COMPANY RESEARCH AND ANALYSIS REPORT

ITOCHU Enex Co., Ltd

8133

Tokyo Stock Exchange First Section

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Index

Summary

Unveils new medium-term business plan; laying the foundation for the future targeting net profit of ¥20,000mn

Itochu Enex Co., Ltd. <8133> (hereafter, also "the Company") is an energy trade company that is playing a pivotal role in the energy field for the ITOCHU Corp. <8001> group. It has a broad business scope, though mainly sells petroleum products and liquefied petroleum (LP; propane) gas to users ranging from industrial businesses to final consumers.

1. Reaches medium-term business plan target by posting FY3/17 net profit of ¥10,000mn

The Company reported FY3/17 results with ¥1,028,939mn in sales (down 4.0% YoY), ¥19,678mn in profit from operating activities (up 20.1%), and ¥10,405mn in net profit attributable to the Company's shareholders (hereinafter, net profit; up 39.3%). The Company achieved considerable profit growth even amid sales decline. Profit from operating activities and net profit both reached record highs and the Company reached the targets set out in its medium-term business plan. Profit from operating activities showed strong growth on strong electric power sales volume growth and improvement in the LP gas inventory impact and net profit topped ¥10,000mn for the first time due to improvement in revenues from equity-method subsidiaries.

2. Announces medium-term business plan, "Moving 2018: Connecting to the future"; focus on creating a foothold for establishing a management base to take the company to the next stage

The Company announced its new two-year medium-term business plan, "Moving 2018: Connecting to the future". The Company has designated the two-year period covered by the new plan as a time when it will create a foothold for establishing a management base to enable the Company to reach net profit of over ¥20,000mn in the near future. This management base consists of two parts, the revenue base and the organizational base and the Company intends to strengthen both of these. Quantitative targets are for FY3/19 profit from operating activities of ¥18,500mn and net profit of ¥10,800mn. While these targets are slightly higher than FY3/17 results, the gap is not very large because the new medium-term business plan focuses less on earnings and more on the content and quality of measures aimed at laying the foundation for the future.

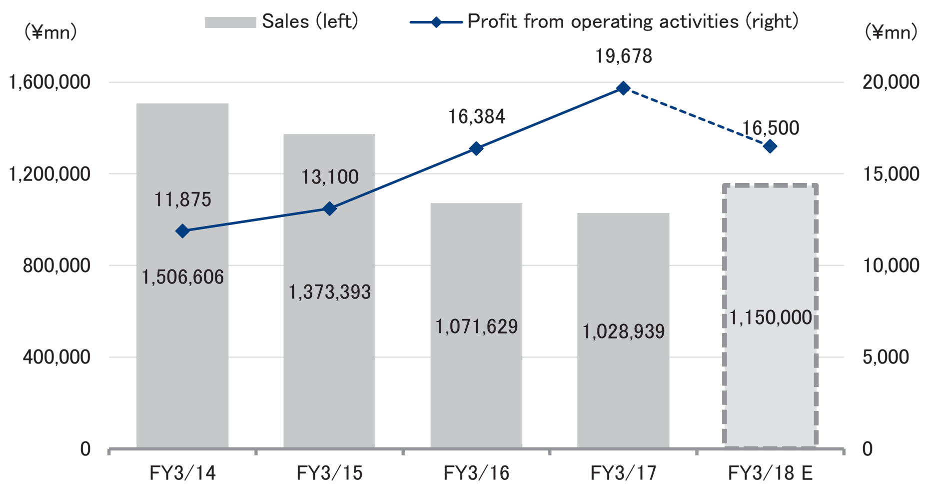
3. Targeting net profit over ¥20,000mn on contribution from environmental business and Asian operations as well as energy businesses

The Company's long-term goal, beyond the targets set out in "Moving 2018", is to transform itself into a Company able to consistently generate annual net profit of over ¥20,000mn. In order to reach its medium- to long-term targets, it believes it must not only expand its existing energy businesses (oil, gas, and electric power), but also achieve growth and earnings contribution its environmental businesses and overseas operations (in Asia). While the Company began some initiatives aimed at achieving these goals in the previous medium-term business plan, "Moving 2016", we believe its efforts build a foundation for the future under "Moving 2018" bear close monitoring.

Key Points

- Posted record-high profit from operating activities and net profit in FY3/17. Net profit topped ¥10,000mn for the first time.
- Announced new medium-term business plan, “Moving 2018: Connecting to the future”. Next two years designated as a period of laying the foundations for the next stage of the Company’s development.
- In FY3/18, we focus less on quantitative results and more on progress on measures to move the Company forward.

Results trends



Source: Prepared by FISCO from the Company's financial results

Results trends

Record-high profit from operating activities and net profit in FY3/17. Net profit topped ¥10,000mn for the first time.

1. Review of FY3/17 results

The Company reported FY3/17 results with ¥1,028,939mn in sales (down 4.0% YoY), ¥695,060mn in revenue (down 4.0%), ¥19,678mn in profit from operating activities (up 20.1%), ¥19,344mn in profit before tax (up 28.9%), and ¥10,405mn in net profit (up 39.3%). The Company achieved considerable profit growth even amid sales decline and profit was well above the Company's initial forecast.

Profit from operating activities and net profit both reached record highs and net profit topped ¥10,000mn for the first time. FY3/17 was the final year covered by the previous medium-term business plan, “Moving 2016” and the Company surpassed its targets for profit from operating activities and net profit set out in that plan.

Review of FY3/17 results

(¥mn)

	FY3/16 Full year	FY3/17			
		Full year (forecast)	Full year	YoY	vs. forecast
Sales	1,071,629	1,060,000	1,028,939	-4.0%	-2.9%
Revenue	723,645	-	695,060	-4.0%	-
Gross profit	89,562	-	93,604	4.5%	-
SG&A expenses	73,226	-	74,697	2.0%	-
Profit from operating activities	16,384	17,500	19,678	20.1%	12.4%
Profit before tax	15,004	17,000	19,344	28.9%	13.8%
Net profit attributable to the Company's shareholders	7,469	10,000	10,405	39.3%	4.1%

Source: Prepared by FISCO from the Company's financial results

Sales and revenue both declined by 4.0% YoY on falling crude oil prices and a decline in sales volume resulting from lower demand for fuel oil. However, profit from operating activities rose by 20.1% YoY on strong growth in electric power sales volume, improvement in the LP gas inventory impact, and one-time gains on the sale of wind power facilities (under the International Financial Reporting Standards (IFRS) used by the Company, gains from asset sales are posted at the operating level). Net profit rose a sizable 39.3% YoY, topping the ¥10,000mn level on contribution from higher earnings at equity-method subsidiaries owing to rising LP gas prices.

Below, we provide a detailed description of trends in each business segment.

