ITOCHU ENEX CO.,LTD.

8133 Tokyo Stock Exchange First Section

8-Jul.-16

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FISCO Ltd. Analyst
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Second Year of the Medium-Term Business Plan, Strengthening Profitability Through Organizational Reforms

A member of the ITOCHU Corp. (8001) group, Itochu Enex (8133) is an Energy Trade company that is playing a pivotal role in the energy field for the group. It has a wide ranging business scope, though mainly sells petroleum products and liquefied petroleum (LP) gas to users ranging from industrial businesses to final consumers.

The company reported upbeat results for FY3/16 with all-time high profits, despite a decline in crude-oil prices. Profits from overall business activities (hereinafter operating profit) climbed 25.1% YoY to ¥16,384mn. Three divisions, excluding the Car-Life Division, booked sharply higher profit. While the Car-Life Division incurred a 7.0% YoY setback due to reduced gasoline margin amid tougher competition, earnings stayed at a high level at ¥4,194mn.

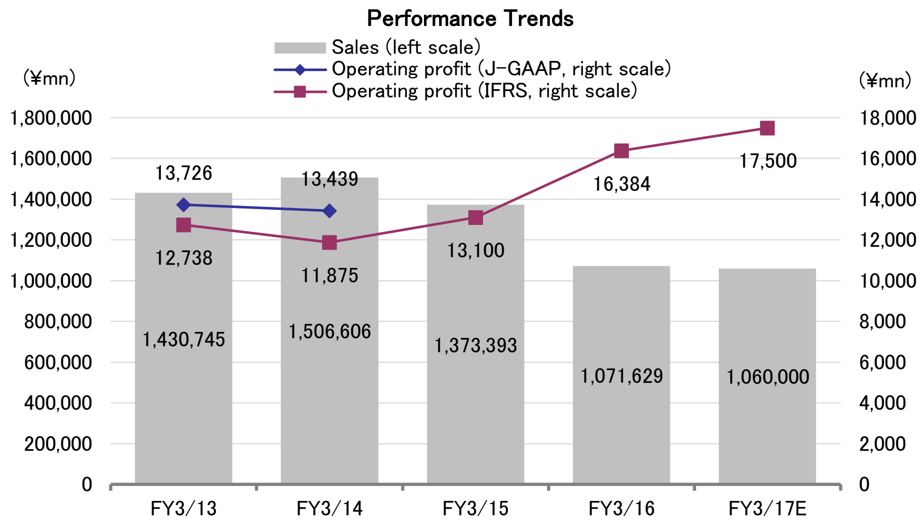
The company is currently in the midst of a two-year medium-term business plan that covers FY3/16 and FY3/17 and finished the first year with healthy results as explained above. For the second year, it changed the organization from four business headquarters to two business groups and four divisions. This reorganization aims to consolidate related business areas and thereby unify and accelerate strategy formation and business implementation.

While each of the four divisions has its own growth strategy and issues, we expect the Power & Utility Division to continue as the main growth engine for the time being. Electricity business is very upbeat. Retail electricity sales volume increased 113% YoY in FY3/16, and the plan calls for a further 124% rise in FY3/17. Itochu Enex is also making healthy progress with power sources. It began operating solar power facilities located in Hofu in February 2016 and started building the Sendai thermal-fired power plant with a ramp-up goal of October 2017.

Itochu Enex expects further profit expansion in FY3/17 with operating profit reaching ¥17,500mn. The plan calls for higher operating profit for the three divisions excluding the Power & Utility Division as well as continuation of an upward profit trend for the Power & Utility Division on a real basis. Crude oil has overcome the temporary slump and recovered to about $50 per barrel. We are not particularly optimistic about prospects, but see a good chance upside in operating profit if the current level continues for the next year.

Check Point

- Crude-oil price fell, but FY3/16 earnings set all-time highs
- Electricity business is very robust
- “Moving 2016” medium-term business plan targets ¥17,500mn in operating profit



FY3/16 Results

Crude-Oil Price Fell, But FY3/16 Earnings Set All-Time High

(1) Results overview

Itochu Enex reported FY3/16 results with ¥1,071,629mn in sales (-22.0% YoY), ¥723,645mn in revenue (-22.8%), ¥16,384mn in operating profit (+25.1%), ¥15,004mn in pretax profit (+23.4%), and ¥7,469mn in net profit attributable to parent shareholders (+35.7%). While sales fell, gross profit, operating profit, pretax profit, and net profit reached all-time highs.

The sharp fall in FY3/16 sales reflects a strong impact from the fall in crude oil prices. This is because crude oil prices affect the sales prices of the core products in all of the company's four segments. While lower sales prices can stimulate demand and lead to higher sales volume in some cases (for example: gasoline), the effect has been limited at this point. Another factor weighing on sales was the reduction in inefficient transactions in the Energy Innovation Division (former Energy Trade Division).

Compared to the plan, sales and net profit missed targets due to the impact of lower crude oil prices, but operating profit and pretax profit were roughly on track with expectations. We think Itochu Enex achieved healthy progress with the "Moving 2016" medium-term business plan.

Overview of FY3/16 Results

(unit: ¥mn)

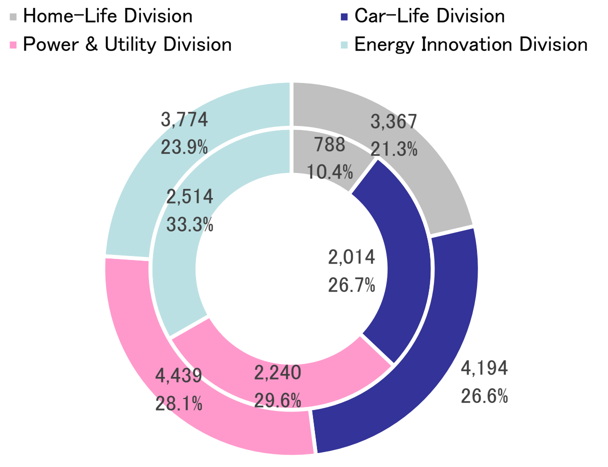
	FY3/15			FY3/16					
	1H	2H	Full year	1H	2H	Full year (E)	Full year	YoY	Versus estimates
Sales	696,637	676,756	1,373,393	564,118	507,511	1,350,000	1,071,629	-22.0%	-20.6%
Revenue	478,762	458,079	936,841	374,235	349,410	-	723,645	-22.8%	-
Gross profit	38,999	46,721	85,720	42,994	46,568	-	89,562	4.5%	-
SG&A expenses	33,133	38,051	71,184	35,887	37,339	-	73,226	2.9%	-
Operating profit	5,972	7,128	13,100	7,384	9,000	16,800	16,384	25.1%	-2.5%
Pretax profit	5,714	6,441	12,155	6,570	8,434	15,200	15,004	23.4%	-1.3%
Net profit	2,807	2,696	5,503	3,209	4,260	8,200	7,469	35.7%	-8.9%

Source: FISCO Ltd. from company materials

While the company performed very well through 3Q FY3/16, we were not optimistic about achieving guidance due to further declines in crude oil pricing and the contract price (CP) for LP gas and other factors during 4Q. However, conditions slightly rebounded around the end of the fiscal year, and this shift enabled Itochu Enex to avoid further profit contraction in 4Q and keep operating profit to just a 2.5% shortfall versus guidance. We review detailed trends in each of the business segments below. At the overall level, operating profit upside of 38.7% in the Power & Utility Division and 4.8% in the Energy Innovation Division largely offset shortfalls in the Home-Life Division and Car-Life Division.

