COMPANY RESEARCH AND ANALYSIS REPORT

ITOCHU ENEX CO., LTD.

8133

Tokyo Stock Exchange First Section

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Index

Summary

Strong progress in business results reflecting an upturn in the external environment and the Company's own efforts. Focus on progress of growth investment

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 ITOCHU Corp. <8001>. It has a broad business scope, though mainly sells petroleum products and liquefied petroleum (LP) gas to users ranging from industrial businesses to final consumers. Its presence has also been growing in electricity sales in recent years.

1. Synergy effects between an upturn in the external environment and the Company's own efforts delivered a new record high in 1H earnings

ITOCHU ENEX reported a higher profit on higher sales in 1H FY3/18 with ¥507,990mn in sales (+8.9% YoY) and ¥9,421mn in profit from operating activities (+21.5%). Synergy effects between an upturn in the external environment and the Company's own efforts delivered a new record high in 1H earnings. In the Life Energy & Logistics Division in 1H FY3/18, the combination of an upturn in the external environment (rise in gasoline prices and stable market conditions) and the Company's own efforts (closures of unprofitable Car-Life Stations (CSs; ITOCHU ENEX's in-house term for gas stations), etc.) produced an especially notable earnings improvement.

2. Making steady progress on its two-year medium-term business plan, "Moving 2018." Capital investment for growth is a focal point

The Company is engaged in a two-year medium-term business plan, "Moving 2018," under which it is focusing its efforts on solidifying its foundation for future growth. In other words, the Company is investing for growth. Over the two-year period, the Company plans to execute ¥45.0bn in capital investments, with ¥19.2bn of this slated for FY3/18. During 1H, the Company executed ¥14.1bn in investments, achieving a progress rate of approximately 73% of its full-year target. These investments included a large-scale business integration in the LP gas business and capacity expansion of its heat-supply facilities. Progress in capital investments will be a key focus in 2H and onwards. We will focus in particular on the core business of power source development, which is a growth field.

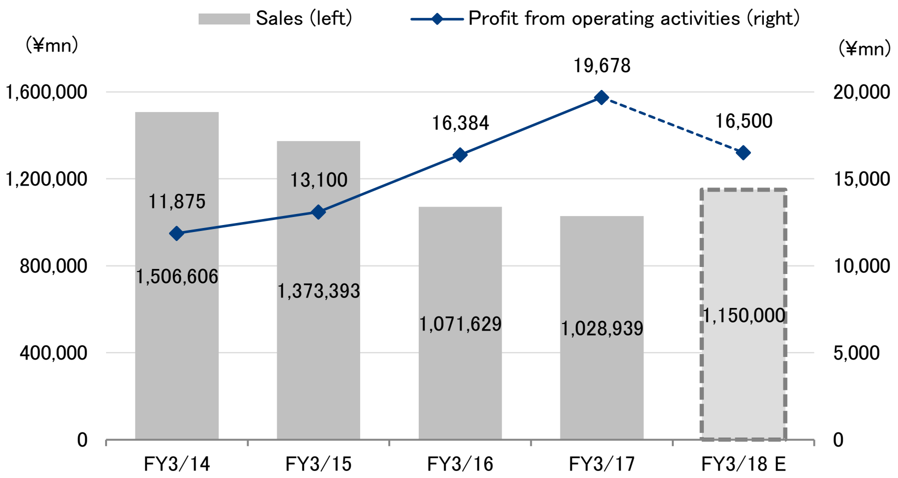
3. Strong possibility of outperforming the FY3/18 forecast, but the situation remains unpredictable

The Company had achieved a high progress rate on its FY3/18 targets in its performance through to the end of 1H, driving growing expectations that full-year results may exceed the forecast. We share this sentiment, but it is important to note that unpredictable factors are present in each business segment. For FY3/19, if the present business environment continues, the Company is likely to achieve increases in sales and profits; however, the current business environment is actually showing signs of growing more adverse. At this point, we consider it most appropriate to retain the trajectory given by the earnings targets in "Moving 2018" as the basic scenario.

Key Points

- Focus on solidifying foundation for the next leap forward under "Moving 2018"
- Focus on growth investments and asset reallocation as a growth strategy. Steady progress in 1H
- Strong possibility of exceeding the Company's FY3/18 forecast, but it is important to note that risk factors remain

Results trends



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

Results trends

An upturn in the external environment combined with the Company's own efforts delivered a new record high in 1H earnings

1. Review of 1H FY3/18 results

The Company reported 1H FY3/18 results with sales and profit increases at ¥507,990mn in sales (up 8.9% YoY), ¥352,395mn in revenue (up 13.9%), ¥9,421mn in profit from operating activities (up 21.5%), ¥8,282mn in profit before tax (up 14.4%), and ¥3,969mn in net profit attributable to the Company's shareholders (up 7.1%).

It is not possible to offer comparison with previous forecasts because ITOCHU ENEX only discloses a full-year forecast. However, progress rates in 1H were 44.2% in sales, 57.1% in profit from operating activities, and 46.5% in profit before tax. Furthermore, the Company achieved new record highs for 1H in profit from operating activities and net profit attributable to the Company's shareholders. As a result, the Company's upbeat results for 1H are expected to have exceeded its internal plans.

Review of 1H FY3/18 results

(¥mn)

	FY3/17		FY3/18			
	1H results	Full-year results	1H results	YoY	Progress rate vs. forecast	Full-year forecast
Sales	466,313	1,028,939	507,990	8.9%	44.2%	1,150,000
Revenue	309,516	695,060	352,395	13.9%	-	-
Gross profit	43,742	93,604	44,193	1.0%	-	-
SG&A expenses	36,210	74,697	35,385	-2.3%	-	-
Profit from operating activities	7,755	19,678	9,421	21.5%	57.1%	16,500
Profit before tax	7,242	19,344	8,282	14.4%	46.5%	17,800
Net profit attributable to the Company's shareholders	3,707	10,405	3,969	7.1%	38.2%	10,400

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

For 1H FY3/18, we believe the Company's upbeat results are due to the beneficial combination of an upturn in the external environment and the Company's own efforts. This pattern started in 1Q and continued through 2Q (July-September).

External environmental factors included a rise (recovery) in crude oil prices and the stabilization of the market and market conditions due to the reorganization of domestic suppliers, as exemplified by the launch of JXTG Holdings, Inc. <5020>. The Company's own efforts included various measures, such as the reorganization of the LP gas business with Osaka Gas Co., Ltd. <9532> in the Home-Life Division and collaboration with other industries in the power and utilities business. Nevertheless, in terms of impact on results, the most notable contribution came from a business structure reorganization in the Life Energy & Logistics Division.