Breakdown of FY3/17 results by business segment

(¥mn)

	FY3/16 Full year	FY3/17			
		Full year (forecast)	Full year	YoY	vs. forecast
Home-Life Division	95,126	94,700	90,768	-4.6%	-4.2%
Power & Utility Division	43,495	58,700	65,654	50.9%	11.8%
Car-Life Division	534,156	538,400	511,156	-4.3%	-5.1%
Energy Innovation Division	398,852	371,300	361,361	-9.4%	-2.7%
Other	0	-	-	-	-
Sales before adjustments	1,071,629	1,063,100	1,028,939	-4.0%	-3.2%
Adjustments	-	-3,100	-	-	-
Total sales	1,071,629	1,060,000	1,028,939	-4.0%	-2.9%
Home-Life Division	3,367	5,000	4,831	43.4%	-3.4%
Power & Utility Division	4,439	3,900	6,640	49.6%	70.3%
Car-Life Division	4,194	4,800	4,169	-0.6%	-13.1%
Energy Innovation Division	3,774	3,800	3,924	4.0%	3.3%
Other	1	-	-	-	-
Sales before adjustments	15,775	17,500	19,564	24.0%	11.8%
Adjustments	609	-	114	-81.3%	-
Total profit from operating activities	16,384	17,500	19,678	20.1%	12.4%

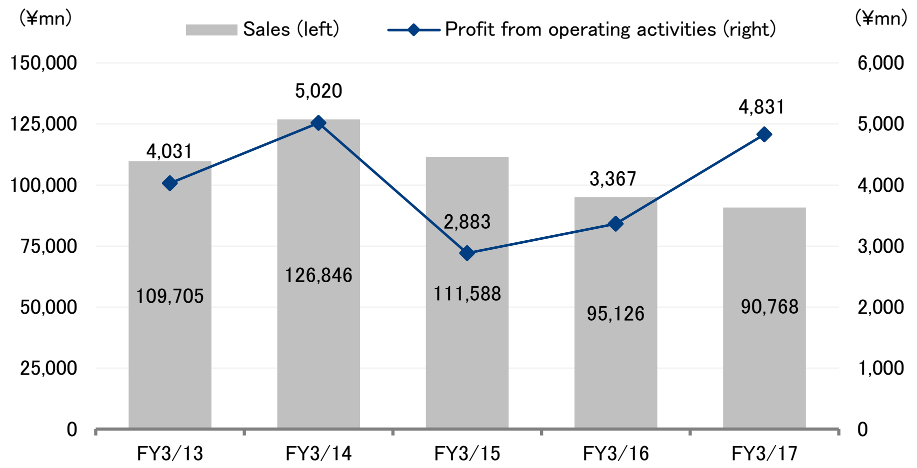
Source: Prepared by FISCO from the Company's financial results

Profit rose sharply on rising LP gas import prices. Secured 32,000 small-volume electricity retail contracts.

2. Home-Life Division

The Home-Life Division reported an increase in profit on weaker sales in FY3/17 with ¥90,768mn in sales (down 4.6% YoY), ¥86,828mn in revenue (including inter-segment transactions; same below) (down 5.2%), ¥4,831mn in profit from operating activities (up 43.4%), and ¥2,823mn in net profit attributable to the Company's shareholders (up 258.4%).

Results trends in the Home–Life Division

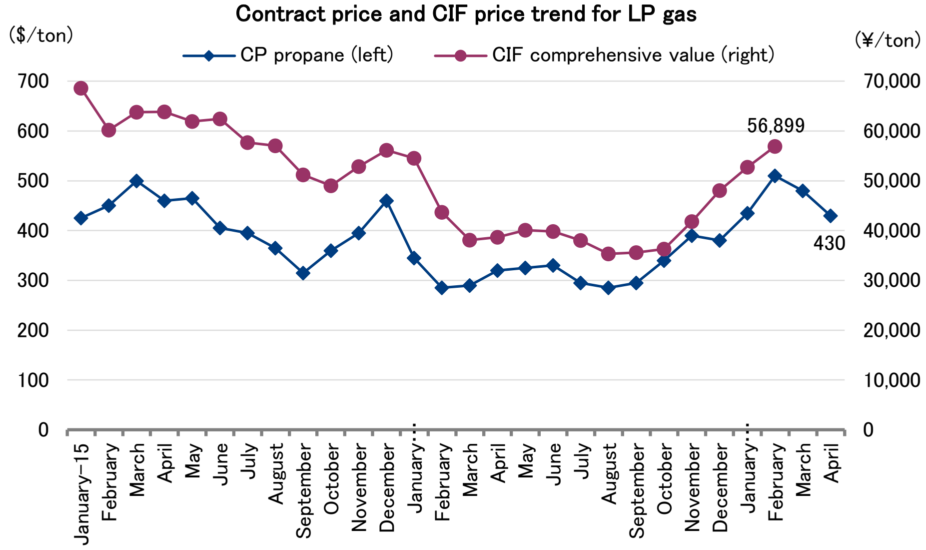


Source: Prepared by FISCO from the Company's financial results

LP gas sales volume declined by 0.6% YoY to 597,000 kilotons as the number of retail sales contracts increased by only roughly 1% YoY (increase of 3,000 contracts, total contracts: roughly 350,000). However, as LP gas import prices rose around the end of FY3/17, the LP gas inventory impact (value of inventory stored in customers' tanks) improved by approximately ¥1,500mn YoY, thereby boosting profit from operating activities considerably. YoY profit from operating activities growth was mostly attributable to this inventory impact improvement.

In addition, as mentioned above, earnings at equity-method affiliates improved owing to higher LP gas import prices and net profit in the Home-Life Division improved by approximately ¥2,000mn, which contributed greatly to the rise in companywide net profit.

Contract price and CIF price trend for LP gas



Source: Prepared by FISCO from the Company's results briefing materials

Among the initiatives carried out by the Company in FY3/17, it secured 32,000 small-volume retail contracts (such as ordinary households and small stores) for combination LP gas and electric power by end-FY3/17, surpassing its target of 30,000 contracts. We understand that through the securing of these contracts, the Home-Life Division receives a certain amount of income from the Power & Utility Division and the Home-Life Division has still not yet achieved profitability when viewed as an independent business.