Operating profit ratios for the four business divisions ended up roughly the same and were well-balanced owing to the above-mentioned deviations from guidance. The Home-Life Division occupied a smaller percentage of net profit because of an equity-method loss. The related company was an LP gas supplier. This business incurred an inventory valuation loss under pressure from a decline in the LP gas price that is linked to the crude-oil price and thereby lowered net profit for the Home-Life Division.

Earnings Composition Ratios by Business Segments



Note: Outer side – Operating profit, Inner side – Net profit attributable to shareholders
Source: FISCO Ltd. from earnings materials

(2) Overview of Business Segments

Detailed results by business segments

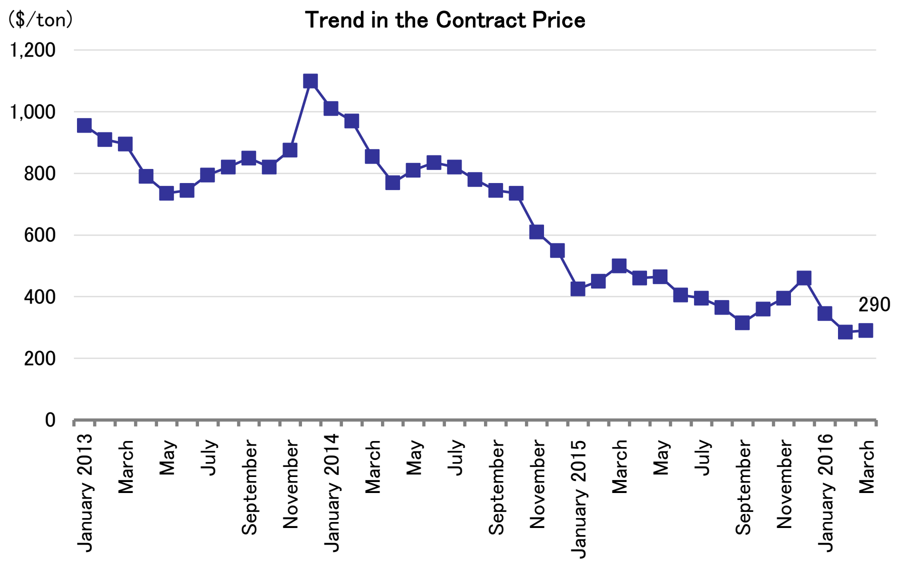
(unit: ¥mn)

		FY3/15			FY3/16					
		1H	2H	Full year	1H	2H	FY3/16 (E)	Full year	YoY change	Versus estimates
Sales	Home-Life Division	51,483	60,105	111,588	44,201	50,925	108,600	95,126	-14.8%	-12.4%
	Car-Life Division	319,139	319,709	638,848	274,465	259,691	649,000	534,156	-16.4%	-17.7%
	Power & Utility Division	19,287	19,456	38,743	21,152	22,343	56,000	43,495	12.3%	-22.3%
	Energy Innovation Division	306,656	277,422	584,078	224,300	174,552	535,700	398,852	-31.7%	-25.5%
	Others	72	64	136	0	0	700	0	-	-
	Sales prior to adjustments (total)	696,637	676,756	1,373,393	564,118	507,511	1,350,000	1,071,629	-22.0%	-20.6%
	Adjustment value	-	-	-	-	-	0	-	-	-
	Sales total	696,637	676,756	1,373,393	564,118	507,511	1,350,000	1,071,629	-22.0%	-20.6%
Operating profit	Home-Life Division	925	1,958	2,883	895	2,472	5,200	3,367	16.8%	-35.3%
	Car-Life Division	732	3,778	4,510	1,434	2,760	4,900	4,194	-7.0%	-14.4%
	Power & Utility Division	2,555	455	3,010	2,642	1,797	3,200	4,439	47.5%	38.7%
	Energy Innovation Division	1,193	1,471	2,664	1,862	1,912	3,600	3,774	41.7%	4.8%
	Others	9	23	32	1	0	0	1	-96.9%	-
	Operating profit prior to adjustments (total)	5,414	7,685	13,099	6,834	8,941	16,900	15,775	20.4%	-6.7%
	Adjustment value	558	-557	1	550	59	(100)	609	-	-
	Operating profit	5,972	7,128	13,100	7,384	9,000	16,800	16,384	25.1%	-2.5%

Source: FISCO Ltd. from company materials

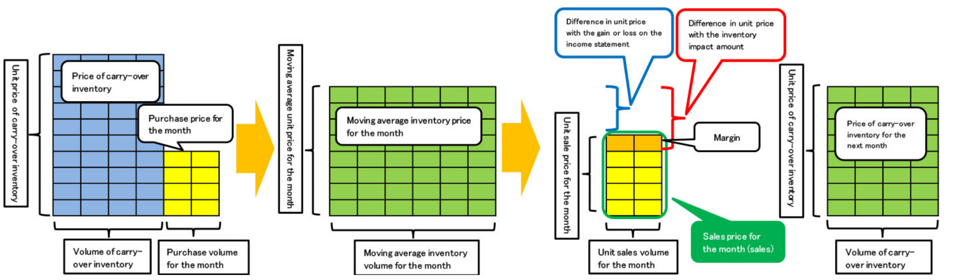
a) Home-Life Division

The Home-Life Division reported ¥95,126mn in sales (-14.8% YoY) and ¥3,367mn in operating profit (+16.8%). In the mainstay LP gas business, sales volume slightly declined YoY due to the warm winter impact, but operating profit improved because of a larger spread than in the previous fiscal year. This business obtains a certain level of spread because of the raw materials cost adjustment program. CP fluctuations, meanwhile, affect LP gas inventories, and these changes can expand or narrow spread. Although CP fell from the end-FY3/15 level in FY3/16 and the resulting inventory impact contributed to a smaller spread, the CP decline was less than in FY3/15 and this reduced the inventory impact too and thereby gave a lift to operating profit.



Note: Propane
Source: FISCO Ltd.

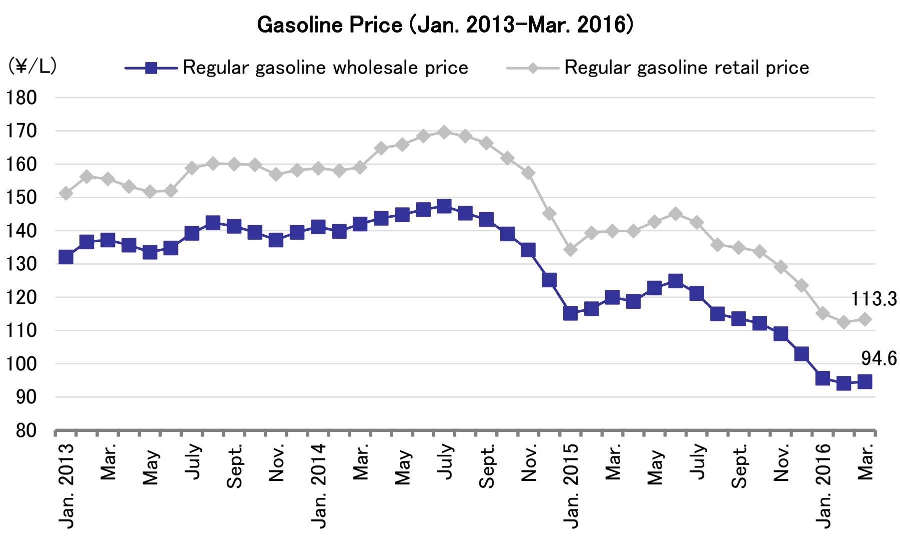
Mechanism of the LP Gas Inventory Impact (phase of market price decline)



Source: FISCO Ltd. from company materials

b) Car-Life Division

The Car-Life Division reported ¥534,156mn in sales (-16.4% YoY) and ¥4,194mn in operating profit (-7.0%). Declines in gasoline, kerosene, and other product prices contributed substantially to the sales dip. We think the company's net elimination (YoY) of 66 Car-Stations (CS; in-house name for gas stations) had an impact. Operating profit shrunk mainly because of reduction of gasoline and other product spreads related to price decline and tougher competition.