With the exception of gasoline, 1H sales volumes of core products were all higher YoY. An increase in power transactions led to a 34.4% YoY increase in sales volume for electricity, while heat sales also grew significantly with the start of heat supply operations for GINZA SIX, which are described below. Meanwhile, gasoline sales declined sharply by 16.0%, affected mainly by a stall in transactions to adjust the supply-demand gap and closures of unprofitable CSs. We estimate movement in the actual demand base for gasoline to have been around 1-2%.

Consolidated sales volume of core products

Main fuel totals		1H FY3/17	1H FY3/18	% change
Gasoline	(thousand kl)	1,974	1,659	△16.0%
Kerosene	(thousand kl)	308	310	+0.5%
Diesel	(thousand kl)	1,581	1,667	+5.5%
Heavy oil	(thousand kl)	1,196	1,325	+10.8%
Fuel total	(thousand kl)	5,059	4,960	△1.9%
Other than main fuels		**1H FY3/17**	**1H FY3/18**	**% change**
Asphalt	(thousand kt)	150	167	+11.6%
LP gas	(thousand kt)	265	270	+1.9%
Electricity	(GWh)	1,521	2,043	+34.4%
Steam	(thousand kt)	303	330	+8.7%
Heat	(TJ)	754	779	+3.4%

Source: The Company's results briefing materials

Broken down by segment, the Life Energy & Logistics Division achieved an increase in profit of ¥1,818mn. In addition, the Home-Life Division and the Power & Utility Division both achieved higher profits YoY. However, the Industrial Energy & Logistics Division saw profits fall by ¥807mn. Overall, profit from operating activities increased by ¥1,666mn YoY.

Breakdown of results by business segment

(¥mn)

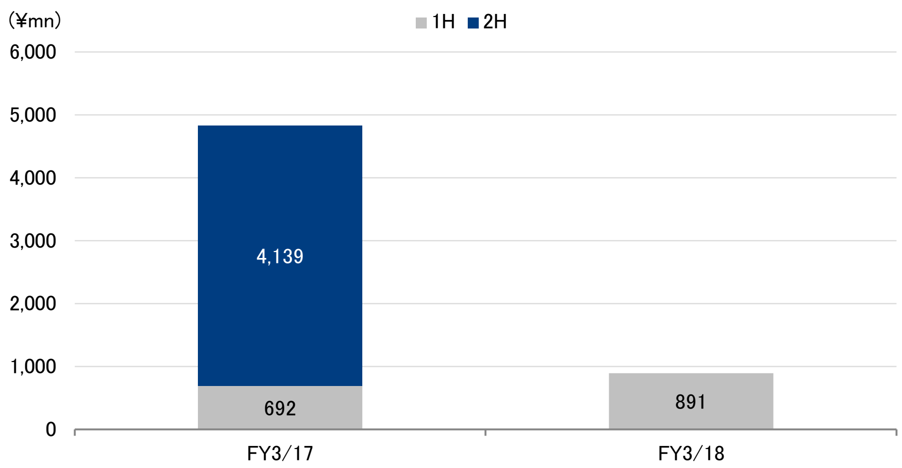
		FY3/17			FY3/18				
		1Q	2Q	1H results	1Q	2Q	1H results	YoY change (%)	YoY change
Revenue	Home-Life Division	19,014	15,902	34,916	21,704	18,419	40,123	14.9%	5,207
	Power & Utility Division	11,481	17,219	28,700	15,309	19,929	35,238	22.8%	6,538
	Life Energy & Logistics Division	105,982	114,044	220,026	119,081	123,176	242,257	10.1%	22,231
	Industrial Energy & Logistics Division	13,309	14,583	27,892	18,336	20,650	38,986	39.8%	11,094
	Revenue before adjustment	149,786	161,748	311,534	174,430	182,174	356,604	14.5%	45,070
	Adjustment	-978	-1,040	-2,018	-1,972	-2,237	-4,209	-	-2,191
	Revenue	148,808	160,708	309,516	172,458	179,937	352,395	13.9%	42,879
Profit from operating activities	Home-Life Division	646	46	692	785	106	891	28.8%	199
	Power & Utility Division	1,301	2,133	3,434	1,915	1,961	3,876	12.9%	442
	Life Energy & Logistics Division	-271	2,172	1,901	1,741	1,978	3,719	95.6%	1,818
	Industrial Energy & Logistics Division	394	737	1,131	-56	380	324	-71.4%	-807
	Profit from operating activities before adjustment	2,070	5,088	7,158	4,385	4,425	8,810	23.1%	1,652
	Adjustment	258	339	597	279	332	611	2.3%	14
	Profit from operating activities	2,328	5,427	7,755	4,664	4,757	9,421	21.5%	1,666
Net profit attributable to the Company's shareholders	Home-Life Division	361	-419	-58	406	-967	-561	-	-503
	Power & Utility Division	652	1,041	1,693	931	951	1,882	11.2%	189
	Life Energy & Logistics Division	-376	1,272	896	1,013	1,041	2,054	129.2%	1,158
	Industrial Energy & Logistics Division	306	514	820	-12	254	242	-70.5%	-578
	Net profit attributable to the Company's shareholders before adjustment	943	2,408	3,351	2,338	1,279	3,617	7.9%	266
	Adjustment	134	222	356	185	167	352	-1.1%	-4
	Net profit attributable to the Company's shareholders	1,077	2,630	3,707	2,523	1,446	3,969	7.1%	262

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

The LP gas business saw higher profit from operating activities on higher sales due to increased sales volume and the positive impact on inventories of an increase in the contract price. The electricity business also began contributing to earnings

2. Home-Life Division

Profit from operating activities in the Home-Life Division



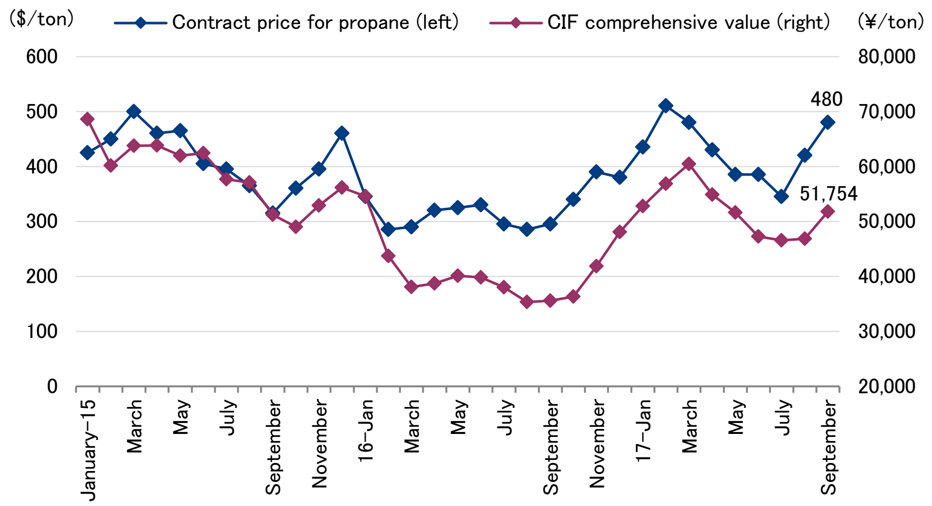
Source: Prepared by FISCO from the Company's financial results

In the Home-Life Division, revenue was ¥40,123mn (+14.9% YoY), while profit from operating activities was ¥891mn (+28.8%). Net loss attributable to the Company's shareholders was ¥561mn (net loss of ¥58mn for the same period of the previous fiscal year). In the LP gas business, sales volume and prices were firm, while the earnings contribution of the electricity business led to an increase in profit from operating activities.

