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

Date & time: February 1, 2019 (Friday) 18:00–18:35
Attendees: Hiroshi Tominaga, Member of the Board/Managing Executive Officer/CSO/CIO
Hideyuki Iwamoto, Member of the Board/Managing Executive Officer/CFO

You maintained a robust operating profit growth rate but profit for the period (attributable to owners of the parent) was down year-on-year. I assume there were one-time items below the operating profit line. What were they?

Excluding one-time items, profit for the period was up nicely again in the third quarter. We booked about 15 billion yen of one-time losses in the third quarter. Adjusted to exclude them, profit for the period was more than 120 billion yen.

The one-time losses included two impairment losses in the Machinery, Energy & Project Division. One was an impairment loss on a gas-fired merchant (non-tariff) power plant project in the Northeast U.S. We booked the impairment loss because the project's profitability worsened as a result of delays in commissioning the plant and competition from renewable energy. Although our stake in the project is 12.5%, we treat it as an equity-method investment. The impairment loss was one factor behind the year-on-year decrease in our share of profits from equity-method investments. The Machinery, Energy & Project Division's other impairment loss was booked against a Texas wind power project, another merchant (non-tariff) project, that we invested in through Eurus Energy. We recognized the impairment loss in response to deterioration in profitability due to a decline in market prices. Additionally, we wrote off previously recognized deferred tax assets related to the same project.

In the Food & Consumer Services Division, we booked an impairment loss against an equity-method investment in response to deterioration in an overseas beverage business's profitability due to a reduction in its capacity utilization rate. In the Africa Division, we incurred a deferred foreign-exchange loss in the third quarter on dividends receivable as a result of recent precipitous adverse exchange rate movements. The loss was included in exchange differences on translation of foreign operations. In the Automotive Division, we booked an impairment loss equivalent to nearly our entire exposure to Venezuela in response to deterioration in Venezuelan economic conditions.

We also had some one-time gains, mostly foreign-exchange gains on the Africa Division's US dollar-denominated assets, but they did not have much impact on profit for the period.

I assume that automotive operations are doing fine but, even excluding one-time items, the Africa Division appears to have performed poorly. With oil prices now recovering, could you provide an update on conditions in oil-producing countries and individual businesses' status?

Excluding one-time items, the Africa Division's operating profit was roughly flat year on year.

The auto business is recovering in East Africa, mainly in Kenya. In West Africa, its overall earnings were flat year on year, with auto sales buoyant in some countries and weak in others. The latter countries include Burkina Faso and Ghana.

Among other businesses, the healthcare business continues to perform well in its core business but its profits were down year on year as a result of a provision to allowance for doubtful accounts and expenses related to launching Maphar in Morocco. The beverage business is facing intensifying competition. Its earnings through the third quarter were tracking at about 60% of its full-year forecast. The retail business remains in the red but its losses are roughly within expectations.

What is the current status of and outlook for businesses related to auto production?

In China, we have heard that domestic automakers and the Big Three, mainly Ford, are faring poorly. Toyota, however, continues to do well in China. With our many Toyota-related businesses, we are likewise still doing well. Production is holding up nicely in the U.S. and Southeast Asia also, partly by virtue of favorable model mixes. We anticipate more of the same in the fourth quarter also.

Looking ahead to next year, we are not too pessimistic about the North American market, though the outlook is subject to change depending on unit production and model mix forecasts. We think North American production will likely fall to around 16 million vehicles next year. In China, we are a little skeptical of the sustainability of Toyota's current outperformance. In Europe, we think Brexit will adversely affect UK auto production. In continental Europe, however, we expect Brexit to have a positive impact on auto production, largely as a result of relocation of production and model mix changes. Additionally, auto production remains buoyant in Turkey. In terms of overall European auto production, we expect the positives and negatives to offset each other. In India, where we have recently launched a Suzuki business, we have a positive outlook for auto-production-related businesses as a whole.

The electronic business's operating profit was up 1.7 billion yen, 1.4 billion yen of which was network related. Am I correct in assuming that automotive electronics accounted for the other 0.3 billion yen?

Automotive electronics did even better. In the year-earlier period, Tomen Devices had strong earnings and electronic component sales for bitcoin-related applications grew robustly. This is down compared with the year-earlier period thereby detracting from year-on-year operating profit growth. This negative was also offset by automotive electronics.

Some electronic component suppliers have been adversely affected by US-China trade frictions. What is your situation?

Our consumer electronics subsidiaries include Elematec, Tomen Devices and so on. Despite the ongoing stream of bad news related to consumer electronics, our subsidiaries do not seem to have suffered a falloff in business. Growth, however, seems to ground to a halt. With monthly sales slowing, we feel a need to be cautious with respect to businesses related to consumer electronics.

In contrast, non-consumer electronics businesses such as automotive electronics continue to enjoy brisk demand as usual. Suppliers have been starting to sell packages that combine automotive and consumer electronics, so we need to be careful to avoid growth in inventories.

Back-calculating from cumulative profits through the third quarter, I see that the Machinery, Energy & Project and Food & Consumer Services Divisions have to earn large fourth-quarter profits to reach their full-year forecasts. Do you expect both to achieve their forecasts?

The Machinery, Energy & Project Division's profits have a seasonal tendency to surge somewhat in the fourth quarter, partly because wind conditions tend to be favorable at that time of year. We believe Machinery, Energy & Project Division could achieve its forecast again this time, but it may fall somewhat short, given the impairment losses discussed earlier. We doubt the Food & Consumer Services Division will achieve its forecast because its impairment loss's impact is likely too big of a setback to overcome.

What are your positive expectations and concerns heading into next fiscal year?

In automotive businesses, including automotive electronics, we expect earnings to be flat or up modestly year on year. In Africa, we expect resource-producing economies to soon bottom out and embark on recovery. Any such recovery should be a positive.

On the downside, we expect retail businesses, among others, to continue to incur losses. Our main concerns are a Chinese market slowdown and concomitant stagnation in electronics-related markets.

You said you are carrying too much inventory. What type of inventory are you referring to and how do you plan to reduce it?

In value terms, our excess inventories are mostly metals and electronics-related. Our metal inventories have been growing partly as a result of rising market prices; inventory turnover is not worsening. We have asked the Metals Division to reduce their inventories of items stored for longer than four months. In terms of electronics, we seem to be holding too much safety inventory, emboldened by market cycles' relatively low amplitude. We believe we need to also clear out excess electronics inventory between now and fiscal year-end. Aside from metal and electronics-related inventories, oil and petroleum product inventories also have been increasing but they are under contract to be sold, so we expect them to be at a lower level by the end of March.

What is your outlook for cash flows from investing activities in the current and next fiscal years?

For the current fiscal year, we expect investing activities to use net cash of around 120 billion yen. Next fiscal year, we will be carrying out digital transformation initiatives internally. To the extent we invest in digital transformation, I imagine that net cash used by investing activities will increase beyond 120 billion yen next fiscal year.

My understanding is that the transfer of Toyota's African sales and marketing operations has been fully underway since January. Could you provide an update?

Toyota seconded about 50 personnel to us in January and they have been assigned to transfer-related operations. We are currently integrating our IT systems with Toyota's and otherwise putting the requisite infrastructure in place, partly to ensure we can use the existing systems that Toyota is using.

Quantitatively speaking, we aim to eventually achieve a sales growth rate of at least double the African market's growth rate.