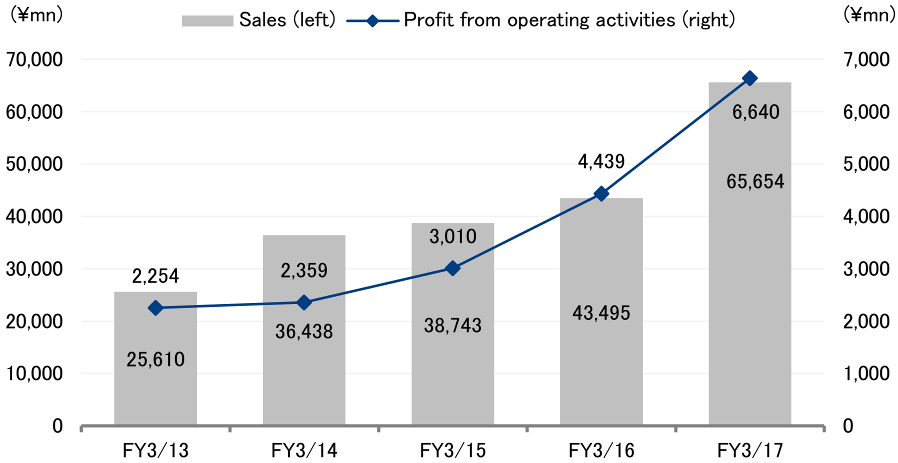
Another initiative is the development of overseas LP gas businesses. In May 2016, the company acquired shares in Philippines-based LP sales business company, Isla Petroleum & Gas Corporation and entered the gas business in the Philippines. Starting in January 2017, the Company began increasing the number of local employees with experience in the business and it is now strengthening its business selling LP sales to Japanese companies in the Philippines. In September 2016, the company's joint venture with Itochu Industrial Gas Co., Ltd. established in Karawang International Industrial City, Indonesia completed construction of an industrial gas facility. The Company plans to expand the operations of this joint venture by expanding its lineup of materials used by Japanese companies located in Indonesia.

Strong growth in retail electric power sales volume. Making progress toward future goals by upgrading asset portfolio.

3. Trends in the Power & Utility Division

The Power & Utility Division reported both sales and profits expanded, with ¥65,654mn in sales (up 50.9% YoY), ¥63,542mn in revenue (up 48.6%), ¥6,640mn in profit from operating activities (up 49.6%), and ¥3,407mn in net profit (up 52.1%) in FY3/17.

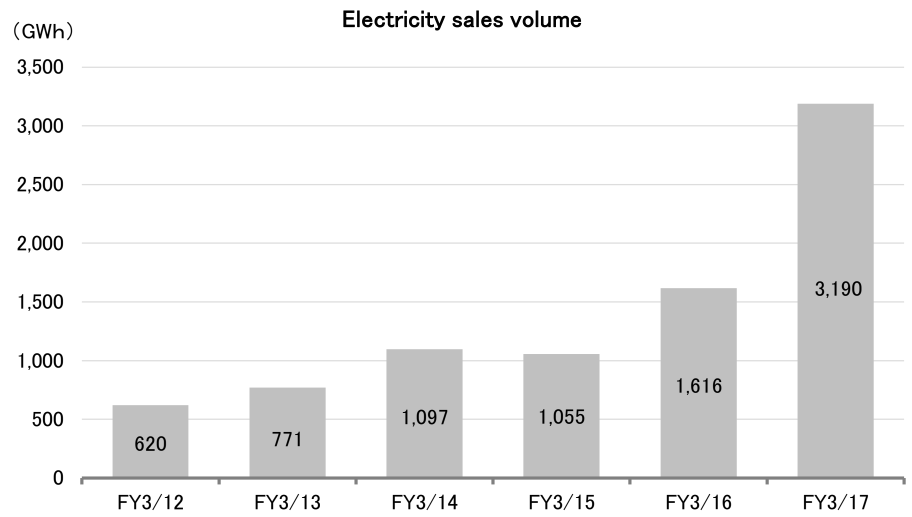
Results trends in the Power & Utility Division



Source: Prepared by FISCO from the Company's results briefing materials

In the electric power business, sales volume rose a strong 97.4% YoY to 3,190GWh, resulting in sizable earnings growth. This was nearly 50% higher than the FY3/17 target of 2,200GWh set out in Moving 2016, the previous medium-term business plan.

Growth in electric power sales is attributable to steady growth in retail sales volume in both the low-voltage segment (small-volume customers such as ordinary households and smaller retailers) and the high-voltage segment (large-volume customers such as plants and offices). As mentioned above, the Company secured 32,000 small-volume retail contracts, surpassing its target. In addition to the focus in the Home-Life Division on selling combined LP gas and electric power packages, the launch of “car and electricity collaboration” as a joint effort with Nissan Osaka Sales from the Car-Life Division contributed to earnings. We believe the number of contracts with large-volume customers increased as PPSs (Power Producer and Suppliers), including the Company, become better able to offer stable electric power supply.



Source: Prepared by FISCO from the Company's results briefing materials

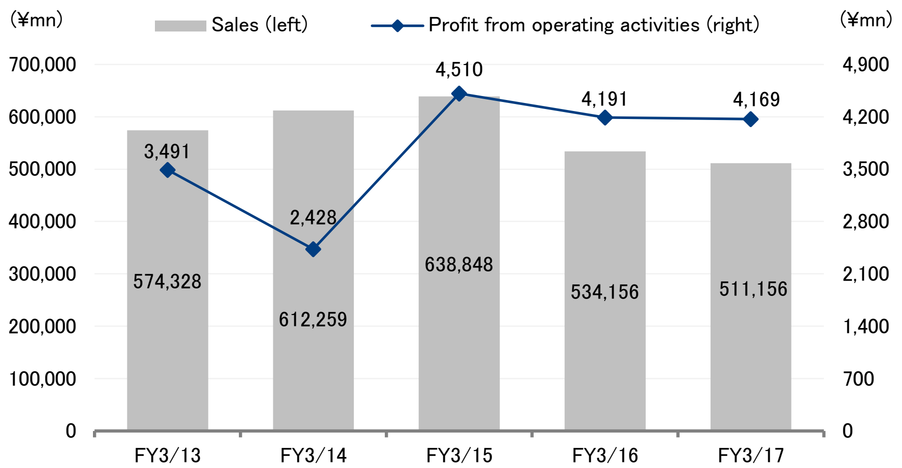
The Company also made progress on forward-looking initiatives amid a favorable operating environment. For example, it sold off some of its wind power facilities in order to upgrade its business portfolio. The gains from these sales were a major factor behind the sizable YoY profit growth achieved in FY3/17. The Company also established a renewable energy generation O&M (operation & maintenance) company to run its O&M business (outsourced operation and maintenance of power generation facilities) as one step in its plan to improve its power generation business.

Impact of lower gasoline sales volume offset by strong sales at Nissan Osaka Sales Co., Ltd

4. Car-Life Division

The Car-Life Division reported ¥511,156mn in sales (down 4.3% YoY), ¥471,132mn in revenue (down 5.1%), ¥4,169mn in profit from operating activities (down 0.5%), and ¥1,576mn in net profit attributable to the Company's shareholders (down 21.7%) in FY3/17.