In the structure of the core LP gas sales business, fluctuations in the contract price, which is the main sellers price, are absorbed by the fuel costs adjustment program to ensure a certain amount of spread. Therefore, profit fluctuations are primarily determined by sales volumes. 1H sales volumes increased by 1.9% YoY, enabling the Company to secure the corresponding amount of profit.

On the other hand, LP gas operators recognize the gas for each customer as their own inventory (value of inventory stored in customers' tanks), and therefore hold a large volume of inventories. As a result, the impact value of inventories due to the level of the contract price at the end of the fiscal year has an impact on profit and loss. Although the contract price declined during 1H FY18/3, it rose towards the end of the period resulting in a positive inventory impact amount that lifted segment profit from operating activities.

Contract price and CIF trend for LP gas



Source: Prepared by FISCO from trade statistics of the Ministry of Finance

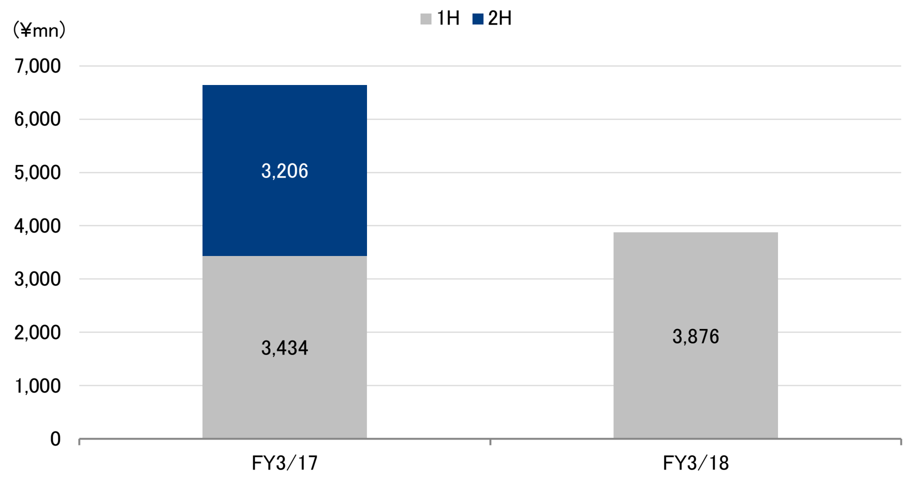
The Home-Life Division started an electricity business following the full liberalization of electricity retail sales in April 2016. In this business, the division sells electric power handled by the Power & Utility Division to the households of LP gas customers. The Home-Life Division sells package discounts for LP gas, its main product, in combination with electricity. This is both its sales strategy and its strength. As of the end of March 2017, the division had 32,000 customer households. This number increased by approximately 10,000 households during 1H FY3/18 to 42,000 at the end of September 2017. The division aims to increase this number by 38,000 during FY3/18 to 70,000 as of the end of the fiscal year. On this basis, customer acquisition has proceeded at a slower pace than planned. However, one key step forward in 1H FY3/18 was that the electricity business became profitable. This profitability was achieved earlier than initially planned both in terms of the timing and the number of households under contract, fueling stronger expectations for the future prospects of the electricity business.

One notable development in the Home-Life Division in 1H FY3/18 was the integration of the LP gas businesses of ITOCHU ENEX and Osaka Gas, as announced on August 3, 2017. The main points of the integration involved setting up ENEARC Co., Ltd. as a 50-50 joint venture between ITOCHU ENEX and Osaka Gas to take ownership of both companies' LP gas sales companies in the Kanto, Chubu and Kansai regions. In other regions, three Osaka Gas LP gas sales companies in Hokkaido and Shikoku will be transferred to ENEARC. These two business realignment measures were initiated on October 1, 2017 as planned. A loss on business realignment was recorded during 1H FY3/18. This loss is presented as equity in losses of affiliates on ITOCHU ENEX's income statement. As a result of this impact, net profit attributable to the Company's shareholders in the Home-Life Division tumbled to a loss of ¥561mn.

Electricity sales volume rose 34%, pushing up earnings. Sales also increased in the heat supply business due to the positive impact of the start of heat supply to GINZA SIX, a large-scale commercial facility in Ginza. Cross-industry collaboration on electricity sales also moved forward

3. Power & Utility Division

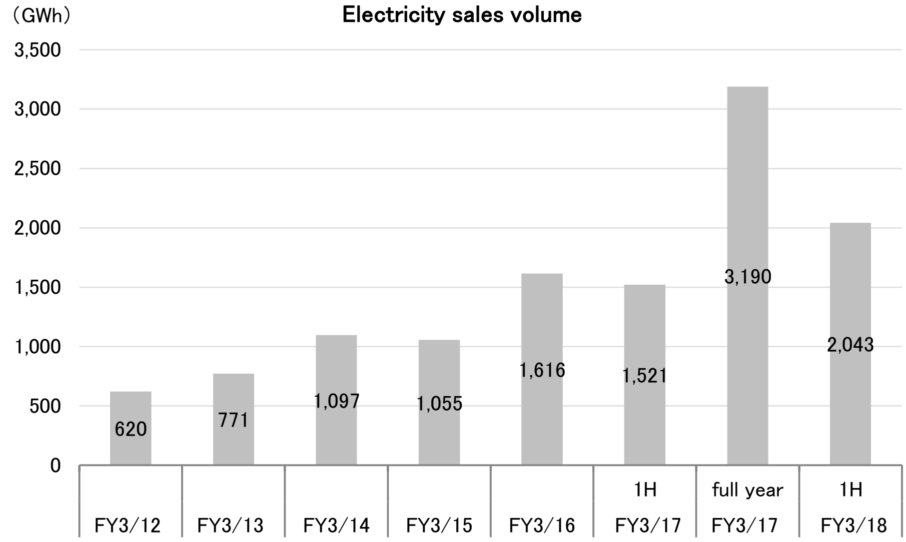
Profit from operating activities in the Power & Utility Division



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

The Power & Utility Division posted higher sales and profits. Revenue increased 22.8% to ¥35,238mn, profit from operating activities rose 12.9% to ¥3,876mn, and net profit attributable to the Company's shareholders was up 11.2% to ¥1,882mn. Looking at each business field, there were both upward and downward movements in profits. However, increased electricity sales volume contributed positively to the overall growth in earnings.

