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Highlights of General Trading Companies' Financial Results for Fiscal Year Ended March 2019

The following are Japan Credit Rating Agency, Ltd. (JCR)'s perception of the current status and highlights for rating concerning the financial results for the fiscal year ended March 2019 (FY2018) and earnings forecasts for FY2019 of Japan's 6 general trading companies: Mitsubishi Corporation ("Mitsubishi"), SUMITOMO CORPORATION ("SUMITOMO"), MITSUI & CO., LTD. ("MITSUI"), Marubeni Corporation ("Marubeni"), ITOCHU Corporation ("ITOCHU") and Sojitz Corporation("Sojitz").

1. Industry Trend

FY2018 saw prices in the resource segment generally stay at a high level, positively contributing to overall results for many general trading companies. The thermal coal price per ton went up from around USD 94 in FY2017 to around USD 106 in FY2018, while the crude oil price per barrel rose from USD 50 - 60 range to around USD 70. Although there are differences among the companies in terms of amount of effects of price change, sensitivity of crude oil to annual net income (effects of price change by UDS 1 per barrel) was 3.1 billion yen for MITSUI (according to its IR materials), and market conditions for crude oil, gas, coal, copper, and other resources appear to have had a positive impact on the net income attributable to owners of the parent by approximately 46 billion yen in FY2018. As resource prices are susceptible to global political and economic changes, however, it is difficult to make highly accurate forecasts. Therefore, it is necessary to keep a close watch on market trends.

The companies have been continuing active new investments to develop new earnings sources. Due partly to disposal of losses in the resource sector in FY2014 and FY2015, their total new investments decreased by a little less than 1 trillion yen from a year earlier to a little less than 2 trillion yen in FY2016, but their new investments increased to a little less than 2.3 trillion yen in FY2017 and then a little less than 2.8 trillion yen in FY2018. As there are now large-scale projects of over 100 billion yen, it is necessary to pay attention to diversification of investment projects. While making these new investments, they are also initiatively working on investment recovery. Continuous replacement of assets is a major characteristic of general trading companies. They pursue recoveries from investments for the purpose of withdrawal from less efficient investments, but some of recoveries are planned to more advantageously sell the peaking-out businesses from a perspective of business life cycle. ITOCHU implemented investment recovery amounting to approximately 480 billion yen including sales of retail and resource related projects, while making new investments of around 500 billion yen in FY2018.

2. Financial Results

Net income of the 6 companies in total increased 8.8% year-on-year to 2,127.3 billion yen for FY2018. Each company maintained a high level net income in resource sector with prices of main products staying at a high level. Mitsubishi and MITSUI, which have a strong business base in resource sector, in particular, ensured a net income of more than 200 billion yen in this sector. ITOCHU recorded a net income of more than 100 billion yen, and SUMITOMO, Marubeni and Sojitz all recorded several tens of billions of net income in this sector. However, there are still cases where losses are recorded in resource sector. For example, Mitsubishi recorded an impairment loss of 30.9 billion yen on the Chilean iron ore business. Net income for non-resource sector decreased for some of the 6 companies due partly to loss recordings, but all companies ensured a high level net income for non-resource sector with the income remaining steady in general for FY2018. As a result, 5 companies except MITSUI increased their consolidated net income, and they all posted a record net income.

Looking at their total financial figures, net DER remained unchanged, because net interest-bearing debt increased by approximately 500 billion yen, while equity capital (total capital less non-controlling interests) grew by around 1,370 billion yen. There were slight differences among companies in terms of changes in net interest-bearing debt: MITSUI and ITOCHU increased, while SUMITOMO, Marubeni, and Sojitz decreased, and Mitsubishi left it roughly unchanged. All companies increased equity capital. All ensured a high level net income and advanced their accumulation of capital. However, there were effects from valuation of financial assets and fluctuations in foreign exchange rates for some companies. For example, while ITOCHU increased its equity capital by 267.4 billion yen, increased valuation of financial assets was a positive factor amounting to 111.2 billion yen, while fluctuations in foreign currency rates were a negative factor amounting to 55.6 billion yen for the equity capital. Equity capital of general trading companies, which have a large amount of foreign assets associated with their overseas investments and also financial assets related to their investment business, is susceptible to valuation of these assets. It should be kept in mind. Some companies issue hybrid securities to strengthen their financial base. In many cases, a credit rating agency considers 50% of the issue amount as capital, but for accounting purposes, they are reported as liabilities or capital in full, depending on issue terms. In such cases, JCR sees that they should be considered 50% as capital and 50% as liabilities when calculating financial indicators.

