Toyota Tsusho Corporation
Earnings Briefing for Six Months Ended September 30, 2016
Condensed Transcript of Q&A Session

Date & time: November 4, 2016 (Friday) 16:00–17:00

Attendees:

Jun Karube, President/CEO
Hideki Yanase, Managing Director
Hiroshi Tominaga, Executive Officer
Hideyuki Iwamoto, Executive Officer

Q: What is your second-half outlook for the Automotive Division?

A: Overall, we expect adverse conditions to persist in the second half also. African demand has been slow to recover.

The Kenya economy in particular is in a slump stemming from an increase in excise duties in addition to a decrease in the government's purchasing power due to fiscal deterioration and reduced tourism revenues. We expect Kenya auto sales to remain depressed (we expect one turning point to arrive when the excise duty increases' impact has run its course). In Angola, auto sales are down but first-half revenues were up slightly year on year by virtue of contributions from parts sales and strengthening of service.

In Russia and Eastern Europe, we anticipate an upturn in auto sales. In Papua New Guinea, however, we expect auto sales to remain sluggish, partly because of a foreign-currency shortage due to resource price declines.

Q: What is the situation in Machinery, Energy & Project Division and the factors behind the downward revision of your forecast?

A: Adjusted to reverse offsetting of non-operating foreign exchange gains/losses, its first-half operating income was, I believe, nearly unchanged year on year. The renewable energy business performed well in the first half, partly reflecting a newly commissioned solar power plant's contribution. Some wind power sites, however, have been shut down in the aftermath of recent typhoons. Our downwardly revised forecast reflects these shutdowns' negative impact in the second half. However, we expect to receive insurance reimbursement of losses due to the shutdowns, though perhaps not until next fiscal year. Overseas development projects also are progressing. The renewable energy business's overall contribution is positive.

Q: Could you provide an update on the Chemicals & Electronics Division?

A: The chemicals business is performing well. In particular, our Toyotsu Chemiplas subsidiary's consolidation of its domestic warehouses, inventory downsizing and logistics cost cutting have paid off. We plan to extend such improvement initiatives to our electronics business also.

The electronics business is beset by an adverse environment but now looks likely to recover earlier than we were expecting. It has not been affected by Samsung Electronics' product recall.

Q: What is Toyota Motor's overseas production outlook?

A: In North America, I believe production is peaking but we should benefit from strong demand for large vehicles and SUVs in the wake of model mix changes. In China, auto sales are robust, bolstered by continued tax breaks on compact (B-segment) vehicles. Production likewise is buoyant in China. In Thailand, domestic auto sales will likely be adversely affected by the Thai king's recent death, but Toyota has not halted IMV production. Its Thai plants are operating as usual.

Q: To what extent will Suzuki Motor's plant in Gujarat, India, and Toyota's new Mexico plant contribute to your earnings?

A: Suzuki plans to commission a manufacturing plant with annual production capacity of 250,000 vehicles in India in 2017. We have already started to deliver production equipment to the plant and are in discussions with Suzuki about supplying the plant with sheet steel, other processed metals, parts, logistics services and so on.

It is our desire and intent to further increase our business with Suzuki related to its auto production operations in Gujarat.

Toyota's Mexico plant is scheduled to commence operations in 2019. We plan to start equipping it in 2018 and supplying production materials and logistics services from 2019.

Q: In your revised earnings forecasts, why did you leave your initial ordinary income forecast unchanged while lowering your operating income forecast by ¥14.0 billion?

A: About ¥10.0 billion of the ¥14.0 billion downward revision was attributable to a non-operating foreign exchange gain/loss offset due to yen appreciation.

For the second half, we revised our forecast's dollar/yen exchange rate assumption to ¥100. This revision was another factor behind the downward revision of our operating income forecast. From the ordinary income line downward, however, we left our forecasts unchanged, largely because of improvement in non-operating income.

Q: What is your quantitative target for net interest-bearing debt?

A: We aim to reduce our net interest-bearing debt to below ¥1 trillion during the current fiscal year.

Q: After curtailing investment in the current fiscal year, do you have any plans to accelerate the investment in the future?