In the electricity business, electricity sales volume totaled 2,043 GWh in 1H FY3/18, up 34.3% from 1,521 GWh in 1H FY3/17. Electricity sales consist of retail and wholesale. For retail, ITOCHU ENEX sells electricity through two channels, specifically a balancing group (BG) and distributors. The BG is led by ITOCHU ENEX. The BG members include ITOCHU ENEX's LP gas sales subsidiaries and external companies. Each BG member leverages its strengths and other resources in its respective region to sell electricity to customers. As noted earlier, sales of packaged products of electricity and LP gas led to growth in the number of households under contract. This growth was attributable to the activities of the BG. For sales through distributor channels, Nissan Osaka Sales Co., Ltd. in the Life Energy & Logistics Division undertakes business activities aimed at winning contracts as a distributor. These activities served to enhance the sales network and sales activities, thereby driving steady expansion in retail electricity sales. Growth in electricity sales volume, in turn, led to increased profits on a year-on-year basis.



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

In the power generation business, total power output declined in 1Q (April-June) due to the impact of scheduled maintenance, but operations returned to normal in 2Q (July-September). As a result, total power output was mostly on par with 1H FY3/17. However, on the earnings front, profit margins were pressured by rising fuel prices (particularly coal), pushing down profits YoY.

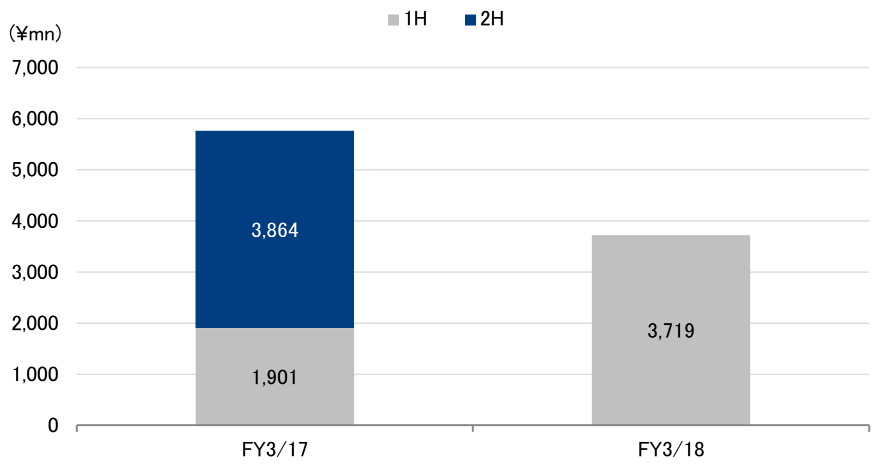
In the heat supply business, the amount of heat supplied increased YoY thanks to the start of heat supply to GINZA SIX in April. This outweighed the negative impact of lower temperatures in the summer, lifting sales YoY. However, earnings fell because ITOCHU ENEX incurred disposal costs related to equipment upgrades.

Looking at notable developments in 1H FY3/18, in the field of electricity retail sales, ITOCHU ENEX formed an electricity retailing alliance with Bay Communications Inc., a cable TV company under the umbrella of Hanshin Electric Railway Co., Ltd. ITOCHU ENEX has long explored opportunities for collaboration with partners in different industries. This alliance marks ITOCHU ENEX's second collaboration with a partner in a different industry, following Nissan Osaka Sales. Bay Communications has initiated electricity sales to households under the service name Baycom Denki since September 11.

Earnings rose sharply as ITOCHU ENEX steadfastly executed business restructuring in an improving business environment due to rising oil prices and the reorganization of oil suppliers

4. Life Energy & Logistics Division

Profit from operating activities in the Life Energy & Logistics Division



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

The Life Energy & Logistics Division finished 1H FY3/18 with higher sales and significant growth in profits. Revenue rose 10.1% YoY to ¥242,257mn, profit from operating activities surged 95.6% to ¥3,719mn and net profit attributable to the Company's shareholders increased 129.2% to ¥2,054mn. The division achieved significant growth in profits owing to both improving externalities, such as a rebound in gasoline prices, and the Company's own efforts, such as a reorganization of unprofitable CSs.

Looking more closely at the improvement in externalities, while the rise in crude oil prices was a primary factor, another key development in Japan was the reorganization of oil suppliers, catalyzed by the emergence of JXTG Holdings on April 1. This reorganization has removed the supply-demand gap in fuel oils and brought about a general stabilization of prices, including the disappearance of extremely cheap retail prices for gasoline. Meanwhile, in terms of demand, the long-term trend of decline in fuel oil demand continued, reflecting the penetration of eco-friendly vehicles and electric vehicles, but gasoline sales volume held firm in a flat range YoY and diesel truck fuel sales climbed atop a recovery in domestic economic activity and increased truck delivery demand.

In the Car-Life Station business, ITOCHU ENEX continued its own initiatives to shutter CSs that are unprofitable. Station numbers as of the end of September had decreased by a net 18 sites to 1,870 in 1H FY3/18. Savings in CS business expenses, such as SG&A expenses, materialized due to the closures of unprofitable sites. Combined with the recovery in sales, these factors aided the large increase in segment profit in 1H FY3/18.

ITOCHU ENEX revamped its organization as part of measures advocated in the new medium-term business plan and launched the Life Energy & Logistics Division from FY3/18. It transferred industrial fuels (fuel oil, etc.), fleet (diesel truck fuel, etc.), and AdBlue (a high-grade urea solution that breaks down and detoxifies NOx in exhaust gases from trucks) businesses from the former Energy Innovation Division to the Car-Life Division. In this field too, costs were reduced by advancing restructuring measures.

We think the aforementioned improvement in the gasoline supply-demand balance had a similar positive effect on industrial fuel, fleet (diesel truck fuel), and other areas because the pricing mechanism, demand drivers, and other changing income factors are fundamentally the same.

Nissan Osaka Sales, which carries out the car dealer business, saw both sales and profit improve YoY in 1H FY3/18, as sales rebounded from a downturn in 1H FY3/17. This downturn reflected the impact of an incident involving the falsification of fuel economy data at Mitsubishi Motors Corporation <7211>.

