

Highlights of General Trading Companies' Financial Results for Fiscal Year Ended March 2020

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 2020 (FY2019) and earnings forecasts for FY2020 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 and Impact of COVID-19 Pandemic

In FY2019, there were the COVID-19 pandemic impacts in parts of the businesses in non-resource sector, and while price of iron ore increased, prices of crude oil, copper and coal dropped in resource sector, which caused the profit to increase and decrease. In the non-resource sector, general trading companies operate diverse businesses and thus enjoy relatively high stability of profit, but the COVID-19 pandemic impacts are different among companies, as they have different business portfolios. Businesses that are being significantly affected include the automotive and materials businesses. Prices in the resource sector remain unstable and crude oil price has recently significantly dropped. As for the price movements of major items from FY2018 to FY2019 and the current ones, crude oil per barrel dropped from approximately USD 70 in FY2018 to approximately USD 60 in FY2019 and currently dropped to around USD 35, coking coal per ton dropped from approximately USD 200 to approximately USD 160 and currently dropped to approximately USD 110, while iron ore per ton increased from approximately USD 70 to approximately USD 95 and currently increased to approximately USD 100. Although there are differences among companies in terms of amount of effects of price change, sensitivity of crude oil to annual net income (effects of price change by USD 1 per barrel) was 3.2 billion yen for MITSUI (according to its IR materials), and changes in prices of crude oil and coal appear to have had a negative impact on the net income attributable to owners of the parent (net income) by approximately 34 billion yen, while those in iron ore appear to have a positive impact on the net income by approximately 50 billion yen in FY2019. As resource prices are susceptible to global political and economic changes, it is difficult to make highly accurate forecasts. Therefore, it is necessary to keep a close watch on their price 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 remained at a high level with a little less than 2.3 trillion yen in FY2017, a little less than 2.8 trillion yen in FY2018, and a little less than 2.6 trillion yen in FY2019. Given the increasing uncertainties about external environment due to the COVID-19 pandemic impact, it is likely that their new investments will be reduced in FY2020. 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. Marubeni recovered its investments by approximately 100 billion yen partly through sales of domestic retail and overseas power generation businesses against new investments amounting to approximately 150 billion yen in FY2019, covering majority of the new investments by recoveries of existing investments.

2. Financial Results

Net income of the 6 companies in total decreased 31.2% year-on-year to 1,462.9 billion yen for FY2019. Although there were many businesses which ensured proper profits mainly in the non-resource sector, the COVID-19 pandemic impact began to be seen in businesses such as automotive and materials businesses. There are differences among companies in financial results, reflecting

differences in their business portfolios. ITOCHU, which has strength in non-resource sector, ensured a net income of 501.3 billion yen, which was almost on a par with the amount for FY2018. Mitsubishi, SUMITOMO, MITSUI, and Sojitz all decreased their net income, but maintained due income. Marubeni, however, recorded a large amount of losses in resource and US grain businesses due partly to the COVID-19 pandemic impact and rapid fall of crude oil price, and plunged into a net loss of 197.4 billion yen. Risks of investments in the past arose due to changes in the external environment.

Looking at their total financial figures, net DER worsened by 0.1 points to 0.90x, as net interest-bearing debt increased by approximately 430 billion yen, while equity capital (total capital less non-controlling interests) decreased by approximately 1,580 billion yen. There were slight differences among companies in terms of changes in net interest-bearing debt: Mitsubishi and Sojitz increased the debt, MITSUI and ITOCHU decreased the debt, and those of SUMITOMO and Marubeni remained unchanged. ITOCHU only increased equity capital and all other 5 companies decreased their equity capital. The net loss has a significant impact on the decrease of equity capital for Marubeni, but there were effects from valuation of financial assets and fluctuations in foreign exchange rates for Mitsubishi, MITSUI, SUMITOMO, and Sojitz. For example, MITSUI decreased its equity capital by 445.4 billion yen, and fluctuations in foreign exchange rates had a negative impact of 301.6 billion yen and write-down of financial assets had a negative impact of 349.0 billion yen on its equity capital. Equity capital of general trading companies, which have a large amount of foreign currency denominated assets associated with their overseas investments and also financial assets related to their investment business, is susceptible to these valuations. 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

The COVID-19 pandemic impact will become serious in FY2020. As for net income, while MITSUI, ITOCHU, and Sojitz expects their net income to decrease 54.0%, 20.2%, and 34.2% year-on-year, respectively, and also Marubeni which incurred a net loss for FY2019 expects its net income to decrease 46.7% year-on-year based on the real net income excluding temporary gains and losses, both Mitsubishi and SUMITOMO did not announce their earnings forecasts for FY2020, explaining that there are uncertainties about outlook of environments. All companies will decrease their income, but the decrease will be relatively small for ITOCHU among them. Businesses which will be less affected include electricity, infrastructure and foods, while those which will be much affected include automotive, materials, aircraft and fiber. The crude oil and other prices are falling, which will have negative impact.

Many companies financially control net DER at around 1. In the face of increasing uncertainties about external environment due to the COVID-19 pandemic impact, every company is increasingly valuing its ensuring positive cash flow and its financials. JCR sees that their net DER will gradually improve.