Source: FISCO Ltd. from statistics of the Agency for Natural Resources and Energy

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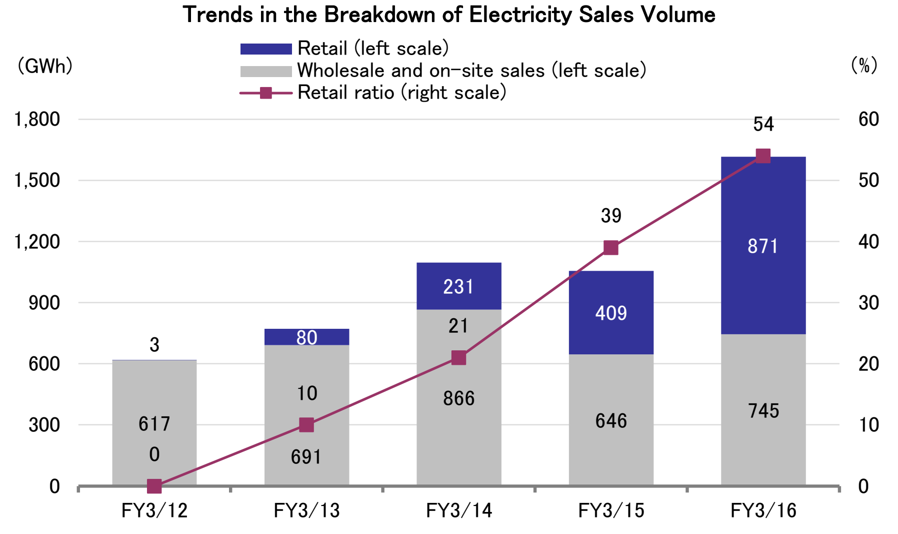
8133 Tokyo Stock Exchange
First Section

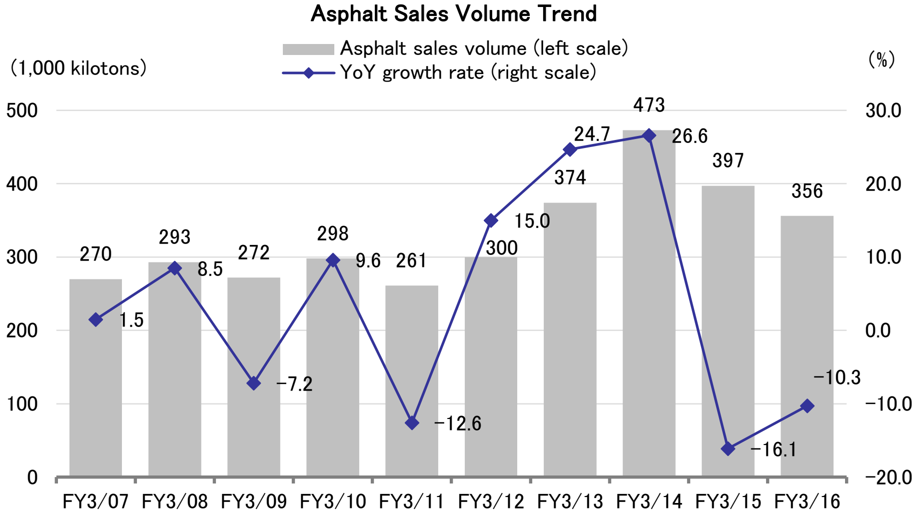
8-Jul.-16

c) Power & Utility Division
The Power & Utility Division reported ¥43,495mn in sales (+12.3% YoY) and ¥4,439mn in operating profit (+47.5%). Electricity sales volume expanded 52.5% YoY to 1,616GWh thanks to continued healthy operation of self-owned power facilities and the addition of electric power from Oji-Itochu Enex Power Retailing Co., Ltd. Operating profit rose sharply (YoY) owing to a lift from higher sales, lower costs for procurement from the electricity wholesale market, decline in raw material costs accompanying lower crude-oil prices at Tokyo Toshi Service, and a rise in electricity retail sales volume (doubling from the previous year's 409GWh to 871GWh).



Source: FISCO Ltd. from company materials

d) Energy Innovation Division
The Energy Innovation Division reported ¥398,852mn in sales (-31.7% YoY) and ¥3,774mn in operating profit (+41.7%). Sales moved sharply lower, but profit increased significantly. Key factors contributing to sales decline were lower prices for oil-related products following the drop in crude oil prices, a slump in asphalt demand (sales volume off by 10.3%), and elimination of inefficient transactions. The large rise in operating profit reflected healthy trends in industrial fuel, bunker fuel oil, and fleet business (areas other than asphalt) and benefits from cost reduction efforts.



Source: FISCO Ltd. from company materials

Progress with the Medium-Term Business Plan

"Moving 2016" Medium-Term Business Plan Targets ¥17,500mn in Operating Profit

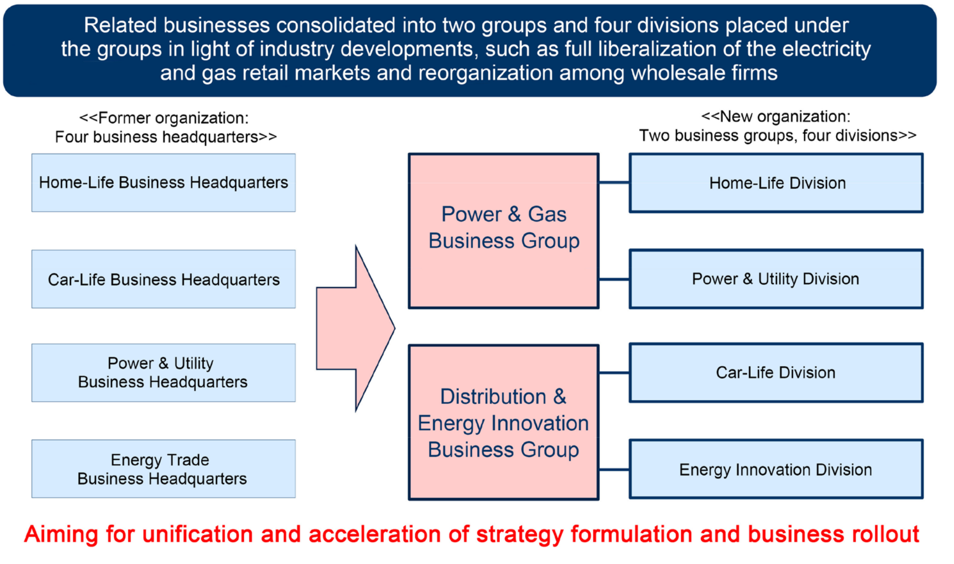
Itochu Enex is currently implementing the "Moving 2016" medium-term business plan, which covers just two years (FY3/16-17). As explained above, it had a very upbeat start in FY3/16, the first fiscal year, reaching all-time highs in all profit categories and booking operating profit and pretax profit roughly on track with the plan.