Business performance trends of Nissan Osaka Sales

1H FY3/18 results (¥bn)		
	Results	YoY change
Sales	504	85
Profit from operating activities	9	3
Net profit*	3	1

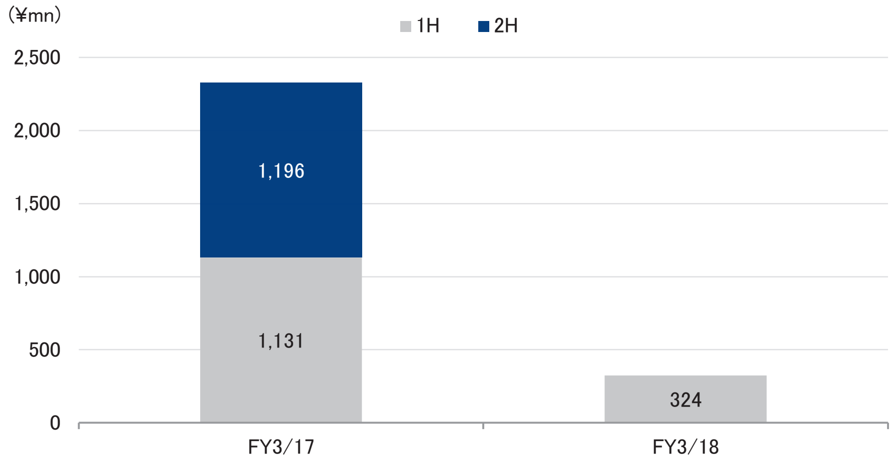
Vehicle sales volume (thousands of units)		
	Results	YoY change
New cars	14	3
Pre-owned cars	14	2

* Net profit represents the share of net profit attributable to ITOCHU ENEX
Source: Prepared by FISCO from the Company's results briefing materials

Supply-demand trade contracted drastically due to the removal of the supply-demand gap. This coincided with a weak demand phase, leading to a sharp decrease in profits

5. Industrial Energy & Logistics Division

Profit from operating activities in the Industrial Energy & Logistics Division



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

The Industrial Energy & Logistics Division posted a large decrease in profits despite a substantial increase in revenue. Revenue rose 39.8% YoY to ¥38,986mn, while profit from operating activities decreased 71.4% to ¥324mn. Net profit attributable to the Company's shareholders decreased 70.5% to ¥242mn.

The aforementioned removal of the supply-demand gap due to the reorganization of oil suppliers and the stabilization of prices acted as a headwind for the petroleum product trading business of the Industrial Energy & Logistics Division. The petroleum product trading business handles surplus contracts that occur due to the supply-demand gap. Its trading activities help to facilitate supply-demand adjustment and removal of any price gap. This serves to expand income at ITOCHU ENEX and also meet the societal need for adjusting the supply-demand balance of oil products across the industry as a whole.

In the asphalt sales business, while sales volume itself rose 11.6% YoY, this business was unable to counter the weak performance of other businesses because its sales are basically concentrated in the second half of each year. Consequently, the asphalt sales business was unable to drive growth in overall segment profit.

One notable development in the Industrial Energy & Logistics Division in 1H FY3/18 was the start of the fly ash recycling business. This business involves collecting fly ash emitted from coal-fired thermal power plants and reusing it as a material for asphalt road paving work and other purposes. In other areas, ITOCHU ENEX is also working to commercialize slop (wastewater remaining after washing marine fuel tanks), recycled oil and related businesses. We eagerly await the successful commercialization of the next business to follow in the footsteps of the fly ash business.

Progress with the medium-term business plan and each business segment

Focus on solidifying foundation for the next leap forward under "Moving 2018"

1. Overview of the new medium-term business plan "Moving 2018"

At the beginning of FY3/18, the Company announced its new two-year (FY3/18-FY3/19) medium-term business plan, "Moving 2018: Connecting to the Future." (For details, please see the FISCO Company Research and Analysis Report on ITOCHU ENEX issued on July 27, 2017.) The concept behind the new plan is two years to lay the management foundations for the next stage of the Company's development.

Quantitative targets in the new medium-term business plan are for profit from operating activities of ¥18.5bn, net profit attributable to the Company's shareholders of ¥10.8bn, and ROE of 9.1% in FY3/19, the final year of the plan. While growth appears to have stalled in the current medium-term business plan versus FY3/17 results, we see this stance as ITOCHU ENEX putting top emphasis on solidification measures to ensure that net profit attributable to the Company's shareholders takes a firm hold above ¥10bn.

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	¥45bn (over 2 years)	
Average rate	Crude oil price		$50/bbl	
	CP price		$400/MT	
	Forex rate		¥108.4/$	

Source: Prepared by FISCO from Company materials

Segment breakdown of quantitative targets in the new medium-term business plan

(¥mn)

	FY3/17 Full year	FY3/18		FY3/19	
		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%
Other	0	0	-	0	-
Total sales before adjustment	1,028,939	1,158,500	12.6%	1,164,500	0.5%
Adjustment	0	-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%
Other	0	0	-	0	-
Profit from operating activities before adjustment	19,564	16,400	-16.2%	18,500	12.8%
Adjustment	114	100	-12.3%	0	-
Total profit from operating activities	19,678	16,500	-16.2%	18,500	12.1%

Note: The restated figures for FY3/17 for the Life Energy & Logistics Division and the Industrial Energy & Logistics Division are disclosed in units of ¥0.1bn. Accordingly, the numerical comparisons with the previous fiscal year are presented for reference only
Source: Prepared by FISCO from the Company's financial results and medium-term business plan briefing materials

Focus on growth investments and asset reallocation as a growth strategy. Steady progress in 1H

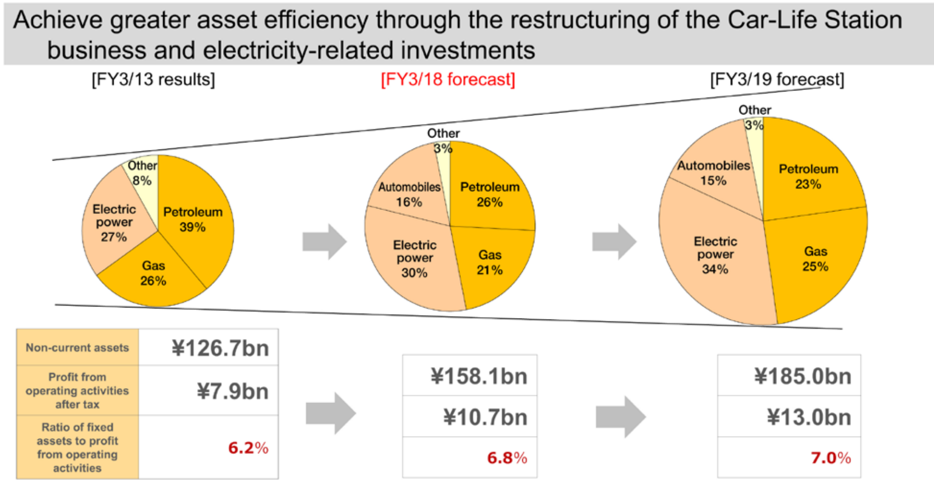
2. Progress with the medium-term business plan

As noted earlier, the Company's basic stance under the current medium-term business plan is to solidify the foundation for the next stage of growth. For this reason, we believe that investors should focus on ITOCHU ENEX's capital investment plan and the execution thereof, rather than concentrate only on business performance.