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 resource sector, many companies recorded large amounts of losses in FY2014 and FY2015 due to fall in prices. Even in non-resource sector, there are cases where business did not proceed as expected and losses were recorded. In FY2019, Marubeni incurred large amounts of impairment losses in the oil and gas development, US grain, Chilean copper mining and other businesses. JCR basically sees that every company will control the amount of losses within the scope of financial strength 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 FY2019, all of 4 companies that disclose their risk assets secured a certain margin against 1.

Hiroyuki Chikusa, Akihisa Motonishi

(Chart 1) Consolidated Business Performance

(JPY 100 mn)

	Mitsubishi (8058)			SUMITOMO (8053)			MITSUI (8031)		
	FY2018	FY2019	FY2020F	FY2018	FY2019	FY2020F	FY2018	FY2019	FY2020F
Revenues	161,037	147,797	-	53,392	52,998	-	69,575	68,850	-
Operating Income	5,844	3,578	-	2,756	1,962	-	2,721	2,545	700
Net Income	5,907	5,353	-	3,205	1,713	-	4,142	3,915	1,800

	Marubeni (8002)			ITOCHU (8001)			Sojitz (2768)		
	FY2018	FY2019	FY2020F	FY2018	FY2019	FY2020F	FY2018	FY2019	FY2020F
Revenues	74,012	68,276	-	116,004	109,829	-	18,561	17,548	-
Operating Income	1,730	1,338	-	3,614	3,994	-	675	472	450
Net Income	2,308	-1,974	1,000	5,005	5,013	4,000	704	608	400

	Total		
	FY2018	FY2019	FY2020F
Revenues	492,584	465,300	-
Operating Income	17,343	14,066	-
Net Income	21,273	14,629	-

Notes:

1. Operating income = Gross profit - SG&A expenses
2. FY2020 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		
	FY2018	FY2019	FY2020F	FY2018	FY2019	FY2020F	FY2018	FY2019	FY2020F
Net Interest-bearing Debt	37,235	43,362	-	24,271	24,687	-	35,921	34,867	-
Equity Capital	56,962	52,273	-	27,714	25,441	-	42,631	38,176	-
Net DER	0.65	0.83	-	0.88	0.97	-	0.84	0.91	-

	Marubeni			ITOCHU			Sojitz		
	FY2018	FY2019	FY2020F	FY2018	FY2019	FY2020F	FY2018	FY2019	FY2020F
Net Interest-bearing Debt	18,588	18,591	18,100	24,067	22,568	-	5,847	6,131	6,800
Equity Capital	19,777	15,154	-	29,369	29,959	-	6,182	5,791	6,000
Net DER	0.94	1.23	-	0.82	0.75	-	0.95	1.06	1.13

	Total		
	FY2018	FY2019	FY2020F
Net Interest-bearing Debt	145,929	150,209	-
Equity Capital	182,638	166,797	-
Net DER	0.80	0.90	-

Notes:

1. Equity capital = Total equity - Non-controlling interests
2. Net DER = Net interest-bearing debt / Equity capital
3. FY2020 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

Japan Credit Rating Agency, Ltd.

Jiji Press Building, 5-15-8 Ginza, Chuo-ku, Tokyo 104-0061, Japan

Tel. +81 3 3544 7013, Fax. +81 3 3544 7026

Information herein has been obtained by JCR from the issuers and other sources believed to be accurate and reliable. However, because of the possibility of human or mechanical error as well as other factors, JCR makes no representation or warranty, express or implied, as to accuracy, results, adequacy, timeliness, completeness or merchantability, or fitness for any particular purpose, with respect to any such information, and is not responsible for any errors or omissions, or for results obtained from the use of such information. Under no circumstances will JCR be liable for any special, indirect, incidental or consequential damages of any kind caused by the use of any such information, including but not limited to, lost opportunity or lost money, whether in contract, tort, strict liability or otherwise, and whether such damages are foreseeable or unforeseeable. JCR's ratings and credit assessments are statements of JCR's current and comprehensive opinion regarding redemption possibility, etc. of financial obligations assumed by the issuers or financial products, and not statements of opinion regarding any risk other than credit risk, such as market liquidity risk or price fluctuation risk. JCR's ratings and credit assessments are statements of opinion, and not statements of fact as to credit risk decisions or recommendations regarding decisions to purchase, sell or hold any securities such as individual bonds or commercial paper. The ratings and credit assessments may be changed, suspended or withdrawn as a result of changes in or unavailability of information as well as other factors. JCR receives a rating fee paid by issuers for conducting rating services in principle. JCR retains all rights pertaining to this document, including JCR's rating data. Any reproduction, adaptation, alteration, etc. of this document, including such rating data, is prohibited, whether or not wholly or partly, without prior consent of JCR.

JCR is registered as a "Nationally Recognized Statistical Rating Organization" with the U.S. Securities and Exchange Commission with respect to the following four classes. (1) Financial institutions, brokers and dealers, (2) Insurance Companies, (3) Corporate Issuers, (4) Issuers of government securities, municipal securities and foreign government securities.

JCR publishes its press releases regarding the rating actions both in Japanese and in English on the same day. In case that it takes time to translate rating rationale, JCR may publicize the summary version, which will be replaced by the full translated version within three business days. (Regarding Structured Finance products, JCR only publicize the summary version in English.)

Copyright © Japan Credit Rating Agency, Ltd. All rights reserved.