For the final fiscal year, Itochu Enex changed the organization from four business headquarters to two business groups and four divisions. The four divisions correspond to previous categories, and the main point is bringing together two divisions each under the two business groups. Management renamed the Energy Trade Division as the Energy Innovation Division as part of the changes.

The Power & Gas Business Group consists of the Home-Life Division (mainly LP gas) and the Power & Utility Division. Itochu Enex had already been planning collaboration among the two divisions via the balancing group (BG), a sales scheme for low-volume electricity power, prompted by the full liberalization of electricity retail business from 2016. We think formation of the Power & Gas Business Group is natural outcome in this sense.

The Distribution & Energy Innovation Business Group consists of the Car-Life Division and Energy Innovation Division. We think Itochu Enex is strongly aware of the need for transformation and growth as a presence that creates added value recognized by external parties as a wholesale trading company that fits between oil wholesale firms and consumers in light of anticipated reorganization in the oil wholesale industry. It aims to accelerate realization of this positioning through the group formation.

Reorganization Content



Source: From company briefing materials

We think the reorganization is a measure that logically makes sense. We believe investors are interested in the how quickly the actions influence earnings and thus will be closely monitoring developments.

Itochu Enex reduced the FY3/17 goal for operating profit from the initial ¥20,000mn to ¥17,500mn in its guidance. We believe the revision factored in a level change in the crude-oil price and switched to an "attainable" value as the fiscal-year target. Management left net profit and ROE goals at existing levels. We do not view the ¥17,500mn guidance for FY3/17 operating profit as a clear-cut downward revision because the outlook includes the possibility of upside.

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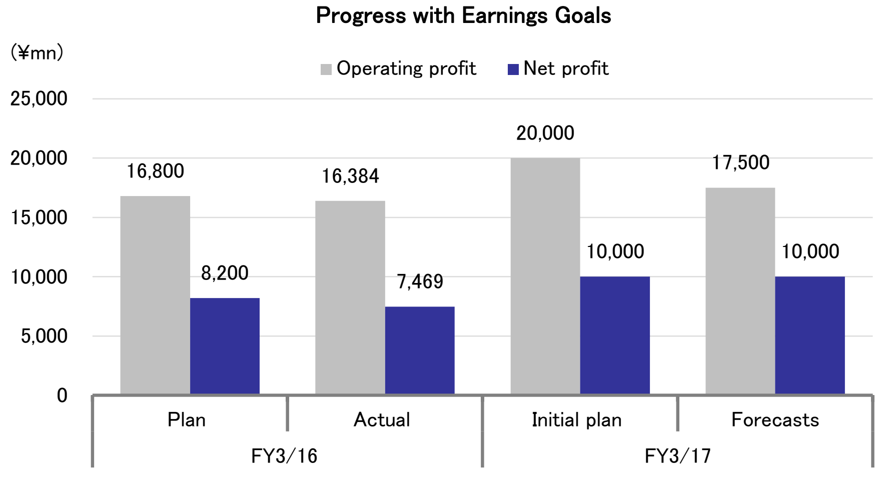
8133 Tokyo Stock Exchange
First Section

8-Jul.-16



Source: FISCO Ltd. from company materials

■ Detailed Trends for the Business Divisions

LP gas sales the primary source of income

(1) Home-Life Division

a) Business overview and growth strategy

The Home-Life Division's core business is selling LP gas. Itochu Enex procures LP gas from Japan Gas Energy Corporation (it owns a 20% stake in this company) and sells LP gas to about 350,000 households through direct-sales subsidiaries. It also sells LP gas on a wholesale basis to about 1,900 distributors (LP gas sales outlets), and these outlets deliver LP gas to final consumers. Itochu Enex covers about 1.08mn households nationwide on a combined basis through direct sales and distributors (including some city gas). Besides gas, it also sells smart energy equipment, home lithium-ion power storage systems, cooking equipment, and cooling and heating equipment. Additionally, it goes beyond equipment sales and makes proposals for ideal energy mix and handles home renovations.

LP gas sales are the primary source of income in the Home-Life Division, and the top point for the company's growth strategy is finding ways to increase its sales of LP gas. While the sales price fluctuates with the contract price (CP; notification price from Saudi Arabia that is fundamentally linked to the crude-oil price), Itochu Enex retains spread at a certain level through the raw materials cost adjustment program. Growth in this business hence is equivalent to expansion of sales volume. This is why the company is always looking for expansion opportunities in both direct sales and wholesale areas through M&A deals and development of new sales distributors. These activities constitute the growth strategy for the company's core business.

A new opportunity as a growth strategy, meanwhile, is collaboration with the Power & Utility Division. The Power & Utility Division has adopted the balancing group strategy as a scheme for electricity retail sales in the low voltage (small volume) segment. The company's plan aims to have LP gas sales companies under the Home-Life Division participate as balancing group members and thereby expand income.

Member companies sell electricity as contract principals in the balancing group scheme. This gives them the freedom to set their own rates and also conduct joint sales with other products. The Home-Life Division aims to expand customers by combining LP gas and electricity. The Power & Utility Division gains access to new customers due to overlapping sales of electricity to existing LP gas customers. Itochu Enex Home-Life Kanto Co., Ltd. and Ecore Co, Ltd. have participated in the balancing group thus far, and a few other sales subsidiaries are slated to join during FY3/17.

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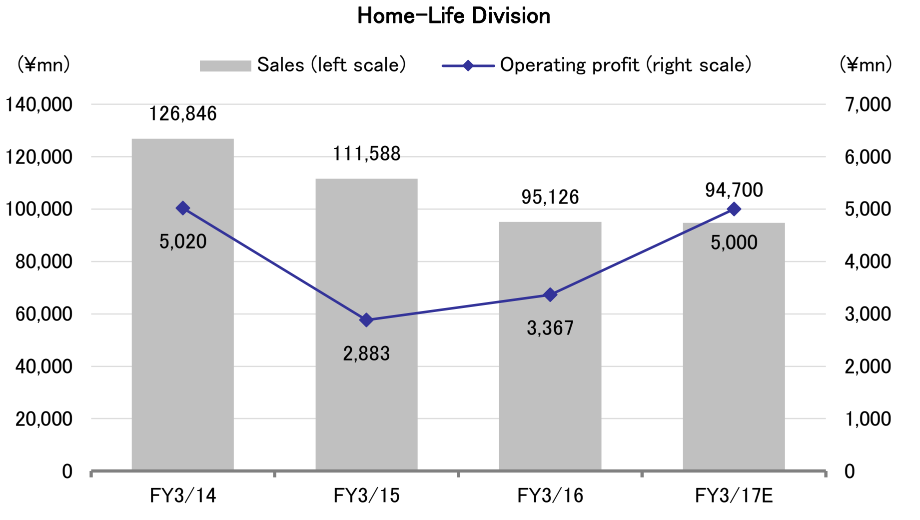
8133 Tokyo Stock Exchange
First Section

8-Jul.-16

Another growth avenue is pursuing overseas business. Itochu Enex is looking to roll out its successful business model from Japan to overseas markets (Asia) amid a lack of prospects for long-term growth in the domestic market. It currently aims to sell industrial gas to Japanese companies through a subsidiary in Indonesia. However, this is an entirely new business, and we think it will take a considerable amount of time until it grows to a noticeable amount of income. In the Philippines, it already indirectly invests in IP&G and plans to participate in the LP gas selling business in the Philippines.

b) FY3/17 outlook
The FY3/17 segment guidance calls for ¥94,700mn in sales (-0.4% YoY) and ¥5,000mn in operating profit (+7.0%). We think this outlook is conservative and particularly expect upside in earnings.



