

Highlights of General Trading Companies' Financial Results for Fiscal Year Ended March 2021

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 2021 (FY2020) and earnings forecasts for FY2021 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

In the resource sector, there were differences in price movements depending on the commodities. For example, price of crude oil fell from around USD 60 per barrel in FY2019 to around USD 40 per barrel in FY2020, and price of coking coal fell from around USD 160 per ton to less than USD 120 per ton. On the other hand, copper price rose from around USD 6,000 per ton to around USD 6,500 per ton, and iron ore price rose from the USD 90 per ton range to USD 120 per ton range. Although the amount of impact differs from company to company, MITSUI recorded a negative impact of 50 billion yen for crude oil and gas and 22 billion yen for coal, and a positive impact of 56 billion yen for iron ore on net income attributable to owners of the parent (net income) for FY2020. It is difficult to forecast resource prices with a high degree of certainty, because they are easily affected by global political and economic changes. It is necessary to continue to carefully monitor market trends.

Each company has been continuing proactive new investments to develop new earnings sources. Total amount of new investments by the 6 companies has been generally between 2 trillion yen and 3 trillion yen. As there have been large projects of over 100 billion yen per project in recent years, it is necessary to pay attention to diversification of investment projects. While making new investments, they are also actively working on investment recovery. Continuous replacement of assets is a major characteristic of a general trading company. Some of the recovery projects are aimed at withdrawing from inefficient investments, while others are aimed at selling off businesses that are peaking out at more advantageous prices from the perspective of the business life cycle. Marubeni invested 111.8 billion yen in new investments in FY2020, while investment recoveries, including sales of overseas power generation and reinsurance businesses, totaled 108.3 billion yen, meaning that the majority of new investment funds were covered by recoveries of existing investments.

2. Financial Results

Total net income of the 6 companies for FY2020 was 1,008.7 billion yen (down 31.0% from the previous year). In the resource sector, there was a decline in the prices of crude oil and coal, while in the non-resource sector, the COVID-19 pandemic affected automobile, lifestyle and textile related businesses. Excluding Marubeni, which posted a loss in FY2019, all 5 companies reported a decline in the net income. However, there are differences in the financial results of companies due to differences in their business portfolios. ITOCHU, which has strength in non-resource sector, secured the industry's highest amount of 401.4 billion yen, despite the decline in the income. Marubeni, which had fallen into the red in FY2019 due to the disposal of a large amount of losses, secured an increase in its net income excluding one-time losses, indicating the stability of its earnings. SUMITOMO posted a loss of 197.4 billion yen in net income due to large one-time losses in a wide range of areas including the nickel business in Madagascar and the steel pipe business.

Looking at their total financial figures, net interest-bearing debt decreased by approximately 340 billion yen and equity capital (total equity less non-controlling interests) increased by approximately 1.78 trillion yen, resulting in a 0.11-point improvement in net DER to 0.79x. Net interest-bearing debt decreased at Mitsubishi, SUMITOMO, MITSUI and Marubeni, and it remained almost unchanged at Sojitz, but increased at ITOCHU due to the acquisition of additional shares in FamilyMart Co., Ltd. There were slight differences in movements among companies. Equity capital increased at all 5 companies except SUMITOMO, which posted a loss. For them, in addition to the increase through profit, positive impact from changes in foreign exchange rates and valuation of financial assets was

significant. ITOCHU, for example, saw its equity capital increase by 320.3 billion yen, of which 169.4 billion yen came from exchange rate fluctuations and 70.7 billion yen came from increased valuation of financial assets. General trading companies hold a large amount of foreign currency-denominated assets related to overseas investments and financial assets related to investment businesses, and their equity capital is often affected by the valuation of these assets, so caution is required. 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, depending on the terms of the issue, the entire amount may be recorded as liabilities or as capital. In these cases, JCR considers that financial indicators should be calculated by considering 50% as capital and 50% as liabilities.