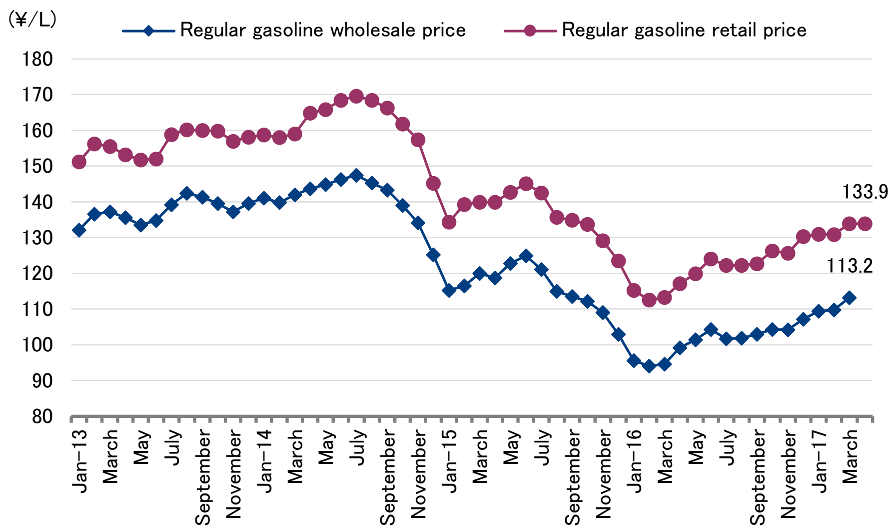
Results trends in the Car-Life Division



Source: Prepared by FISCO from the Company's financial results

The Company also continued to restructure its CS (CS is an abbreviation for Car-Life Station, it refers to service stations providing multiple services provided by the Company) business. The number of CS declined by 85 as the Company shuttered less profitable stations, falling to 1,888 by end-FY3/17. Gasoline sales volume fell by 3.6% YoY to 3,587,000 kiloliters owing to the reduction in the number of CS and an increase in the number of hybrid vehicles. The Company's earnings structure is such that profit margins on gasoline are fairly stable and declines in sales volume therefore have a direct impact on profit.

Gasoline price trend (January 2013 to March 2017)



Source: Prepared by FISCO from the Company's financial results

The purpose of the restructuring of the CS business is to increase income from automotive services other than fuel sales. In FY3/17, the Company established Car-Life Stadium, an integrated service brand that encompasses three different car-related businesses - rental cars, auto purchasing, and auto sales. The Company is also in the car wash business. While we expect these auto businesses that are unrelated to fuel sales to gradually increase earnings, we believe it will take some time for this to offset the decline in fuel sales.

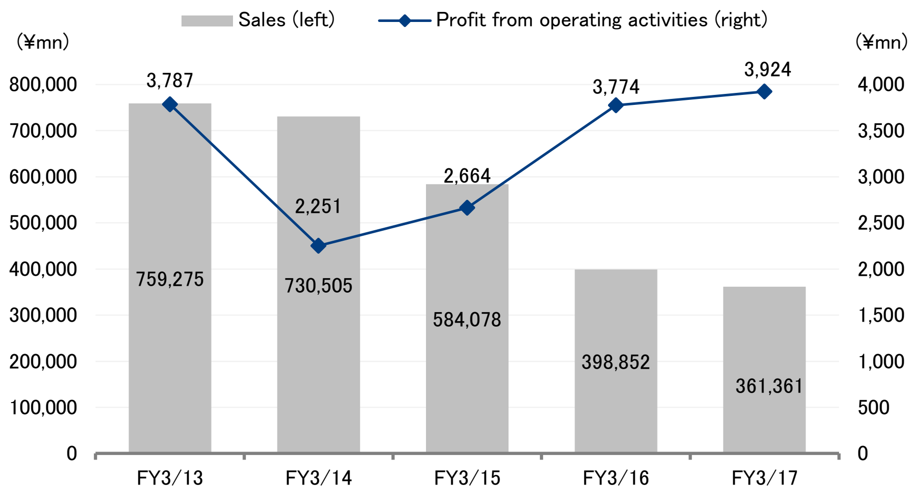
The reason profit from operating activities held steady even under these conditions was strong sales at subsidiary Nissan Osaka Sales, where sales increased by ¥5,000mn YoY to ¥101,100mn and profit from operating activities doubled to ¥2,600mn. Contribution to net profit also doubled, rising to ¥800mn. Auto sales volume declined by 1,000 units for new cars to 30,000 units and by 2,000 units for used cars to 23,000. This was attributable to a decline in sales of compact cars in 1H owing to the falsification incident at Mitsubishi Motors Corporation <7211>. After that, the product mix improved on the newly released Serena and Note models, resulting in revenue growth.

Profit also increased on improvements in the asphalt business and the AdBlue business as the company made steady progress on portfolio management.

5. Energy Innovation Division

The Energy Innovation Division reported increase in profits on weaker sales with ¥361,361mn in sales (down 9.4% YoY), ¥76,949mn in revenue (down 21.4%), ¥3,924mn in profit from operating activities (up 4.0%), and ¥2,644mn in net profit attributable to the Company's shareholders (up 5.2%) in FY3/17.

Results trends in the Energy Innovation Division



Source: Prepared by FISCO from the Company's financial results

Division sales declined by 9.4% YoY as sales of industrial fuel (heavy oil) declined 9.1% to 2,642,000 kilotons and overseas sales of bunker fuel oil for ships declined sharply on sluggishness in the global marine transport industry. In the run-up to the end of the fiscal year, the rise in crude oil prices impacted the Company's asphalt inventory value, thereby improving profitability, and division profit from operating activities increased YoY. Sales of AdBlue (an NOx decomposition solution additive for diesel engines) also rose by 14% YoY, contributing to earnings.

In the Energy Innovation Division, based on its slogan of “portfolio management”, the Company is finding ways to appropriately and dynamically leverage business assets and moving forward with commercialization of new businesses. In the AdBlue business, the Company created an integrated production and sales system utilizing 20 supply sites and 10 alliance plants nationwide, which contributed to the abovementioned doubling of sales volume. The Company is also making progress toward the full-scale launch of new businesses such as the fly ash business and recovered oil business. While the Company handles many products that are unfamiliar to most consumers, it has strengths in each of these fields and has secured considerable profit through its constant efforts to improve its earnings potential.

New medium-term business plan and growth strategy

Announced new two-year medium-term business plan “Moving 2018”. Next two years designated as time to lay foundation for the future.