Source: FISCO Ltd. from the company outlook

Management uses assumptions of $35-40 per barrel for the crude-oil price and $270 per ton as the annual average CP for LP gas in the FY3/17 outlook. These correspond to levels from the end of FY3/16. The Home-Life Division's operating profit outlook factors in removal of the inventory impact from the CP decline seen in FY3/16 for FY3/17.

We see a possibility of upside because crude oil prices are trending upward, and this trend should contribute favorably to the inventory impact value.

Operating Power Generation Facilities at Six Sites Nationwide to Procure Electricity

(2) Power & Utility Division

a) Business overview and growth strategy
The Power & Utility Division consists of electricity sales (retail and wholesale) and heat supply. In electricity sales, the company procures electricity from its own power-source facilities, which include thermal-fired base load power and natural energy power, and externally through partner companies (Oji Holdings (3861) and Kansai Electric Power (9503)) and aims to expand retail electricity sales to large-volume and small-volume customers.

Itochu Enex entered the heat supply business with the acquisition of a 66.6% stake in Tokyo Toshi Service (TTS) Company from Tokyo Electric Power (9501) in 2012. TTS operates electricity-type heat supply centers at 18 sites in the metro Tokyo area. While electricity sales and heat supply businesses both make positive contributions to earnings, we think management has higher expectations for electricity sales in terms of growth potential and is building the growth strategy based on electricity sales business.

Japan has been incrementally liberalizing electricity sales since 2000. Itochu Enex registered as a new power company (power producer and supplier; PPS) and entered the electricity sales business in 2010. It almost entirely engaged in wholesale sales to Japan Electric Power Exchange (JPEX) after the initial market entry, but has been steadily raising the ratio of retail sales to high-volume customers. It sold 1,616GWh of electricity in FY3/16, as noted above, and this included 871GWh in retail sales to high-volume customers.

Japan liberalized the low-voltage (small-volume customers) segment and fully opened up electricity sales from April 2016. We estimate that the low-voltage segment, which includes ordinary households, accounts for about 40% of total electricity demand, and PPS firms are earnestly pursuing sales that target this segment as an important growth opportunity. A key point in entering this market is how to build the sales network. Itochu Enex selected a balancing group scheme out of the various choices. It serves as the leader of the balancing group, capitalizing on its own power sources and knowhow in supply-demand balance adjustments, and recruits companies with customer networks and sales capabilities as members aimed at conducting electricity retail sales through the members. It expects balancing group members to include group companies, including LP gas sales subsidiaries, as well as external energy firms, companies from other industries, local governments, and other entities.

Electricity Demand by Market Size

	Special high voltage	High voltage	Low voltage
Percentage of electricity demand	About 25%	About 35%	About 40%
Electricity sales liberalization timing	April 2000	April 2004	April 2016
Main customers	Large plants, large offices	Smaller plants, supermarkets	Ordinary households, convenience stores, shops
Electricity voltage	20,000 volts or more	6,000 volts or more	100-200 volts
Demand scale	2,000kw or more	50kw up to just under 2,000kw	Less than 50kw

Source: FISCO Ltd.

Subsidiaries Itochu Enex Home-Life Kanto and Ecore are already members of the balancing group, and Itochu Enex has announced a business alliance with Tottori Citizen Electricity Co., Ltd. There are also some reports of an alliance with Co-op Sapporo affiliate Todock Electricity Co., Ltd.

Itochu Enex operates six power facilities nationwide as electricity sources. It has been sustaining healthy operations at all six facilities, and related subsidiaries are maintaining profits. As an external partner, it announced construction of a thermal-fired plant by Sendai Power Station, a joint venture between fully-owned subsidiary JEN Holdings Co., Ltd. (now Enex Electric Power Co, Ltd.) and Kanden Energy Solution Co., Inc., a wholly owned subsidiary of Kansai Electric Power, in March 2016. This initiative aims to have facilities with output of 112,000kW running by October 2017. Additionally, Oji-Itochu Enex Power Retailing (Enex owns a 60% stake) sells electricity from power sources held by Oji Holdings.

List of the Company's Power Generation Facilities

(Power generation capacity: kW)

	Coal	Natural gas	Hydropower	Wind power	Solar power	Total	Notes
Hofu Energy Service	43,550				1,500	45,050	Solar power launched in February 2016
Joetsu Energy Service		30,600	8,490			39,000	
Amagasaki Energy Service		4,000				4,000	
JEN Kusu Wind Farm				11,000	1,000	12,000	
JEN Konbumori Wind Farm				10,000		10,000	
JEN Tainai Wind Farm				20,000		20,000	Launched in October 2014
Hofu No.2 Power Station	36,000					36,000	Launched in March 2015
Total as of March 2016	79,550	34,600	8,490	41,000	2,500	166,140	

Source: FISCO Ltd. from company materials and other sources

We maintain our existing view of Itochu Enex's electricity business from an investor perspective.

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8133 Tokyo Stock Exchange First Section

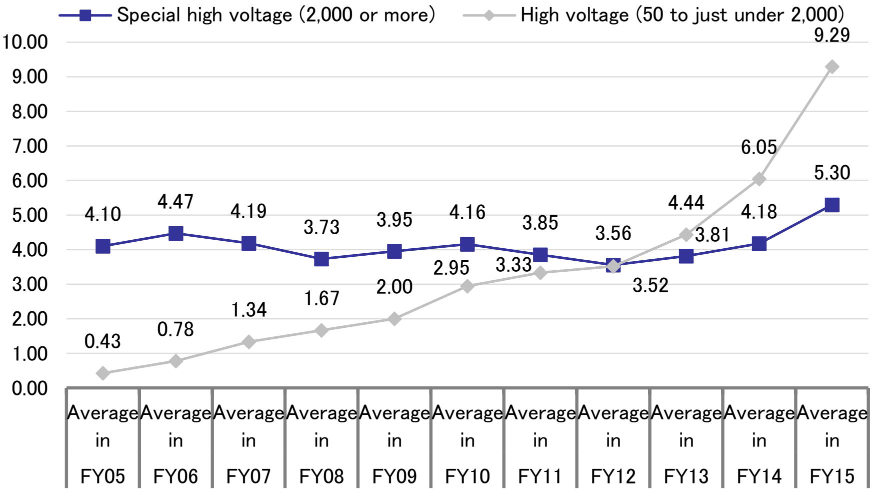
8-Jul.-16

We believe Itochu Enex is interested in the low-voltage market from a medium-term perspective after it has the balancing group scheme fully in place. It has been placing emphasis on "regional specialization" as a key word for retail electricity sales. This approach aims to develop regions where the company has a strong presence that resembles the "regional dominance" store-opening strategies of supermarkets and convenience stores. Itochu Enex's subsidiaries and affiliated distributors have robust customer bases mainly in Kansai, Hokkaido, Chugoku, and Kyushu areas for LP gas and other businesses. The "regional specialization" aims first to solidify these areas. We think this is a very rational and effective approach.

For the time being, we expect the high-voltage business to continue making contributions to the company's earnings. Itochu Enex more than doubled retail electricity sales volume in the high-voltage segment during FY3/16.