With regard to capital investment, the Company plans to make ¥45.0bn 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 a matter of course 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 ¥46.0mn and that the Company is therefore positioned to make aggressive investments even as it maintains or strengthens its financial position.

The reason why the Company is focusing on capital investment is that it is striving to enhance asset efficiency by replacing assets in step with business restructuring. As noted earlier, the Company is pushing ahead with business restructuring centered on the closures of unprofitable stations in the Car-Life Station business in line with changes in the external environment. At the same time, the Company has taken various initiatives to drive growth both in the fields of power generation and electricity sales in the electricity business.

Medium-term business plan: Illustration of asset replacement



1H FY3/18

HL	PU	LL	Other	Company-wide
¥5.7bn (40%)	¥6.2bn (44%)	¥1.2bn (9%)	¥0.9bn (6%)	¥14.1bn (100%)

Source: The Company's results briefing materials

In 1H FY3/18, the Company made capital investments of ¥14.1bn. This represented approximately 73% of the capital investment budget of ¥19.2bn for FY3/18, signaling the Company's firm commitment to executing investments. Looking at the components and description of capital expenditure by business segment, in the Home-Life Division, ITOCHU ENEX acquired shares of LP gas sales companies in Hokkaido and Shikoku as part of the reorganization of the LP gas business. In the Power & Utility Division, the Company took steps such as executing capital investment in heat supply infrastructure for GINZA SIX. In the Life Energy & Logistics Division, the Company worked to renovate the dealerships of Nissan Osaka Sales.

Overview of capital investment in 1H FY3/18

Division	Capital expenditure (¥bn)	Item	Main points
Home-Life	57	Acquisition of shares, capital investment, etc.	Acquired shares of LP gas sales companies in Hokkaido and Shikoku (Ehime, Kochi) from Osaka Gas
Power & Utility	62	Acquisition of shares, capital investment, etc.	Ramped up capacity in connection with the start of heat supply to GINZA SIX and upgraded existing facilities
Life Energy & Logistics	12	Renovation of dealerships, capital investment, etc.	Renovated the dealerships of Nissan Osaka Sales
Industrial Energy & Logistics	9	Capital investment, etc.	Built a new marine fuel supply ship
Company-wide	141		

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

We have the impression that capital investments have been progressing steadily as envisioned by the Company. ITOCHU ENEX obtained business markets in Hokkaido and Shikoku through the integration of its LP gas business with Osaka Gas, as announced in 1H FY3/18. We believe that this has delivered greater benefits than initially anticipated.

Among the initiatives laid out in the Company's future plans, we are particularly interested in its plans for a new power plant. In press materials for its current medium-term business plan, ITOCHU ENEX identified strengthening the power generation business based on natural power sources and bolstering biomass power generation business initiatives as its key measures. Considering that the Company's power generation facilities have a relatively high dependence on coal, the development of power generation based on renewable energy, including biomass power, is highly significant in terms of the diversification of the Company's energy mix. The inclusion of these plans in the capital investment budget of the current medium-term business plan is important because it implies that construction will start before the end of FY3/19. We eagerly await the announcement of detailed plans by the Company in the near future.

Business outlook

Strong possibility of exceeding the Company's FY3/18 forecast, but it is important to note that risk factors remain

1. Outlook for FY3/18

The Company forecasts sales rising, but profit declining with ¥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 attributable to the Company's shareholders (down ¥5mn) in FY3/18. The Company's forecasts remain unchanged from its initial forecasts.

Overview of the forecast for FY3/18

(¥mn)

	FY3/17			FY3/18					
	1H results	2H results	Full-year results	1H results	2H forecast	YoY	Full-year forecast	YoY % change	YoY Change
Sales	466,313	562,626	1,028,939	507,990	642,010	14.1%	1,150,000	11.8%	121,061
Revenue	309,516	385,544	695,060	352,395	-	-	-	-	-
Gross profit	43,742	49,862	93,604	44,193	-	-	-	-	-
SG&A expenses	36,210	38,487	74,697	35,385	-	-	-	-	-
Profit from operating activities	7,755	11,923	19,678	9,421	7,079	-40.6%	16,500	-16.2%	-3,178
Profit before tax	7,242	12,102	19,344	8,282	9,518	-21.4%	17,800	-8.0%	-1,544
Net profit attributable to the Company's shareholders	3,707	6,698	10,405	3,969	6,431	-4.0%	10,400	-0.0%	-5

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

Results for 1H FY3/18 represented high progress rates against the full-year forecasts. As a result, the hurdles that need to be cleared in order to achieve the full-year forecasts for FY3/18 have been substantially lowered. In fact, even if profit from operating activities were to decline by 30% YoY and profit before tax were to decrease by 20% in 2H FY3/18, ITOCHU ENEX would still be able to reach its targets comfortably. Considering that the Company's sales and earnings tend to be concentrated in the second half of each fiscal year, the Company's full-year forecasts may seem to be too conservative. Therefore, it is not surprising to see investors hold heightened expectations for the Company to outperform those forecasts.

Our basic scenario is for ITOCHU ENEX to finish FY3/18 with results surpassing its full-year forecasts. Meanwhile, we believe that investors should avoid holding unrealistically high expectations for the Company to outperform its profit forecasts. We will discuss the details later in the outlook for each business segment. For now, we note that there are factors that could cause profits to deviate from forecasts in each business segment.

The main points of the outlook for each business segment are described below.

(1) Home-Life Division

The LP gas business in the Home-Life Division enters a phase of strong demand in the second half of each year, when winter heating demand emerges. The amount of demand varies significantly with weather conditions. Notably, temperatures in western Japan can substantially influence demand. In terms of price, the fuel cost adjustment system keeps the spread between the sales prices and fuel price (contract price) at a certain level. Therefore, fluctuations in price do not present a very big problem for the Company. However, caution is warranted because the spreads at the beginning and end of each fiscal year could have a large impact on profitability through the inventory impact value. The contract price in September was US$480 per ton, but had increased to US$575 per ton by November. If the contract price remains at this level until March 2018, the inventory impact value might act to push up profits substantially. Caution is advisable as both weather conditions and the contract price, while steady until now, could also move in an adverse direction.

The other main point to watch in the Home-Life Division is the effect of the realignment of the LP gas business, beginning with ENEARC, which started business activities on October 1. Given that the business markets will be maintained without any changes, sales are expected to trend largely as planned. Meanwhile, profits will vary depending on the extent to which cost savings are realized through the business integration. Since equity in losses of affiliates of ¥0.8bn has already been recorded in 1H FY3/18, we estimate that the Company will reap positive gains in 2H FY3/18. The LP gas sales companies in Hokkaido and Shikoku (Ehime, Kochi) that were brought under the umbrella of ITOCHU ENEX are expected to generate the same amount of sales as in the previous fiscal year (approximately ¥16.2bn for the three companies combined). We also believe that the materialization of positive integration effects will contribute positively to profits.