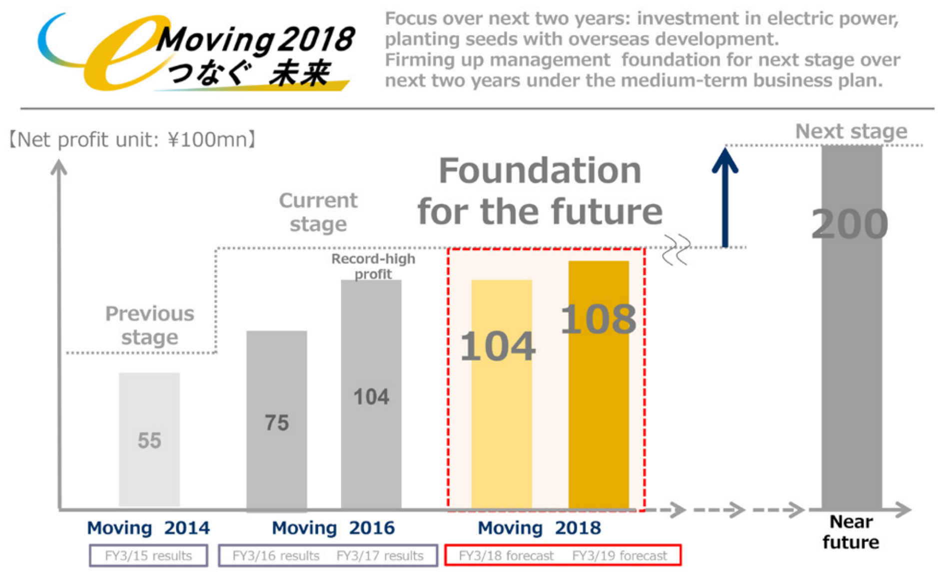
1. Outline of the new medium-term management plan

The Company announced its new two-year (FY3/18 and FY3/19) medium-term business plan, “Moving 2018: Connecting to the future”. The concept behind the new plan is “two years to lay the management foundations for the next stage of the Company's development” as expressed by the subtitle of the Plan “Connecting to the future”.

During the two-year period ending with FY3/17, the Company worked toward the goals of its previous medium-term business plan, “Moving 2016 – Sowing seeds for tomorrow”. As mentioned above, net profit topped ¥10,000mn in FY3/17. While this is a significant milestone, it is not the Company's goal. In its next stage, the Company targets annual net profit of ¥20,000mn.

However, as it is not possible for the Company to go from ¥10,000mn to ¥20,000mn in a single jump, it has made a strong statement by designating the period covered by “Moving 2018: Connecting to the future” as a time to focus on creating a foothold to take the Company to the ¥20,000mn stage.

Concept and positioning of new medium-term business plan



Source: The Company's medium-term business plan briefing materials

Quantitative targets in the new medium-term business plan are for profit from operating activities of ¥18,500mn, net profit of ¥10,800mn, and ROE of 9.1% in FY3/19, the final year of the plan. While the profit from operating activities target is below the FY3/17 level, this is because, as mentioned above, FY3/17 profit from operating activities was lifted by one-off factors and the Company expects growth in profit from operating activities when adjusted for these factors. Also, we believe the net profit target of ¥10,800mn is important in that it sends the message that the Company will prioritize the establishment of net profit levels over ¥10,000mn.

We focus more on investment plans in the new medium-term business plan than on quantitative targets. The Company plans to make ¥45,000mn in investments during the two years covered by the plan. On an annualized basis, this is roughly 70% higher than investments made in FY3/17. This is perhaps to be expected given that the Company has designated the period covered by the plan as a time to lay the foundations for the next stage. However, we believe it is important to note that operating cash flow over the two-year period is expected to reach ¥46,000mn and that the Company is therefore positioned to make aggressive investments even as it maintains or strengthens its financial position.

Quantitative targets in the medium-term business plan

	FY3/17	Moving 2018	
		FY3/18	FY3/19
Profit from operating activities	¥19.7bn	¥16.5bn	¥18.5bn
Net profit attributable to the Company's shareholders	¥10.4bn	¥10.4bn	¥10.8bn
ROE	10.0%	9.3%	9.1%
Dividend payout ratio	Over 30%	Over 30%	Over 30%
Cash flows from operating activities	¥17.8bn	¥22.0bn	¥24.0bn
Investment plan	¥13.4bn	¥45.0bn (over 2 years)	
Average rate			
Crude oil price		$50/bbl	
CP price		$400/MT	
Forex rate		¥108.4/$	

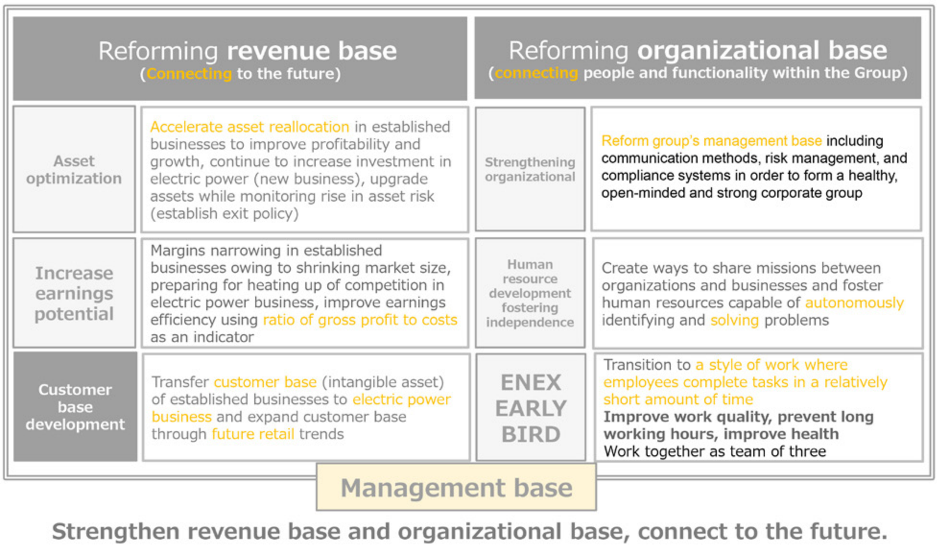
Source: The Company's medium-term business plan briefing materials

Two initiatives: reforming the revenue base and reforming the organizational base

2. Basic initiatives in the medium-term business plan

The new medium-term business plan consists of two basic initiatives, reforming the revenue base and reforming the organizational base. As these two initiatives will result in the reformation of the Company's management base, we believe the Company will not be able to move to the next stage without strengthening both of these bases.