While the PPS share in the high-voltage segment is steadily climbing, it is still only at about 10%. We expect a faster shift to PPS amid heightened awareness of PPS even among high-voltage customers thanks to the start of advertisements aimed at consumers by a variety of companies as part of full liberalization. We think this is likely to be the largest growth driver for Itochu Enex's electricity business in the near term.

Trend in PPS Composition Ratios by Demand Segment



Source: FISCO Ltd. from Electric Power Statistics

b) FY3/17 outlook

The FY3/17 segment guidance calls for ¥58,700mn in sales (+35.0% YoY) and ¥3,900mn in operating profit (-12.6%). While the outlook nominally projects lower profit on stronger sales, we believe it should sustain sales and profit gains in real terms for the following reasons.

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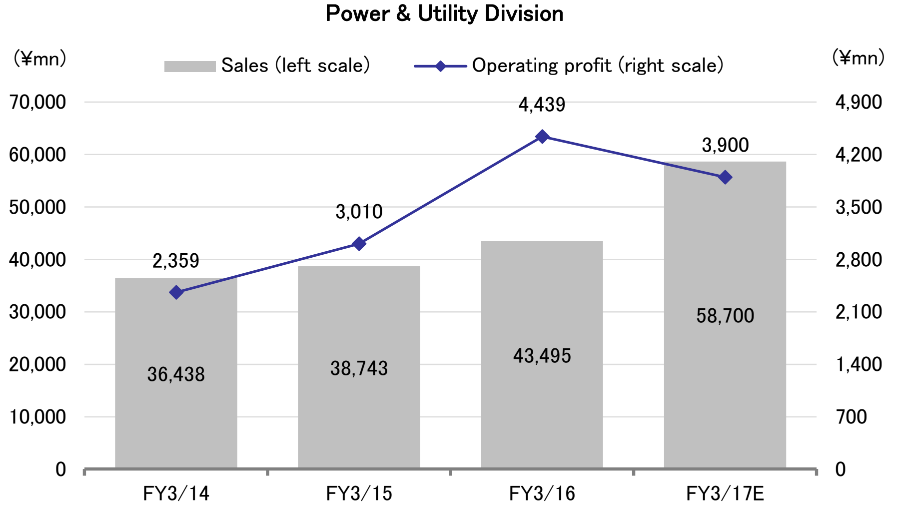
ITOCHU ENEX CO.,LTD.
8133 Tokyo Stock Exchange
First Section

8-Jul.-16



Source: FISCO Ltd. from company estimates

Itochu Enex expects healthy sales growth in retail and wholesale businesses, including a robust gain in retail electricity volume. The plan factors in a 123.9% YoY rise to 1,950GWh. The medium-term business plan targeted 2,200GWh in FY3/17 sales volume with retail sales at 1,700GWh. We advise investors to monitor trends in retail electricity sales volume as the KPI (key performance indicator) because of the prospect of the company actively varying wholesale business in light of market conditions and other trends.

An accounting item is the main reason for the likely decline in operating profit. Heat supplier TTS plans to book a major urban development deal and upgrade equipment and has factored in a related disposal loss of ¥600mn. The loss is recognized as an operating expense under IFRS accounting (used by Itochu Enex). This cost lowers operating profit and is the main source of the profit decline outlook. The plan also includes profit setbacks from booking costs related to scheduled maintenance of Hofu power generation facilities and a rise in raw material costs at TTS related to the upswing in the crude oil price.

Strengthening the Car-Life Stadium Brand

(3) Car-Life Division

a) Business overview and growth strategy
The Car-Life Division has two major businesses. One is Car Station (CS) management and related sales of gasoline and other automobile fuels, kerosene, and other products. The other is car-related business that mainly consists of Nissan Osaka Sales Co., Ltd., a leading national car dealer.

The CS business continues to face difficult conditions against a backdrop of growing adoption of electric vehicles (EVs) and energy-saving vehicles, population decline, and less interest in cars among young people. Many CS are also encountering challenges, such as updating equipment (particularly underground storage tanks) and a lack of successors. Itochu Enex operates about 2,000 CS including direct operations (by Enex Fleet Co., Ltd., Kyushu Energy Co., Ltd., and other subsidiaries) and affiliates. It intends to steadily dispose of unprofitable CS, in line with the existing policy. While it is also adding new affiliates, net declines are continuing. The net drop of 66 CS in FY3/16 lowered period-end CS volume to 1,973 sites (putting it under 2,000 sites). We think this trend will continue for some time.

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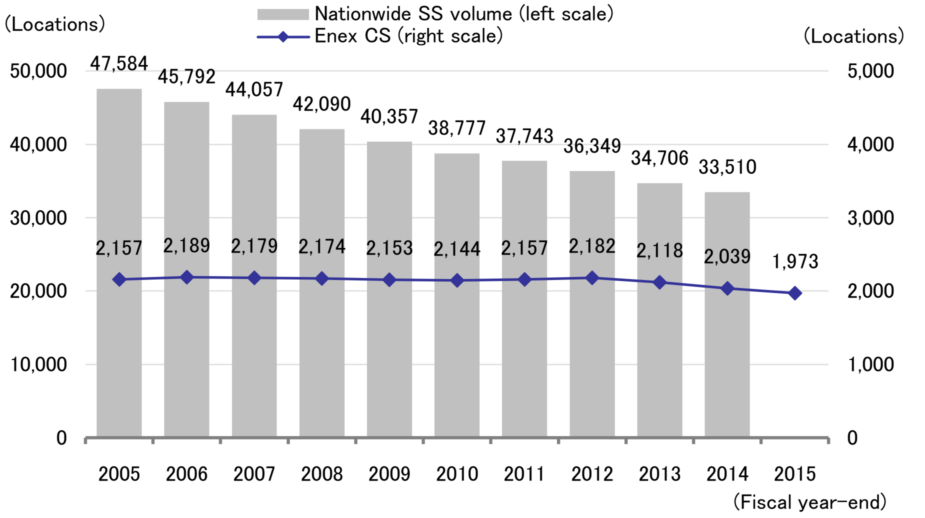
8133 Tokyo Stock Exchange First Section

8-Jul.-16

Trends in Enex CS and Nationwide SS (Gas Stations) Volumes



Note: SS volume for FY3/16 not announced yet
Source: FISCO Ltd. from METI data and company materials

However, it is also promoting measures to increase CS income and aims to bolster six vehicle-related businesses (statutory vehicle inspections, car washes, insurance, car rentals, car purchasing, and panel flattening) in order to increase sales from other sources besides gasoline. As specific marketing measures, it is promoting and solidifying “Car-Life Stadium” as a unified business and service brand and adopting a new POS format and R points and cards.