(2) Power & Utility Division

In the Power & Utility Division, the Sendai Power Station (Sendai PS) began commercial operations on October 1. The output of the Sendai PS is 11.2 kW, with half of this amount belonging to the Company. The start of operation of the Sendai PS will increase the Company's power generation capacity by nearly 30%. However, it is important to note this will not increase the Company's electricity sales volume by the same amount.

In anticipation of the start of operation of the Sendai PS, the Company has worked to secure electricity customers and has addressed their demand for electricity by procuring power from external sources. After the new power station comes online, the Company will replace the externally procured power with power generated by the Sendai PS. Therefore, the electricity sales volume will not increase in proportion to the amount of power generated by the Sendai PS.

In the electricity business, we must pay close attention to the rising price of coal (thermal coal). Although rising coal prices could have a positive effect on profits, the transaction volume with the wholesale market could decrease. Moreover, in the retail market, the major electric power companies have started to step up efforts to regain ground. As the timing for the renewal of one-year contracts approaches, the Company must not let its guard down. It plans to maintain growth in electricity sales volume and ensure a sustained pace of earnings growth in the electricity business by implementing measures such as getting its alliance with Bay Communications started in earnest and accelerating electricity sales to households through LP gas sales companies.

(3) Life Energy & Logistics Division

In the Life Energy & Logistics Division, the Company plans to keep on solemnly advancing business realignment through the closures of CSs in 2H FY3/18. Nevertheless, it is probably safest to assume that the effect of business restructuring for the division as a whole will shrink in 2H FY3/18 relative to what was achieved in 1H FY3/18. The reason for this contraction is that the cost savings effect is projected to subside in businesses that joined the division through the reorganization undertaken in April 2017. These businesses included industrial fuel (heavy oil, etc.) and fleet (diesel truck fuel, etc.).

In 2H FY3/18, changes in external factors surrounding the Life Energy & Logistics Division will also need to be watched carefully. The improvement in earnings in 1H FY3/18 was attributable in large part to the effects of the removal of the supply-demand gap brought about by the reorganization of oil suppliers and the resulting stabilization of prices. However, there is no guarantee that this situation will continue indefinitely. Although we believe that a similar external environment to that seen in 1H FY3/18 will prevail in 2H FY3/18, the Company itself must remain vigilant in this respect.

Nissan Osaka Sales contributed positively to the YoY increases in sales and earnings in 1H FY3/18. That is expected to change dramatically in 2H FY3/18, and the company is expected to become a risk factor. The reason for this change is the final vehicle inspection issue at Nissan Motor Co., Ltd. <7201>. Nissan Osaka Sales' normal operating activities are falling behind schedule because of the need for each dealership to re-do the final vehicle inspections and related procedures. While the impact is unlikely to cause the company to fall into the red, we believe that investors should keep in mind the possibility of the company posting a YoY decline in earnings.

(4) Industrial Energy & Logistics Division

In the Industrial Energy & Logistics Division, the Company will see asphalt, the division's main product, enter a phase of strong demand in connection with public works investment. Asphalt sales volume posted positive YoY growth in 1H FY3/18. We anticipate that the same trend will continue in 2H FY3/18.

Meanwhile, we expect to see a continuation in 2H FY3/18 of the downtrend in supply-demand trade in petroleum products due to the removal of the supply-demand gap. If the stability of the market collapses, supply-demand trade could once again increase. The flip side to this is that it could have a negative impact on the Life Energy & Logistics Division. From an overall perspective, we believe that the stabilization of the market will have a greater positive impact on the Company as a whole.

The fly ash business was launched in 1H FY3/18, one of several new businesses in the Company's pipeline. This has fueled heightened expectations for other new businesses to follow. The slop (wastewater after washing marine fuel tanks) business and the recycled oil business have been in the pipeline for the same amount of time as the fly ash business, and are expected to be launched as viable businesses soon. The fly ash business still has ample potential for growth, through such means as regional expansion of service areas.

With expectations for higher sales and profits mixed with uncertainties, the performance level envisioned by “Moving 2018” provides appropriate guidance at this time.

2. Prospects for FY3/19

Looking at the performance outlook for FY3/19 and judging from the Company’s earnings growth trend in the past few years, the earnings targets laid out in the “Moving 2018” medium-term business plan might appear to be too conservative. However, we believe that it is still premature to draw such conclusions about these forecasts at this time.

Two factors have contributed immensely to growth in the Company’s business results over the past few years: (1) business restructuring, notably the closures of unprofitable CSs in the Life Energy & Logistics Division (former Car-Life Division), and (2) rapid expansion of electricity sales volume in the Power & Utility Division. Notably, the electricity business may face a major turning point in April 2018 onward. Specifically, this business may face competition from major electric power companies seeking to regain ground in the market. In many cases, contracts with power producers and suppliers like ITOCHU ENEX have terms of one year. Two years have passed since the full liberalization of electricity retailing in April 2016. Over the past two years, the major electric power companies have made progress on reshaping their operating structures. The larger the customer, the more susceptible business will be to competition from major electric power companies seeking to regain ground. If the Company were to lose business with major customers to the electric power companies, the impact on business performance would also be that much larger.

Another concern is how much longer the effect of the reorganization of oil suppliers will last. In FY3/18, excessive price competition and supply-demand gaps subsided following the emergence of JXTG Holdings in April 2017. The question of how long this situation will last is an important theme for not just ITOCHU ENEX but also the industry as a whole. Although conditions have remained calm until now, it is entirely unclear how the situation will develop going forward. While these concerns may prove to be groundless, the Company should not let down its guard.

In conclusion, at this time, we believe that the earnings targets for FY3/19 laid out by the Company in “Moving 2018” have been set an appropriate level as guidance. Moreover, at present, we believe that investors should refrain from holding any excessive expectations for the Company to outperform its earnings targets.

Income statement

(¥mn)

	FY3/15	FY3/16	FY3/17	FY3/18		
				1H results	2H (E)	Full year (E)
Sales	1,373,393	1,071,629	1,028,939	507,990	642,010	1,150,000
YoY	-8.8%	-22.0%	-4.0%	8.9%	14.1%	11.8%
Revenue	936,841	723,645	695,060	352,395	-	-
YoY	-3.0%	-22.8%	-4.0%	13.9%	-	-
Gross profit	85,720	89,562	93,604	44,193	-	-
YoY	19.7%	4.5%	4.5%	1.0%	-	-
% of sales	6.2%	8.4%	9.1%	8.7%	-	-
SG&A expenses	71,184	73,226	74,697	35,385	-	-
YoY	23.0%	2.9%	2.0%	-2.3%	-	-
% of sales	5.2%	6.8%	7.3%	7.0%	-	-
Loss from tangible assets, intangible assets and goodwill	-1,825	-593	-982	-86	-	-
Other – net	389	641	1,753	699	-	-
Total other expenses	-72,620	-73,178	-73,926	-34,772	-	-
Profit from operating activities	13,100	16,384	19,678	9,421	7,079	16,500
YoY	10.3%	25.1%	20.1%	21.5%	-40.6%	-16.2%
Profit before tax	12,155	15,004	19,344	8,282	9,518	17,800
YoY	-12.2%	23.4%	28.9%	14.4%	-21.4%	-8.0%
Net profit attributable to the Company's shareholders	5,503	7,469	10,405	3,969	6,431	10,400
YoY	-22.7%	35.7%	39.3%	7.1%	-4.0%	-0.0%
EPS (¥)	48.71	66.10	92.09	35.14	56.91	92.05
Dividend (¥)	22	24	32	16	16	32
Book-value per share (¥)	862.3	889.7	960.37	-	-	-