Basic initiatives of Moving 2018: two connections



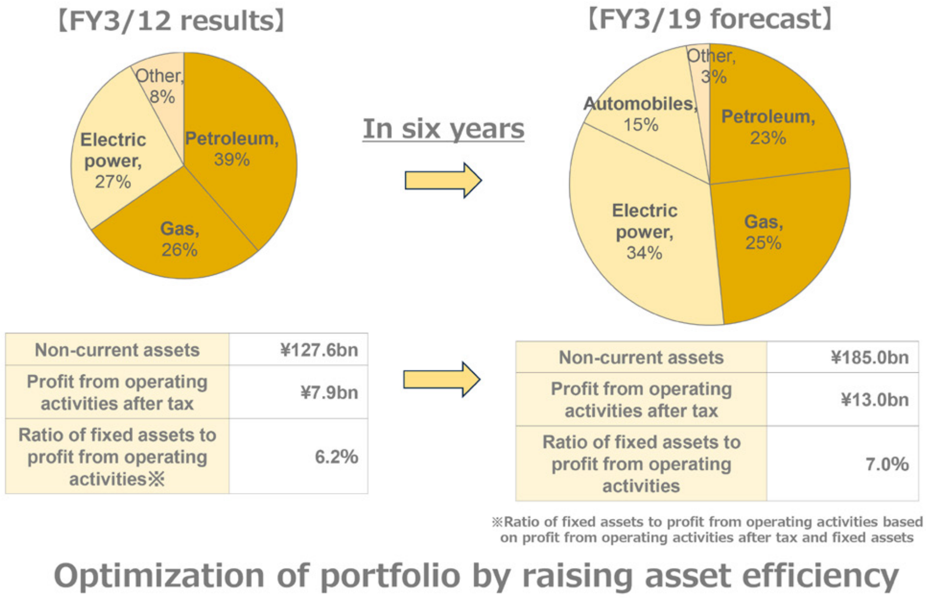
Source: The Company's medium-term business plan briefing materials

(1) Reforming the revenue base

The Company plans to reform its revenue base in order to achieve future earnings growth. The new medium-term business plan calls for "asset optimization". This refers to the upgrading of assets in order to achieve profitability and growth in both established businesses (oil and gas) and new businesses (electric power). We will provide details below, but the Company has already begun this process, as evidenced by the selling off of a portion of its wind power facilities in FY3/17.

In FY3/13, the Company's established oil and gas businesses accounted for 65% of total assets and the new electric power business and other businesses accounted for 35%. By FY3/19, the Company envisions a structure wherein established businesses account for less than 50% of its assets and new businesses (electric power, automobiles) and other businesses account for the majority of assets. By upgrading its assets, the Company aims to improve its ratio of fixed assets to profit from operating activities from 6.2% to 7.0%. It also plans to optimize assets within each individual business segment. As mentioned above, the selling off of a portion of the wind power generation facilities in the electric power business is part of this initiative.

Optimization of assets



Source: The Company's medium-term business plan briefing materials

(2) Reforming the organizational base

The Company aims to change its organizational structure from one where each product (oil, gas, electric power, etc.) is managed separately to a healthy, open-minded and strong corporate group organization. This is based on the decision that the organizational system governing the group's management must be reformed in order to improve communication methods, risk management, and compliance systems.

One aspect of organizational reform is the strengthening of the skills of each and every employee by fostering human resources capable of autonomously identifying problems, proposing solutions, and solving problems. This will involve demanding higher quality of work from employees. The Company is also simultaneously transforming its approach to work. Under the slogan "Enex Early Bird" the Company aims to transition to a style of work where employees complete tasks in a relatively short amount of time.

Changing segment divisions and names in order to achieve more effective business growth

3. Trends by business segment

In FY3/18, the Company redrew its segment divisions and renamed its business segments. Previously, the Car-Life Division and the Energy Innovation Division were classified under the Distribution & Energy Innovation Business Group, but the lines between these divisions have been redrawn based on their functional roles and some of their names have been changed. The Fleet (diesel truck fuel), AdBlue, and Industrial Fuels businesses have been moved from the Energy Innovation Division to the Car-Life Division and the name of the Car-Life Division has been changed to the Life & Logistics (LL) Division. Also, the name of the Energy Innovation Division was changed to the Industrial Logistics (IL) Division.

Changes to business divisions

Business group	Old segments	Main businesses	New segments
Industrial Logistics (IL) Group	Car-Life Division	Petroleum products: stores wholesale	Life & Logistics (LL)
		Petroleum products: CS retail	
		Autos: dealers, etc.	
	Energy Innovation Division	Petroleum products: industrial fuels, fleet, AdBlue	
		Petroleum products: asphalt, bunker fuel, supply-demand transactions, recovered oil, etc.	Industrial Logistics (IL)

Source: Prepared by FISCO from Company materials

Aims to increase number of direct LP gas customers and electric power customers and establish new earnings model

(1) Home-Life Division

This division has introduced a dual system (retail and wholesale) for its established businesses (LP gas, etc.) and plans to clearly quantify the profitability of each business and improve the profitability of the less-profitable businesses. There are also plans to establish a development team within the division to strengthen its direct-sale customer base.

The new electric power business, had secured 32,000 small-volume retail contracts as of end-FY3/17 and targets 70,000 contracts by end-FY3/18. This means it aims to secure 38,000 new customers in FY3/18. As part of the Company's customer relationship management (CRM) efforts, it plans to put customer management information in a database and leverage electric power business customers to develop new businesses.

Overseas business development, especially in Asia, has been identified as a key strategic initiative for the Home-Life Division. We believe the near-term goals will be to get the businesses in the Philippines and Indonesia up and running. In Japan, the Company plans to offer integrated services tailored to the needs of each region and increase customer satisfaction.

The Company forecasts Home-Life Division profit from operating activities of ¥4,500mn (down 6.9% YoY) in FY3/18 and ¥5,000mn (up 11.1%) in FY3/19. The reason the Company forecasts profit from operating activities decline in FY3/18 is that it expects a reactive decline from one-time gains posted in FY3/17 from the sale of assets. Adjusted for this factor, the Company expects profit to increase on growth in the number of direct customers in the LP gas business. In FY3/19, the Company expects a continued increase in profits on growth in the number of direct customers. In addition to this, if the Company reaches its goal of securing 70,000 small-volume retail contracts by end-FY3/18, we believe this could result in the electric power business entering the black on a fiscal year basis.

Turning to natural power sources and biomass to improve power generation business

(2) Power & Utility Division

The most important initiative in the Power & Utility Division is improving the power generation business. In response to environmental regulations, the Company plans to strengthen its power generation capabilities based on natural power sources. We believe the market will focus on the Company's plans to finance capital investment through this project completion financing such as project financing and non-recourse loans. The Company may also replace existing power generation facilities based on a long-term outlook. While the Company's power generation capacity may decline temporarily, it is making progress with its O&M (operation & maintenance) business, partly in order to address this issue, and it plans to maintain its managed power generation capacity at a stable level.

The Company is also considering using biomass as a power source and has begun considering how to select and procure biomass fuel as well as how to create the necessary infrastructure. As this is a massive undertaking, the Company may remain in the consideration and preparation stages during the two years covered by the new medium-term business plan. However, we believe it is likely to move toward more concrete discussions regarding the use of biomass as a base load power source with low environmental impact.

In the area of sales, in addition to cooperation between the Home-Life Division and the Life Energy & Logistics Division, the Company plans to proactively make use of alliances with outside partners. The Company will continue to strengthen sales to large-volume customers (mainly corporate customers such as plants and medium-sized stores).