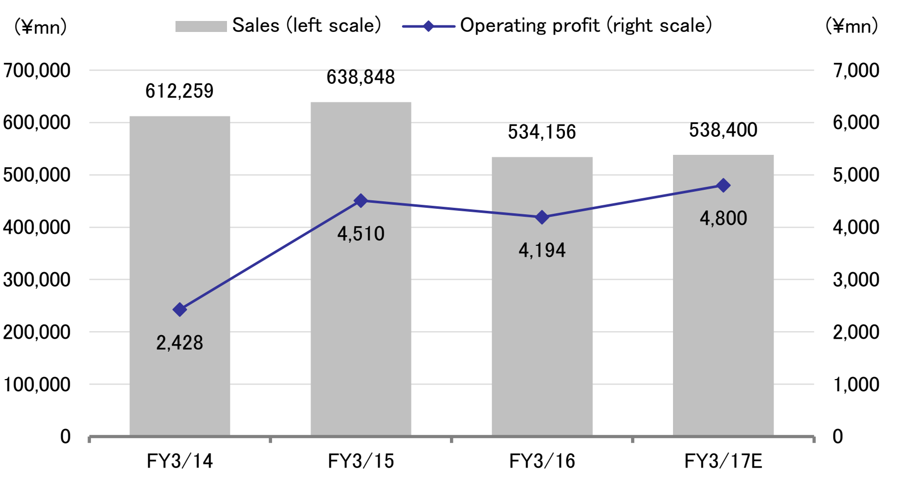
In car-related businesses, besides dealer business for new cars, Itochu Enex has entered used car distribution, is expanding car rental shops, and is developing the portfolio for future opportunities.

We are closely watching the Car-Life Stadium effort. While the company’s roughly 2,000 CS have mix of wholesale brands, Itochu Enex is unifying the brand for services other than gasoline as Car-Life Stadium. While some observers suggest that consumers are not even cognizant of gasoline brands (let alone CS services), the branding process focuses on advancing brand awareness among consumers. We think this effort is confronting a difficult hurdle, but Itochu Enex could lay the groundwork for revitalizing and improving the CS business if it succeeds.

b) FY3/17 outlook

The FY3/17 segment guidance calls for ¥538,400mn in sales (+0.8% YoY) and ¥4,800mn in operating profit (+14.9%).

Car-Life Division



Source: FISCO Ltd. from company estimates

This outlook projects flat sales YoY in both CS-related and car-related businesses. While it appears conservative in light of the rebound trend in the crude oil price, we think it is a solid view since it is difficult to be optimistic about sales volume due to accelerated adoption of energy-saving vehicles and the downward trend in CS sites.

Management factors in earnings lifts from continuing actions to deal with unprofitable CS, improved efficiency in the wholesale business, and rising CS services income (inspections, car washes, panel flattening, and others). We do not expect a full-fledged earnings recovery at Nissan Osaka Sales until at least FY3/18 because it is still investing in stores.

Expansion of the Business Portfolio to Address Changes in the External Environment

(4) Energy Innovation Division

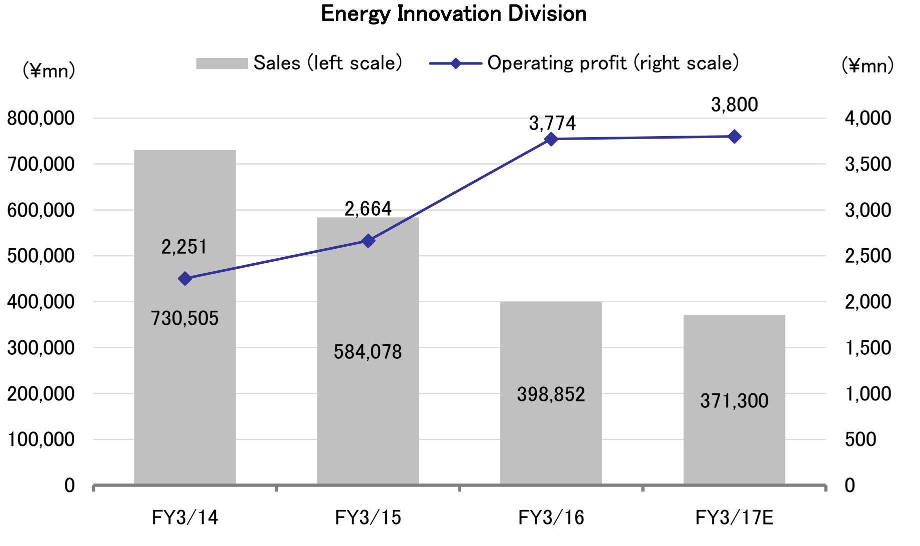
a) Business overview and growth strategy
The Energy Innovation Division covers various industrial businesses. These roughly include bunker fuel oil sales, oil trading for supply-demand adjustment, asphalt business, industrial fuel (fuel oil and others) sales, and new businesses.

The asphalt business holds a domestic share of just over 20%, and we think it makes strong contributions to earnings. Demand has been declining and preventing the business from delivering its true profitability over the past few years. We expect road infrastructure upgrade demand and other sources to create an earnings base for the division over the longer term.

Oil trade and industrial fuel sales businesses also contribute to a stable profit base for the division. Profit remains stable even with high exposure to crude-oil price fluctuation impacts and steep sales decline related to scaling back inefficient transactions. We think a strength is having opportunities to acquire profits when prices are rising or declining.

Itochu Enex has presented a theme of “expanding the business portfolio to be capable of responding to changes in the external environment” for this segment in the current medium-term business plan. New businesses offer this potential. Some examples ramping up in recent years are the slop and recycled oil and fly ash (coal ash) business. A key point is what other new businesses will be ramped up after these. Itochu Enex has 3,500 corporate partners and operates logistics sites nationwide with 12 asphalt bases, 20 AdBlue bases, and three tank terminals. We will be paying close attention to its utilization of these assets.

b) FY3/17 outlook
The FY3/17 segment guidance projects ¥371,300mn in sales (-6.9% YoY) and ¥3,800mn in operating profit (+0.7%).



Source: FISCO Ltd. from company estimates

We believe sales fluctuations do not reflect actual conditions in the Energy Innovation Division because of the company's efforts to revise inefficient transactions. We expect a real increase in sales for FY3/17 based on flat volume and rising prices in light of crude-oil prices and actual demand for the company's various products.

We agree with the outlook for flat earnings. This reflects the prospect of profit settling down at a flat level in an income structure of profit expressed as "margin x volume" given little change in margin and an absence of volume growth in FY3/17. Asphalt is the main potential source of change. We will be focusing on how the national election, disaster recovery, and other factors affect public investments.

FY3/17 Outlook

Projects Lower Sales and Higher Profits in FY3/17

Itochu Enex projects ¥1,060,000mn in sales (-1.1% YoY), ¥17,500mn in operating profit (+6.8%), ¥17,000mn in pretax profit (+13.3%), and ¥10,000mn in net profit (+33.9%) for FY3/17.

FY3/17 Forecasts by Business Segments

(unit: ¥mn)

		FY3/16			FY3/17	
		1H	2H	Full year	Full year (E)	YoY change
Sales	Home-Life Division	44,201	50,925	95,126	94,700	-0.4%
	Power & Utility Division	21,152	22,343	43,495	58,700	35.0%
	Car-Life Division	274,465	259,691	534,156	538,400	0.8%
	Energy Innovation Division	224,300	174,552	398,852	371,300	-6.9%
	Others	0	0	0	0	-
	Sales total	564,118	507,511	1,071,629	1,060,000	-1.1%
Operating profit	Home-Life Division	895	2,472	3,367	5,000	47.0%
	Power & Utility Division	2,642	1,797	4,439	3,900	-12.6%
	Car-Life Division	1,434	2,760	4,194	4,800	14.9%
	Energy Innovation Division	1,862	1,912	3,774	3,800	0.2%
	Others	1	0	1	0	-
	Operating profit prior to adjustments (total)	6,834	8,941	15,775	17,500	10.9%
	Adjustment value	550	59	609	0	-
	Operating profit	7,384	9,000	16,384	17,500	6.8%

Source: FISCO Ltd.