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

Balance sheet

(¥mn)

	FY3/14	FY3/15	FY3/16	FY3/17	1H FY3/18
Current assets	188,193	157,708	137,865	178,127	160,142
Cash and cash deposits	14,251	16,184	20,824	22,727	17,199
Trade receivables	140,289	98,449	71,968	94,759	84,661
Inventories	18,655	27,794	25,160	27,155	24,568
Other	14,998	15,281	19,913	33,486	33,714
Non-current assets	132,531	171,351	166,188	166,476	158,054
Investments accounted for by the equity method	5,927	10,551	8,786	11,749	11,007
Other investments	7,349	8,924	8,029	7,461	8,294
Property, plant and equipment	66,988	88,836	88,311	87,588	82,759
Intangible assets	10,280	23,474	24,329	23,638	20,375
Other	41,987	39,566	36,733	36,040	35,619
Total assets	320,724	329,059	304,053	344,603	334,165
Current liabilities	158,336	149,443	111,997	143,751	129,898
Short-term bonds and borrowings	11,499	14,208	5,299	9,318	7,502
Trade payables	125,655	104,564	80,745	101,902	98,872
Other	21,182	30,671	25,953	32,531	23,524
Non-current liabilities	58,268	66,669	74,894	73,375	70,963
Non-current bonds and borrowings	27,099	26,746	32,366	31,702	31,208
Other	31,169	39,923	42,528	41,673	39,755
Equity	94,651	97,432	100,526	108,511	110,586
Common stock	19,878	19,878	19,878	19,878	19,878
Capital surplus	18,737	18,743	18,740	18,740	18,740
Retained earnings	59,884	62,223	66,024	73,300	75,180
Other components of equity	-2,098	-1,661	-2,364	-1,655	-1,339
Treasury stock	-1,750	-1,751	-1,752	-1,752	-1,873
Non-controlling interests	9,469	15,515	16,636	18,966	19,562
Total equity	104,120	112,947	117,162	127,477	130,148
Total liabilities and equity	320,724	329,059	304,053	344,603	334,165

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

Cash flow statement

(¥mn)

	FY3/14	FY3/15	FY3/16	FY3/17	1H FY3/18
Cash flows from operating activities	17,530	34,336	30,322	17,831	9,957
Cash flows from investing activities	-12,556	-20,410	-16,673	-14,712	-8,971
Cash flows from financing activities	-8,859	-12,115	-9,059	-1,195	-5,924
Net increase/decrease in cash and cash equivalents	-3,885	1,811	4,590	1,924	-4,938
Cash and cash equivalents at the beginning of the period	18,062	14,251	16,184	20,824	22,727
Effect of exchange rate changes on cash and cash equivalents	74	122	-27	-21	9
Cash and cash equivalents at the end of the period	14,251	16,184	20,824	22,727	17,797

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

Shareholder returns

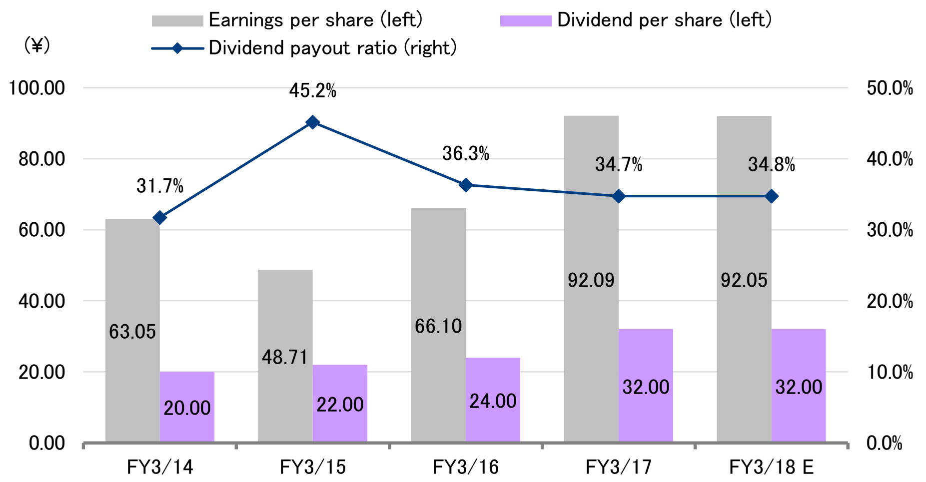
Projecting a flat dividend YoY at ¥32 in FY3/18

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

The Company has announced a flat annual dividend forecast of ¥32 per share (¥16 for the interim dividend and ¥16 for the period-end dividend). As of the earnings announcement for 1H FY3/18, there has been no change in the initial forecast. The Company's target of ¥92.05 for net profit attributable to the Company's shareholders per share has remained unchanged from the previous year. We believe that this lies behind the Company's decision to maintain its initial forecast of dividends.

As mentioned earlier, earnings for 1H FY3/18 were very strong. While we believe the Company is even more likely than before to outperform its full-year earnings targets, the outlook for conditions in the demand phases of 3Q and 4Q is unclear. Therefore, we believe that it is still premature to raise expectations of any upside in performance at this time. The same applies to dividends. We advise investors to expect dividends to be largely in line with the Company's forecasts.

Earnings and dividend per share and dividend payout ratio



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

Information security

Acquired certification based on international standards for information security, in addition to setting strict in-house rules

ITOCHU ENEX has defined its own personal information protection policy for protecting the personal information of customers. The Company has been working to put an organizational framework in place, implement and maintain information security measures and pursue continuous improvements. The Company also fosters awareness among directors, employees, and other relevant personnel, along with actively promoting personal information protection.

In the electricity business, the electricity supply-demand group handles personal information as part of electricity sales. This group obtained ISO/IEC27001/JIS Q 27001 (known as ISMS*) approval, the international standard for information security management systems, in October 2016, thereby ensuring secure information handling.

* ISMS (Information Security Management System) is a comprehensive information security management system that protects information assets from various threats and mitigates risks. It has international and domestic standards (ISO/IEC27001/JIS Q 27001). Satisfying these criteria and acquiring certification is usually referred to as having “acquired ISMS.”

Disclaimer