The Company forecasts Power & Utility Division profit from operating activities of ¥4,400mn (down 33.7% YoY) in FY3/18 and ¥5,500mn (up 25.0%) in FY3/19. The reason the Company forecasts profit from operating activities decline in FY3/18 is that it expects a reactive decline from one-time gains posted in FY3/17 from the sale of assets. Adjusted for this factor, the Company expects profit from operating activities to rise by ¥500mn YoY. The Company expects profit growth to accelerate in FY3/19 on an increase in electric power sales volume.

Aims to expand operations by leveraging local networks and become a life infrastructure company

(3) Life Energy & Logistics Division

The most important initiative in the Life Energy & Logistics Division is organizational reform and merger of businesses within the division. The division has been split into four sections and has adopted sales strategies tailored to each region. In addition to petroleum products, the Company aims to provide integrated services vital to local societies.

In the CS business, the Company plans to continue to reduce assets by shuttering less-profitable CS and thereby optimizing assets on a companywide level. However, the Company plans to cultivate automobile-related businesses such as car rental, car purchasing, insurance, and maintenance under the Car-Life Stadium brand and use existing CS to provide services tailored to the needs of each region, thereby becoming an essential part of the local infrastructure.

In the dealership business run by Nissan Osaka Sales, the Company aims to implement highly efficient management, cut costs, improve management quality, and enhance its ability to respond to changes in the operating environment. It also plans to deepen recognition of the value of Nissan Osaka Sales' customer base as the top dealership in Osaka, and protect this advantageous position.

The Company forecasts Life Energy & Logistics Division profit from operating activities of ¥5,400mn (down 6.9% YoY) in FY3/18 and ¥5,600mn (up 3.7%) in FY3/19. The reason the Company forecasts profit from operating activities decline in FY3/18 is that it does not expect to be able to fully offset negative impacts from the pullback in the CS business and declining gasoline sales volume with positive impacts from strong performance in the fleet and AdBlue businesses and cost cuts. In FY3/19, the Company expects the weightings of these positive and negative factors to reverse even as the business structure remains the same, resulting in profit growth.

Aims to reallocate division's business portfolio by strengthening established businesses and moving forward with new and strategic projects.

(4) Industrial Energy & Logistics Division

Initiatives in the Industrial Energy & Logistics Division include improving profitability by optimizing the value chains (sales, logistics, and procurement) of established businesses. We believe another challenge facing the division is restructuring the cost structure by pursuing opportunities in businesses related to or derived from established businesses and improving facilities management by focusing on the unique characteristics of the equipment industry.

Possible new and strategic projects include launching a recycling business or participation in a bio-based jet fuel project. We understand the Company has already made progress toward the launch of a recovered oil and fly ash recycling business and is nearly ready to start operations as a profitable business. Regarding participation in a bio-based jet fuel project, the Company partnered with Euglena Co. Ltd. <2931> in a domestic biofuel project which, in June 2017 received a third-party capital infusion and is now working toward starting operation of a proof-of-concept plant in 2019.

The Company forecasts Industrial Energy & Logistics Division profit from operating activities of ¥2,100mn (down 4.5% YoY) in FY3/18 and ¥2,400mn (up 14.3%) in FY3/19. Despite an upturn in asphalt prices, the Company expects division profit from operating activities to trend sideways or decline in FY3/18 on a decline in overall volume. In FY3/19, the Company expects YoY profit growth on a recovery in asphalt demand ahead of the Tokyo Olympic Games and a bottoming of bunker oil (ship fuel) prices.

Forecast by segment

(¥mn)

	FY3/17	FY3/18		FY3/19	
	Full year	Full year (forecast)	YoY	Full year (forecast)	YoY
Home-Life Division	90,768	99,400	9.5%	107,300	7.9%
Power & Utility Division	65,654	84,300	28.4%	90,800	7.7%
Life Energy & Logistics Division	740,400	763,100	3.1%	771,800	1.1%
Industrial Energy & Logistics Division	132,100	211,700	60.3%	194,600	-8.1%
Sales before adjustments	1,028,939	1,158,500	12.6%	1,164,500	0.5%
Adjustment	-	-8,500	-	0	-
Total sales	1,028,939	1,150,000	11.8%	1,164,500	1.3%
Home-Life Division	4,831	4,500	-6.9%	5,000	11.1%
Power & Utility Division	6,640	4,400	-33.7%	5,500	25.0%
Life Energy & Logistics Division	5,800	5,400	-6.9%	5,600	3.7%
Industrial Energy & Logistics Division	2,200	2,100	-4.5%	2,400	14.3%
Profit from operating activities before adjustments	19,564	16,400	-16.2%	18,500	12.8%
Adjustment	114	100	-12.3%	-	-
Total profit from operating activities	19,678	16,500	-16.2%	18,500	12.1%

Source: The Company's financial results and medium-term business plan briefing materials

Business outlook

Focus more on progress toward future goals than on earnings levels

The Company forecasts ¥1,150,000mn in sales (up 11.8% YoY), ¥16,500mn in profit from operating activities (down 16.2%), ¥17,800mn in profit before tax (down 8.0%), and ¥10,400mn in net profit (down less than 0.1%) in FY3/18, with sales rising, but profit declining. The Company issues guidance on a full-year basis and has not issued an earnings forecast for 2Q FY3/18.

Overview of the forecast for FY3/17

(¥mn)

	FY3/17		FY3/18		
				YoY	
	Full year	YoY	Full year (forecast)	% change	Change
Sales	1,028,939	-4.0%	1,150,000	11.8%	121,061
Profit from operating activities	19,678	20.1%	16,500	-16.2%	-3,178
Profit before tax	19,344	28.9%	17,800	-8.0%	-1,544
Net profit attributable to the Company's shareholders	10,405	39.3%	10,400	-0.0%	-5

Source: Prepared by FISCO from the Company's financial results

Segment earnings forecasts are as discussed above. As also mentioned above, the main reasons the Company expects FY3/18 profit from operating activities to decline by 16.2% (¥3,178mn) YoY are that it expects a reactive decline from one-time gains posted on asset sales in FY3/17 and a decline in fuel (gasoline, etc.) sales volume in the Life Energy & Logistics Division.

Based on the Company's assumptions regarding crude oil and LP gas prices and actual levels, we believe it should be able to reach its FY3/18 targets as long as there are no major changes in the operating environment. As the Company has designated the period covered by the new medium-term business plan as a time to lay the foundation for the future rather than chase after earnings growth, we see the Company's forecast as realistic and achievable.

Our focus for FY3/18 is therefore not on earnings, but on whether steady progress is made on initiatives laying the groundwork for medium- to long-term growth. While we have discussed important initiatives in each business segment above, we especially focus on 1) electric power customer contract numbers in the Home-Life Division, 2) progress in the power generation business in the Power & Utility Division, 3) cultivation of the CS business (especially growth in non-fuel oil businesses and progress in region-focused sales) in the Life Energy & Logistics Division, and 4) development of new businesses in in the Industrial Energy & Logistics Division.