For sales, it expects a roughly flat outcome in light of using a crude-oil price assumption on par with the level from the end of FY3/16. It factors in a steep rise in sales for the Power & Utility Division based on an anticipated large rise in electricity sales volume, but lower sales for the Energy Innovation Division because of revisions to inefficient transactions and hence a flat overall result. While it is difficult to identify because of steady decline in crude oil prices, Itochu Enex has been rapidly scaling back transactions that just inflate sales over the past few years. We see a possibility of this effort continuing in FY3/17 and thus suggest viewing the overall sales trend as essentially a reference value.

We think it is vital to analyze the company's earnings situation by individual business segments and provided these details above. We believe the target of ¥17,500mn in total operating profit is overly conservative. As noted above, the Home-Life Division does not factor in boost from the inventory impact due to the rise in crude oil prices. Management might be relying on this effect as a buffer against downside risk in other businesses, and it is something to watch in FY3/17.

■ FY3/17 Outlook

Income Statement

(unit: ¥mn)

	FY3/13	FY3/14	FY3/15	FY3/16	FY3/17 (E)
Sales	1,430,745	1,506,606	1,373,393	1,071,629	1,060,000
YoY change	1.2%	5.3%	-8.8%	-22.0%	-1.1%
Revenue	864,589	966,044	936,841	723,645	-
YoY change	-	11.7%	-3.0%	-22.8%	-
Gross profit	69,666	71,599	85,720	89,562	-
YoY change	7.8%	2.8%	19.7%	4.5%	-
Ratio to sales	4.9%	4.8%	6.2%	8.4%	-
SG&A expenses	55,668	57,862	71,184	73,226	-
YoY change	0.1%	3.9%	23.0%	2.9%	-
Ratio to sales	3.9%	3.8%	5.2%	6.8%	-
Fixed asset income	-914	-1,460	-1,825	-593	-
Other income	-346	-402	389	641	-
Other income and costs (total)	-56,928	-59,724	-72,620	-73,178	-
Operating profit	12,738	11,875	13,100	16,384	17,500
YoY change	42.0%	-6.8%	10.3%	25.1%	6.8%
Pretax profit	12,234	13,844	12,155	15,004	17,000
YoY change	-	13.2%	-12.2%	23.4%	13.3%
Net profit	7,393	8,050	6,529	8,964	-
YoY change	-	8.9%	-18.9%	37.3%	-
Net profit	6,470	7,124	5,503	7,469	10,000
YoY change	-	10.1%	-22.8%	35.7%	33.9%
EPS (¥)	57.26	63.05	48.71	66.10	88.50
Dividend (¥)	16.00	20.00	22.00	24.00	27.00
Portion attributable to company stock per share (BPS, ¥)	791.42	833.20	862.30	889.70	-

Balance Sheet

(unit: ¥mn)

	IFRS standard			
	FY3/13	FY3/14	FY3/15	FY3/16
Current assets	189,196	188,193	157,708	142,797
Cash and equivalents	18,062	14,251	16,184	20,824
Operating credits	136,578	140,289	98,449	72,084
Inventory assets	18,134	18,655	27,794	25,160
Others	16,422	14,998	15,281	5,603
Non-current assets	126,697	132,531	171,351	166,188
Equity method investments	6,032	5,927	10,551	8,786
Other investments	8,925	7,349	8,924	8,029
Tangible fixed assets	57,655	66,988	88,836	88,311
Intangible fixed assets	10,999	10,280	23,474	24,329
Others	43,086	41,987	39,566	36,733
Assets total	315,893	320,724	329,059	308,985
Current liabilities	161,738	158,336	149,443	116,929
Corporate bonds and loans	14,745	11,499	14,208	5,299
Operating liabilities	124,046	125,655	104,564	85,677
Others	22,947	21,182	30,671	25,953
Non-current liabilities	56,500	58,268	66,669	74,894
Corporate bonds and loans	26,158	27,099	26,746	32,366
Others	30,342	31,169	39,923	42,528
Equity attributable to parent owners (total)	89,424	94,651	97,432	100,526
Capital	19,878	19,878	19,878	19,878
Surplus capital	18,737	18,737	18,743	18,740
Surplus earnings	54,086	59,884	62,223	66,024
Others	-1,527	-2,098	-1,661	-2,364
Treasury shares	-1,750	-1,750	-1,751	-1,752
Minority equity	8,231	9,469	15,515	16,636
Capital total	97,655	104,120	112,947	117,162
Liabilities and capital total	315,893	320,724	329,059	308,985

Cash Flow Statement

(unit: ¥mn)

	IFRS standard			
	FY3/13	FY3/14	FY3/15	FY3/16
CF from operating activities	22,754	17,530	34,336	30,322
CF from investment activities	-24,930	-12,556	-20,410	-16,673
CF from financing activities	4,759	-8,859	-12,115	-9,059
Change in cash and deposits	2,583	-3,885	1,811	4,590
Period-start cash and deposits balance	15,436	18,062	14,251	16,184
Currency fluctuation impact value	43	74	122	-27
Period-end cash and deposits balance	18,062	14,251	16,184	20,824

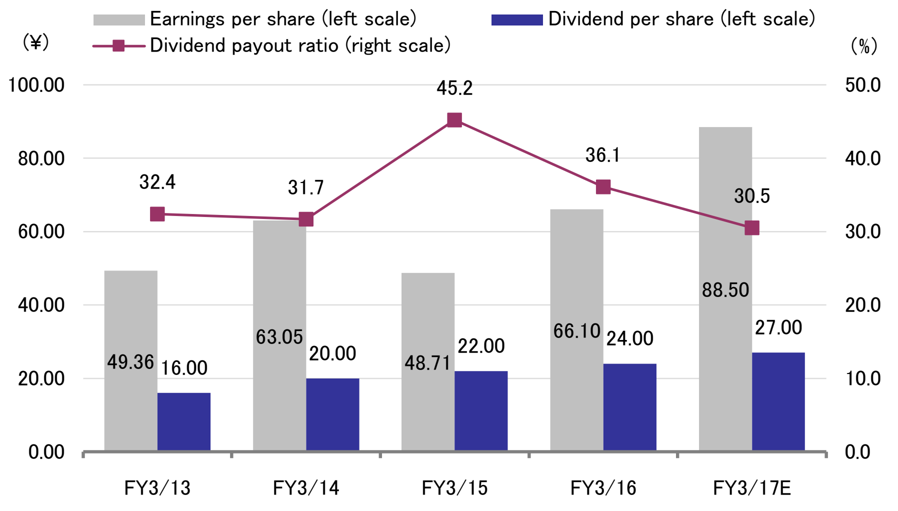
Shareholder Returns

30% Dividend Payout Ratio is the Basic Policy

The basic policy on shareholder returns is to maintain a dividend payout ratio exceeding 30% or more. For FY3/16, the company paid a dividend of ¥24 (interim dividend: ¥12, year-end dividend ¥12), for an increase of ¥2 YoY. This represented a dividend payout ratio of 36.3% because earnings per share only reached ¥66.1.

For FY3/17, Itochu Enex disclosed a dividend outlook of a ¥3 hike to ¥27 (¥13.5 interim, ¥13.5 year-end). It forecasts ¥10,000mn in net profit (as previously), or ¥88.5 in earnings per share, for FY3/17, the final year of the current medium-term business plan. These levels put the dividend payout ratio at 30.5%. We expect an increase of the dividend in a phase of further profit expansion.

Earnings and Dividend Per Share and Dividend Payout Ratio Trends



Source: FISCO Ltd. from earnings materials

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