3. Highlights for Rating

While many companies conservatively estimate resource prices, they forecast steady trend for all business areas in the non-resource sector for FY2019. Consequently, total net income of 6 companies is expected to increase 3.5% year-on-year to 2,202 billion yen, and 5 companies except ITOCHU expect to mark a new record. Proportions of resource and non-resource sectors in the net income considerably vary among them. Based on current resource prices, resource sector accounts for more than half of the net income for MITSUI, which highly relies on resource sector. The resource sector accounts for roughly 10% to 30% for other companies. This sector is susceptible to price changes and the profit is volatile. In the non-resource sector, on the other hand, although there are some businesses that are affected by price fluctuations, the profit is stable as compared with resource sector. Accordingly, many companies aim to strengthen earnings in the non-resource sector, and JCR is looking at progress in their efforts.

On the financial front, many companies control net DER at around 1. There is a strong tendency to secure a positive cash flow and focus on financial conditions. JCR sees that their net DER will continue gradually improving.

Operating in wide-ranging business areas, general trading companies inevitably incur a certain amount of losses every fiscal year. In particular, new investments are more likely to cause losses than existing businesses due to changes in external environment. In the resource sector, substantial losses were recorded in FY2014 and FY2015 due to fall of prices. Even in the non-resource sector, there are some cases where business did not proceed as expected and losses were recorded. JCR sees that each company will control the amount of losses within the scope of financial strength for the time being thanks to the ongoing asset reviews, but risk management continues to be a key management challenge.

Risk management against unexpected losses is also important for a general trading company operating a wide range of businesses. Many companies calculate risk assets (maximum amount of losses assumed under certain conditions) and manage them by balancing them with risk buffers such as equity capital (risk assets / risk buffers). As of the end of FY2018, all of 4 companies that disclose their risk assets secured a certain margin against a factor of 1.

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(Chart 1) Consolidated Business Performance

(JPY 100 mn)

	Mitsubishi (8058)			SUMITOMO (8053)			MITSUI (8031)		
	FY2017	FY2018	FY2019F	FY2017	FY2018	FY2019F	FY2017	FY2018	FY2019F
Revenues	75,673	161,037	-	48,273	53,392	-	48,921	69,575	-
Operating Income	4,993	5,844	-	2,248	2,756	-	2,190	2,721	3,100
Net Income	5,601	5,907	6,000	3,085	3,205	3,400	4,184	4,142	4,500

	Marubeni (8002)			ITOCHU (8001)			Sojitz (2768)		
	FY2017	FY2018	FY2019F	FY2017	FY2018	FY2019F	FY2017	FY2018	FY2019F
Revenues	75,403	74,012	-	55,100	116,004	-	18,164	18,561	-
Operating Income	1,180	1,730	1,750	3,169	3,614	4,390	697	675	775
Net Income	2,112	2,308	2,400	4,003	5,005	5,000	568	704	720

	Total		
	FY2017	FY2018	FY2019F
Revenues	321,537	492,584	-
Operating Income	14,479	17,343	-
Net Income	19,556	21,273	22,020

Notes:
1. Operating income = Gross profit - SG&A expenses
2. FY2019 forecasts are as announced by each company.

Source: Prepared by JCR based on financial materials of above companies

(Chart 2) Consolidated Financial Structure

(JPY 100 mn, times)

	Mitsubishi			SUMITOMO			MITSUI		
	FY2017	FY2018	FY2019F	FY2017	FY2018	FY2019F	FY2017	FY2018	FY2019F
Net Interest-bearing Debt	37,141	37,235	-	25,215	24,271	-	30,892	36,592	-
Equity Capital	53,324	56,962	-	25,581	27,714	-	39,747	42,631	-
Net DER	0.70	0.65	-	0.99	0.88	-	0.78	0.86	-

	Marubeni			ITOCHU			Sojitz		
	FY2017	FY2018	FY2019F	FY2017	FY2018	FY2019F	FY2017	FY2018	FY2019F
Net Interest-bearing Debt	19,158	18,588	18,100	23,204	24,067	25,500	6,034	5,847	6,400
Equity Capital	17,714	19,777	-	26,694	29,369	30,000	5,864	6,182	6,600
Net DER	1.08	0.94	-	0.87	0.82	0.85	1.03	0.95	0.97

	Total		
	FY2017	FY2018	FY2019F
Net Interest-bearing Debt	141,646	146,601	-
Equity Capital	168,927	182,638	-
Net DER	0.84	0.80	-

Notes:
1. Equity capital = Total equity - Non-controlling interests
2. Net DER = Net interest-bearing debt / Equity capital
3. FY2019 forecasts are as announced by each company.

Source: Prepared by JCR based on financial materials of above companies

<Reference>

Issuer: ITOCHU Corporation

Long-term Issuer Rating: AA Outlook: Stable

Issuer: Marubeni Corporation

Long-term Issuer Rating: A+ Outlook: Stable

Issuer: Sojitz Corporation

Long-term Issuer Rating: BBB+ Outlook: Positive

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