Income statement

(¥mn)

	FY3/15	FY3/16	FY3/17	FY3/18
Sales	1,373,393	1,071,629	1,028,939	1,150,000
YoY	-8.8%	-22.0%	-4.0%	11.8%
Revenue	936,841	723,645	695,060	-
YoY	-3.0%	-22.8%	-4.0%	-
Gross profit	85,720	89,562	93,604	-
YoY	19.7%	4.5%	4.5%	-
% of sales	6.2%	8.4%	9.1%	-
SG&A expenses	71,184	73,226	74,697	-
YoY	23.0%	2.9%	2.0%	-
% of sales	5.2%	6.8%	7.3%	-
Loss from tangible assets, intangible assets and goodwill	-1,825	-593	-982	-
Other - net	389	641	1,753	-
Total other expenses	-72,620	-73,178	-73,926	-
Profit from operating activities	13,100	16,384	19,678	16,500
YoY	10.3%	25.1%	20.1%	-16.2%
Profit before tax	12,155	15,004	19,344	17,800
YoY	-12.2%	23.4%	28.9%	-8.0%
Net profit attributable to the Company's shareholders	5,503	7,469	10,405	10,400
YoY	-22.7%	35.7%	39.3%	-0.0%
EPS (¥)	48.71	66.10	92.09	92.05
Dividend (¥)	22	24	32	32
Book-value per share (¥)	862.30	889.70	960.37	-

Source: Prepared by FISCO from the Company's financial results

Balance sheet

(¥mn)

	FY3/14	FY3/15	FY3/16	FY3/17
Current assets	188,193	157,708	137,865	178,127
Cash and cash equivalents	14,251	16,184	20,824	22,727
Trade receivables	140,289	98,449	71,968	94,759
Inventories	18,655	27,794	25,160	27,155
Non-current assets	132,531	171,351	166,188	166,476
Investments accounted for by the equity method	5,927	10,551	8,786	11,749
Other investments	7,349	8,924	8,029	7,461
Property, plant and equipment	66,988	88,836	88,311	87,588
Intangible assets	10,280	23,474	24,329	23,638
Total assets	320,724	329,059	304,053	344,603
Current liabilities	158,336	149,443	111,997	143,751
Short-term bonds and borrowings	11,499	14,208	5,299	9,318
Trade payables	125,655	104,564	80,745	101,902
Non-current liabilities	58,268	66,669	74,894	73,375
Non-current bonds and borrowings	27,099	26,746	32,366	31,702
Equity	94,651	97,432	100,526	108,511
Common stock	19,878	19,878	19,878	19,878
Capital surplusc	18,737	18,743	18,740	18,740
Retained earnings	59,884	62,223	66,024	73,300
Other components of equity	-2,098	-1,661	-2,364	-1,655
Treasury stock	-1,750	-1,751	-1,752	-1,752
Non-controlling interests	9,469	15,515	16,636	18,966
Total equity	104,120	112,947	117,162	127,477
Total liabilities and equity	320,724	329,059	304,053	344,603

Source: Prepared by FISCO from the Company's financial results

Cash flow statement

(¥mn)

	FY3/14	FY3/15	FY3/16	FY3/17
Cash flows from operating activities	17,530	34,336	30,322	17,831
Cash flows from investing activities	-12,556	-20,410	-16,673	-14,712
Cash flows from financing activities	-8,859	-12,115	-9,059	-1,195
Net increase/decrease in cash and cash equivalents	-3,885	1,811	4,590	1,924
Cash and cash equivalents at the beginning of the period	18,062	14,251	16,184	20,824
Increase/decrease in cash and cash equivalents resulting from merger	74	122	-27	-21
Effect of exchange rate changes on cash and cash equivalents	-	-	77	-
Cash and cash equivalents at the end of the period	14,251	16,184	20,824	22,727

Source: Prepared by FISCO from the Company's financial results

Shareholder returns

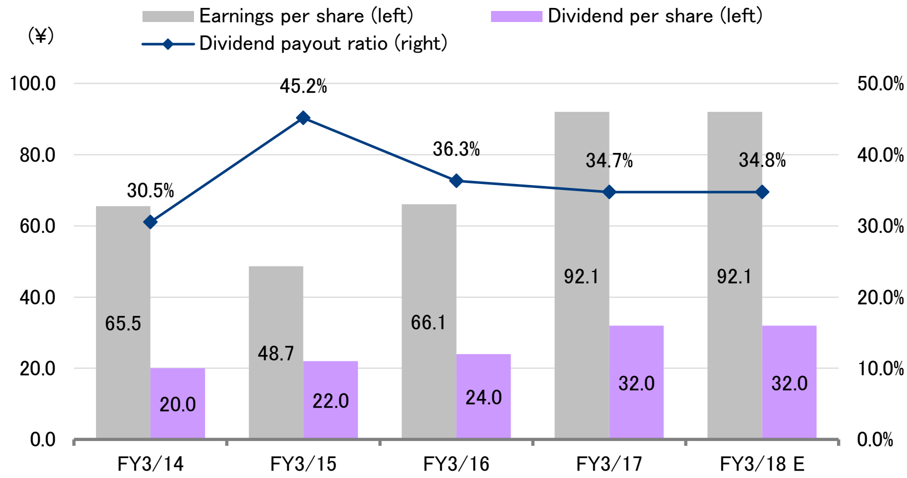
Raised annual dividend distributions by ¥8 YoY to ¥32 per share to reflect profit growth in FY3/17

The Company utilizes dividends to compensate shareholders and has a basic policy on shareholder returns of maintaining a dividend payout ratio of 30%.

The Company's initial FY3/17 dividend target, based on its forecast of ¥88.5 in earnings per share, was ¥27 per share (dividend payout ratio of 30.5%). However, earnings per share surpassed the Company's target, coming in at ¥92.09 per share (up 39.3% YoY) and the Company therefore hiked annual dividend distributions by ¥8 YoY to ¥32 per share (¥13.5 interim dividend and ¥18.5 year-end dividend), for a dividend payout ratio of 34.8%.

The Company plans to maintain FY3/18 dividends at ¥32 per share (¥16 interim dividend and ¥16 year-end dividend), the same level as in FY3/17, based on a forecast of steady YoY earnings per share at ¥90.05. However, we focus on the fact that the Company raised its interim dividend because we believe this may reflect management's confidence that it will reach its earnings targets. This puts the dividend payout ratio forecast at 34.8% and we believe it indicates that the Company is likely to keep annual dividend distributions at ¥32 per share even if net profit rises or falls slightly.

Earnings and dividend per share and dividend payout ratio



Source: Prepared by FISCO from the Company's financial results

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