A: We take last fiscal year's loss seriously. It prompted us to review our past investments and realize that our operations had become bloated in certain areas. In the current fiscal year, we are placing priority on streamlining our operations in the aim of getting leaner. Our pipeline of investment deals itself has not shrunk much, but we are proceeding more cautiously than in the past based on our review of previous investments. I expect investment to start increasing again from next fiscal year.

Q: What are the factors behind the first-half improvement in working capital?

A: Last fiscal year, we generated positive operating cash flow in excess of ¥300.0 billion as a result of a thorough reassessment of long-term inventories and sites. We are diligently continuing such activities again in the current fiscal year. With our inventories now below ¥600.0 billion, I doubt we can reduce them further, but we will continue with the site reforms. However, if sales grow, working capital also will increase. We consequently do not expect operating cash flow to permanently remain at its current level, but we intend to maintain a lean financial position and continue to steadily make incremental improvements. From next fiscal year, we plan to allocate cash flow to investment also.

Q: Could you provide an update on CFAO on a segment-by-segment basis?

A: The equipment & services segment has been hard hit by the economic slump in West Africa. Its sales are sluggish in Algeria and Nigeria, the latter of which is an oil producer, and, as a result of discontinuation of sales of Nissan vehicles, in Ghana and the Republic of Congo also. Its recent sales trend is unlikely to change for the time being.

The healthcare segment's performance has been stable, although demand has softened a bit in the Maghreb region, particularly in the Algerian market.

In the consumer goods segment, the beverage business's earnings have been reduced by intensification of competition with Castel in the Republic of Congo. However, CFAO is expanding its beverage business into Cote d'Ivoire, where Castel has a large market share. CFAO aims to gain a new source of earnings.

The retail JV with Carrefour plans to open six additional stores. We expect it to start incurring up-front costs to open the new stores within 2-3 years.

Q: What are the factors behind the auto sales slump in Africa?
A: One factor behind CFAO's subpar performance is that the African auto market itself has contracted in the wake of resource price declines. However, CFAO has not lost market share in the countries in which it sells Toyota vehicles. On the contrary, it has been gaining market share in some countries. It intends to focus more intently on sales going forward. Additionally, CFAO has been hurt by expiration of sales agreements with Nissan and certain other OEMs. We are now discussing this with CFAO, including what steps to take next.

Q: What is your auto sales strategy in Africa going forward?
A: We feel that motorization is accelerating, driven by growth in the middle class. Auto demand in Africa is currently shifting from used vehicles to low-priced new vehicles. Amid such an environment, CFAO is increasingly stocking its dealerships with Suzuki vehicles. Its strategy is to expand its model lineup to include Yamaha motorcycles at entry-level price points, Suzuki compact cars as the next rung on the ladder and Toyota vehicles at the high end.

Q: Over the past several years, your operating income has been flat while Toyota Motor's auto production has increased marginally. Are you no longer functioning as well as in the past?
A: From a functional standpoint, I believe that most important metric is gross profit margin. We have maintained a gross profit margin in the vicinity of 7%–no negative impression there. However, we are involved in new businesses such as CFAO and Eurus Energy Holdings in addition to our traditional functions, namely operations peripheral to auto production, such as blanking and tire assembly. But we have not yet developed new functions that substantially boost gross profit margin.

Q: What factors have contributed negatively and positively to recent earnings?
A: One positive factor is that we have built strong relationships with Toyota and the Toyota Group and have had many business expansion opportunities. A second positive in terms of auto production is that we have started doing business with automakers other than Toyota–for example, Nissan, Volkswagen and Suzuki. A negative factor is that once core businesses such as molten aluminum and Green Metal (metal recycling) are back to normal, customer demands for cost savings will intensify.

Q: What you expect to drive earnings growth going forward?
A: In response to last fiscal year's loss, we are repositioning in the current fiscal year. We aim to get back to a lean financial position. We have numerous business opportunities we want to pursue. First, we believe it is important to ensure our standing as a supplier to Suzuki's Gujarat plant and Toyota's new Mexican plant. Second, we are steadily expanding our renewable energy business and strengthening our electronics business by merging two subsidiaries to form Nexty Electronics. In the Food & Consumer Services Division, we are currently discussing how to best proceed in the Toyota Tsusho tradition, including in Brazil with NovaAgri, a subsidiary acquired last year. We intend to chart a course into the future.