Toyota Tsusho Corporation
Earnings Briefing for Fiscal Year Ended March 31, 2019 (FY2018)
Condensed Transcript of Q&A Session

Date & time: Wednesday May 8, 2019, 14:00–15:10
Location: Toyota Tsusho Corporation's Tokyo Head Office
Attendees: Ichiro Kashitani, President/CEO
Hiroshi Tominaga, Member of the Board/CSO/CIO
Hideyuki Iwamoto, Member of the Board/CFO

Could you recap your actual performance value of FY2018 after excluding one-time items? And how much growth are you forecasting in FY2019 on the same adjusted basis?

Excluding one-time items, I believe our profit (profit attributable to owners of the parent) was over 140 billion yen in FY2018.

The Metals Division earned an all-time record profit again in FY2018. Even qualitatively, its earnings were not bad. It had no one-time gains and losses. While its earnings are somewhat dependent on the market values of sheet steel, aluminum and other metals, it was able to boost its profit margins by providing high-value-added services such as aluminum processing. Our FY2019 forecast does not factor in any demand growth or metal price increases. In FY2019, we expect the Metals Division to achieve growth in earnings ex one-time items.

The Global Parts & Logistics Division likewise earned an all-time record profit in FY2018. Its parts shipment volume also were good. Despite concerns that increasingly fewer parts will be required as migration to EVs progresses, parts shipment volumes are holding up well, at least for now. We are becoming more involved in parts supply chains of not only Toyota but also other brands with ties to Toyota. The Global Parts and Logistics Division incurred a modicum of one-time losses in FY2018. We believe its FY2019 forecast is attainable before one-time items.

The Automotive Division performed well. Its sales were buoyant in Russia and South Korea in particular. Additionally, it achieved its sales budgets in the South Pacific, primarily Papua New Guinea, and in Central and South America, including Jamaica. In certain other regions, however, sales were sluggish, resulting in a mixed performance overall. In FY2019, we anticipate growth in sales of not only Toyota vehicles but also other brands. We accordingly expect the Automotive Division to grow its earnings ex one-time items.

The Machinery, Energy & Project Division's incurred substantial one-time losses in FY2018. Excluding such one-time items, its profit was around 27 billion yen. Its profit for FY2019 is forecast to be at about the same level, which we believe is attainable before one-time items.

The Chemicals & Electronics Division incurred a one-time loss on an equity-method investment, the details of which were disclosed by Sanyo Chemical Industries. Adjusted to exclude one-time items, its profit was around 23 billion yen. Its profit for FY2019 before one-time items is forecast to be at about the same level, but we consider the forecast to be slightly conservative because we anticipate further growth in electronics businesses' profits.

The Food & Consumer Services Division also incurred one-time losses. Excluding one-time items, its FY2018 profit was around 6 billion yen, which includes the US-China trade conflict's positive impact on our Brazilian grain business. Its FY2019 profit forecast is 5 billion yen, which does not factor in any benefit from the US-China trade conflict.

In the Africa Division, auto sales were robust in both East and West Africa but non-automotive businesses performed poorly. In the automotive business, Toyota completed the transfer of its African sales and marketing operations to us. In non-automotive businesses, market conditions have recently been improving. However, given the high degree of country risk in Africa, we are conservatively forecasting the Africa Division's FY2019 profit at 11 billion yen in light of the potential for adverse developments.

Regarding the transfer of Toyota's African sales and marketing operations, how much growth potential do you see? Also, does the transfer pose any negatives as far as you know?

Our projections are conservative, but we intend to substantially increase Toyota sales in Africa from their current level of 200,000 vehicles by executing the six pillars outlined in our new Three-Year Management Plan. We aim to grow sales at a minimum of double Africa's GDP growth rate. Among the six pillars, we expect efforts to strengthen the product lineup and build a knockdown business to start driving sales growth soon and the other four pillars to take longer to bear fruit. We are currently strengthening these other four pillars.

On the negative side, we do not yet see any prospect of economic recovery in Algeria and Nigeria, both of which are resource producers. Although the Algerian and Nigerian markets have potential, they are languishing under the weight of depressed resource prices. Additionally, Algeria has a national policy prohibiting imports of fully assembled vehicles. Vehicles sold in Algeria must be locally produced. We see little likelihood of economic recovery in the Maghreb region until Algeria and Nigeria start to recover.
We are investing in infrastructure such as dealerships, stockyards, and body mounting and conversion facilities. We expect the expenses incurred in doing so to detract from earnings for a while. To surmount these headwinds, we believe we need to further strengthen our sales capabilities.

In 2019 to date, auto sales have been slowing in Southeast Asian markets such as Thailand and Indonesia. How does the slowdown affect your FY2019 earnings forecast?

In FY2018, our auto sales growth was concentrated mainly in South Korea, where sales of new Lexus models were strong; Russia, where auto demand surged before a VAT hike took effect; and the Caucasus region, which benefited from higher resource, mainly crude oil, prices. In Thailand, we have two Toyota dealers and one Hino dealer, all relatively small. In Indonesia, we have a few equity-method investees. All told, Southeast Asian markets' impact on our earnings is limited. Going forward, Southeast Asia may become more of a growth driver, depending on the outcome of major contract bids in countries such as Bangladesh and Pakistan. Our FY2019 forecast does not factor in much Southeast Asian growth, only organic growth.