3. Highlights for Rating

Given the rising prices of major commodities such as iron ore, copper, coal, and crude oil in resource sector, JCR expects the COVID-19 pandemic impact to ease in non-resource sector in FY2021. As a result, resource and non-resource sectors both are expected to perform well in general, and the 6 companies' total net income is planned to increase 88.7% year on year to 1,903 billion yen. All 6 companies expect the net income to increase. Ratios of resource sector and non-resource sector to net income vary from company to company. Assuming the current resource prices, MITSUI is characterized by a high degree of dependence on the resource sector, with the resource sector accounting for the majority of the income. For other companies, resource sector accounts for about 10% to 30%. Resource sector is susceptible to price fluctuations, and profits are likely to change. On the other hand, in non-resource sector, there are some businesses that are affected by price fluctuations, but profits are more stable than in resource sector. Many companies are aiming to further strengthen earnings in their non-resource sector, and JCR is watching the progress.

On the financial side, many companies control their net DER at around 1x. There is no change in their attitudes placing importance on financial structure, and JCR expects their net DER to remain at the current level by securing a positive free cash flow.

General trading companies have a wide range of business fields, and they inevitably incur losses of a certain scale every fiscal year. New investments, in particular, are more prone to losses due to changes in external environment than existing businesses. Recent examples of large losses include Marubeni in FY2019 and SUMITOMO in FY2020, both of which posted net losses. In resource sector, there are many cases where losses from interests acquired at high prices in the past are recorded due to market fluctuations. In non-resource sector as well, there are cases where businesses do not progress as planned at the time of investment and losses are recorded. In the future, JCR thinks that losses may become apparent in cases where companies are in a hurry to sell their resource interests as an ESG response. As each company is continuously reviewing its assets, JCR basically believes that the amount of loss is expected to be within the financial strength of each company, but risk management remains an important management issue.

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 expected under certain conditions) and manage them by balancing the amount with equity capital, etc. as risk buffer (risk assets/ risk buffer). As of the end of FY2020, all 4 companies that disclose their risk assets secured a certain margin for 1x.

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(Chart 1) Consolidated Business Performance

(JPY 100 mn)

	Mitsubishi (8058)			SUMITOMO (8053)			MITSUI (8031)		
	FY2019	FY2020	FY2021F	FY2019	FY2020	FY2021F	FY2019	FY2020	FY2021F
Revenues	147,797	128,845	-	52,998	46,450	-	84,841	80,102	-
Operating Income	3,578	2,073	-	1,962	505	-	2,545	2,050	2,300
Net Income	5,353	1,725	3,800	1,713	-1,530	2,300	3,915	3,354	4,600

	Marubeni (8002)			ITOCHU (8001)			Sojitz (2768)		
	FY2019	FY2020	FY2021F	FY2019	FY2020	FY2021F	FY2019	FY2020	FY2021F
Revenues	68,276	63,324	-	109,829	103,626	-	17,548	16,024	-
Operating Income	1,338	1,415	-	3,994	4,034	4,440	472	270	420
Net Income	-1,974	2,253	2,300	5,013	4,014	5,500	608	270	530

	Total		
	FY2019	FY2020	FY2021F
Revenues	481,291	438,373	-
Operating Income	13,892	10,349	-
Net Income	14,629	10,087	19,030

Notes:

1. Operating income = Gross profit - SG&A expenses
2. FY2021 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		
	FY2019	FY2020	FY2021F	FY2019	FY2020	FY2021F	FY2019	FY2020	FY2021F
Net Interest-bearing Debt	43,362	41,784	-	24,687	23,004	-	34,867	32,997	-
Equity Capital	52,273	56,136	-	25,441	25,279	-	38,176	45,704	-
Net DER	0.83	0.74	-	0.97	0.91	-	0.91	0.72	-

	Marubeni			ITOCHU			Sojitz		
	FY2019	FY2020	FY2021F	FY2019	FY2020	FY2021F	FY2019	FY2020	FY2021F
Net Interest-bearing Debt	18,591	16,878	18,500	22,568	26,013	-	6,131	6,106	7,800
Equity Capital	15,154	18,190	-	29,959	33,162	-	5,791	6,191	6,400
Net DER	1.23	0.93	-	0.75	0.78	-	1.06	0.99	1.22

	Total		
	FY2019	FY2020	FY2021F
Net Interest-bearing Debt	150,209	146,785	-
Equity Capital	166,797	184,664	-
Net DER	0.90	0.79	-

Notes:

1. Equity capital = Total equity - Non-controlling interests
2. Net DER = Net interest-bearing debt/ Equity capital
3. FY2021 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: A- Outlook: Stable

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