamoto, Member of the Board/Managing Executive Officer/CFO

Your second quarter earnings look somewhat weak. Were they affected by changes in the external environment?

Profit for the period was 46.6 billion yen in the first quarter and 32.0 billion yen in the second quarter. Dividend income tends to be disproportionally concentrated in the first quarter, but second quarter earnings did seem a bit weak even on the operating profit line. However, logistics continued to perform solidly in China and the U.S. The second quarter profit decline appears to have been a reflexive reaction to exceedingly high profits in the first quarter. The only business that arguably performed poorly in the second quarter was chemicals, as a result of deterioration in resin margins. Recent reported conditions also indicate that demand remains buoyant. We currently have no concerns about the second half.

Have there been any changes in the Africa Division's automobile business? And what will be the earnings impact of the transfer of African sales and marketing operations from Toyota Motor Corporation (TMC)?

Looking at Africa as a whole, conditions are increasingly diverging between East and West Africa. In East Africa, Kenya has been recovering since the controversy surrounding last year's presidential elections subsided. Economic conditions in West Africa remain largely unchanged from the first quarter. Sales in West Africa have bottomed out and are beginning to improve, though they are down relative to last fiscal year.

Africa's overall growth rate was around 3.4% last fiscal year and is expected to exceed 4% this fiscal year. About seven of Africa's 54 countries have negative economic growth rates. It is our view that the countries of Africa have generally bottomed out and have resumed growing. Among West African countries, Ivory Coast, for example, is growing at 6%. While non-oil-producing countries continue to perform well economically, countries such as Nigeria and Angola remain in the doldrums, and we do not expect our West African earnings to recover until these countries start growing.

We are not yet able to quantify the earnings impact of the transfer of TMC's sales and marketing operations to us. While the incoming operations themselves will have a positive impact, we will incur costs to incorporate them into our group. We are currently conferring with TMC to finalize the scope of the operations to be transferred and other such details. We expect to have more clarity on the earnings impact in the near future.

Would it be correct to assume that there will not be much earnings impact because TMC's more profitable dealership operations will not be included in the transfer?

The so-called shipper portion of TMC's African sales and marketing operations will have a substantial impact. For example, in Northern Africa we will take over TMC's direct trading operations conducted through local companies. Additionally, in Southern Africa, we will take over shipper operations related to supplying parts and other products to Toyota South Africa. However, operations involving distribution within South Africa and from South Africa to neighboring countries are wholly owned by TMC and will remain so.

Another major impact is that sales to the UN and other international aid organizations, which we refer to as direct sales, will be entirely consolidated into our operations. CFAO also has been engaged in direct sales through a logistics center in Antwerp, but its direct sales operations will also be consolidated into our direct sales business because they partially overlap TMC's operations.

How did you set the unit-sales target for your Africa strategy's Toyota vehicle sales challenge and how rapidly do you plan to ramp up your new automobile businesses in Africa?

In setting the Toyota vehicle sales challenge's sales target, we took into account both market share growth and market growth. We formulated a target predicated on achieving market share growth in excess of the market's growth rate. TMC's share of new vehicle unit sales throughout Africa is currently around 20%. To increase the share, we believe we must achieve market share growth of at least double the market's growth rate.

Regarding the new automobile businesses, we aim to expand the Suzuki business throughout Africa, not only in countries where we currently sell them. Additionally, in the auto parts business, we expect our business alliance with Total, the major French oil company, to play a crucial role. Total operates some 5,000 gas stations throughout Africa. By partnering with Total, we plan to provide repair services and sell common auto parts at gas stations. We are already doing so at 30 gas stations in three countries and plan to expand this to about 200 gas stations within three years. We aim to ultimately expand repair and parts sales throughout Africa by tapping into our pan- African network. The standardized parts we are selling are made in Europe or Japan and are compatible with vehicle models available in each country. We plan to also offer low-price parts made in India, China, and elsewhere.

What does the Toyota vehicle sales challenge mean? Does it refer to incremental sales from the transfer of TMC's African sales and marketing operations or incremental sales derived from your own efforts? And how much of a revenue impact will it have?

In the bar graph on slide 13 of our presentation, the "natural growth" portion of the bars represents market growth only. The "ambitious growth target" portion represents sales in excess of the market's growth rate due to our efforts. CFAO previously set a growth target of double the market's growth rate and has achieved this for the past 10 years. We believe we can do likewise. The keys to doing so will be pan-African expansion, marketing and better logistical efficiency. We have been handling logistics in particular on a country-by-country basis for not only fully assembled vehicles but also parts. We intend to consolidate logistics in three locations–Antwerp, Dubai and South Africa–and supply vehicles and parts manufactured in Japan, Thailand, Turkey and elsewhere through optimal logistics hubs. By doing so, we expect to be able to improve distribution, shorten delivery times, and reduce country risk. Additionally, in terms of production, we have received eager requests to set up semi-knocked-down (SKD) kit production operations in seven of Africa's regional economic communities for a number of reasons, including tariff barriers. Together with TMC, we are vetting these requests with the intention of aggressively launching production in regions where we can gain a cost advantage. We are currently assembling the Toyota Fortuner in Egypt and Toyota Land Cruiser in Kenya. We are looking into assembling vehicles in other large markets such as Nigeria. I am unable to answer your question on the revenue impact of the transfer of TMC's African sales and marketing operations because, as I mentioned earlier, we are still in the process of quantifying it ourselves.

What is the scale of the new automobile businesses' earnings in monetary terms and how rapidly do you plan to ramp them up?

The Suzuki business and used vehicle business will have large monetary impacts. The Suzuki business is already up and running. We expect it to grow to a sizable scale within three years. We plan to initially launch the used vehicle business in three or so selected pilot countries and move forward with five-year planning horizons.

The Machinery, Energy & Projects' earnings remained strong again in the second quarter by virtue of growth in plant-related machinery trading volume. How sustainable is such growth?

Plant-related machinery trading volume is growing briskly in North America, driven largely by construction of a new plant in Alabama and capacity expansions at plants in Indiana and Kentucky. In China as well, machinery demand from plants in Tianjin and Guangzhou is robust. In Guangzhou, plans for future construction of plants number four and five have started to take shape. Looking ahead to 2020, we had previously envisioned a crisis scenario of no business at all for the entire year, but we currently see favorable

business prospects in every year without exception. We expect plant-related machinery demand to remain buoyant for the next two to three years.

What is the electronics business's current status?

The increase in current assets on our balance sheet was largely attributable to electronics-related factors, particularly a buildup in inventories. The electronics business is performing well. I think its inventory growth was related to product transitions, including EOL products. Although there is currently no P/L impact we expect the electronics business to increasingly sell high-gross-margin products.