In production-related businesses, the added value we offer is changing. With new automotive materials increasingly supplanting existing ones, we aim to boost profit margins by mastering difficult technologies. Our automotive businesses' earnings growth has recently been diverging from auto production growth. We attribute this divergence to initiatives like the ones I mentioned.

How much did Eurus Energy Holdings Corporation earn in FY2018 and what is its FY2019 earnings forecast?

We do not disclose individual subsidiaries' earnings, so I cannot share any specifics. But its FY2018 earnings were not so good because it booked an impairment loss against a wind power generation business in Texas. In FY2019, we anticipate profit growth of 10-20% relative to FY2018 profit adjusted to exclude the impairment loss.

Your Three-Year Management Plan's FY2021 profit target is 20 billion yen higher than your FY2019 profit forecast. How much of this 20 billion yen increase represents existing businesses' growth and how much represents investment returns? Also, which divisions do you expect to contribute most and least to achieving your three-year plan's profit target?

We envision the 20 billion yen increase being split roughly 50:50 between growth in existing businesses and returns from previous and new investments. Our three-year plan's target factors in downside risk scenarios also. In the Metals Division, for example, such downside risks include cessation of auto production growth and decreased sheet steel sales due to replacement of steel with new materials. On the upside, the three-year plan's target also factors in the positive impact of growth in, for example, aluminum processing and tailored blanking.

Among individual divisions, we expect the Metals, Chemicals & Electronics, and Africa Divisions to grow the most. We do not anticipate much growth in the Machinery, Energy & Project Division given the expenses it is incurring while investing in projects that will not start contributing to profits until after FY2021. For the other three divisions, we are projecting organic growth.

What was the breakdown of your investments in R&E (resources & environment) businesses in FY2018 and what is the breakdown of planned R&E investments in your new three-year plan? Also, how long before these investments start contributing to profits?

In FY2018, the vast majority of our R&E investments were related to renewable energy, which will account for most of our R&E investments over the next three years also. Other businesses in which we are investing include recycling of metal resources, including batteries. We don't think the renewable energy investments will begin contributing to profits until after the three-year plan's term, but we expect investments in business such as metal resource recycling to contribute to profits relatively soon.

Is your increase in inventories healthy growth accompanying profit growth or problematic inventory accumulation that needs to be pared down?

We believe it is healthy inventory growth accompanying profit growth. At the same time, we still see room to reduce inventories. We manage inventories based on their absolute level. We aim to keep inventories at around 700 billion yen, whereas they ended FY2018 in the vicinity of 750 billion yen. Additionally, we manage working capital on a cash-conversion-cycle basis. Our cash conversion cycle is currently around 40 days. We aim to reduce it to 39 days during FY2019.

I realize you care a lot about the size of your dividends. Do you plan to maintain a 28% dividend payout ratio even if you surpass your earnings forecast in FY2019? Additionally, with ROE projected to decrease in the wake of the annual profit increases of ¥10 billion targeted by your three-year plan, will you change your dividend policy in the future?

What we care about is dividend growth. This mindset has not changed. In FY2019, our first priority is to increase our dividend per share for a 10th consecutive year. A 28% dividend payout ratio does not have any special significance to us. This year, we changed to a basic policy of maintaining a dividend payout ratio of 25% or more. We consider this policy to be a sort of commitment to a minimum payout ratio of 25%. However, we understand that 28% is one benchmark. If earnings surpass our forecast, we intend to rethink our dividend plan.

We recognize that ROE will decrease if we do not increase our dividends enough, but we place priority on cash flow over ROE. To the extent we can maintain a free-cash-flow surplus after dividends by generating 200-220 billion yen of operating cash flow per year, limiting investments to roughly 150 billion yen per year and paying dividends of 120 yen per share, which equate to about 42 billion yen in total, we believe our dividend still has room to grow.

In FY2018, we were able to slim down our balance sheet, achieving our goals of reducing our net debt/equity ratio to 0.8 and our net interest-bearing debt to below 1 trillion yen. We will consequently have more funds available for dividends going forward and plan to pay FY2019 dividends of 120 yen per share.

You said you plan to invest about 20 billion yen in digital transformation. What areas are you planning to invest in and how much do you plan to invest in each?

We plan to invest in four digital transformation initiatives as set forth in our three-year plan. From a P/L standpoint, however, the four initiatives can be reframed as three objectives: (1) overhead cost-cutting, (2) reduction in cost of sales and (3) sales growth. We plan to spend about 20% of the 20 billion yen on overhead cost-cutting, about 40% on reducing cost of sales, and the remainder in pursuit of sales growth. To reduce overhead expenses, we are automating internal business processes through such means as installing RPA (robotic process automation). To reduce cost of sales, we are carrying out *kaizen* (continuous improvement) activities through an "on-site, hands-on, in-touch" approach. Reduction in cost of sales mainly correspond to value chain digitalization and reform of existing business models in our digital transformation framework. To grow sales, we aim to create new businesses and innovation. However, we plan to do so through a process that involves proof-of-concept testing, so the probability of any given idea reaching the commercialization stage is low. We accordingly do not anticipate rapid sales growth.