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

2-Oct.-15

Important disclosures and disclaimers appear at the end of this document.

FISCO Ltd. Analyst
Hiroyuki Asakawa

* Itochu Enex Group adopted IFRS (International Financial Reporting Standards) from FY3/14. In this report, "Profit from operating activities" is described as "Operating profit" and "Net profit attributable to owners of the parent" is described as "Net profit."

Full liberalization of the electricity retail market is a business expansion opportunity for PPS's

A member of the ITOCHU Corp. (8001) group, Itochu Enex (8133) is an energy trading company that is playing a pivotal role in the energy field. Its wide ranging business scope includes selling petroleum products and liquefied petroleum (LP) gas to users ranging from industries to final consumers.

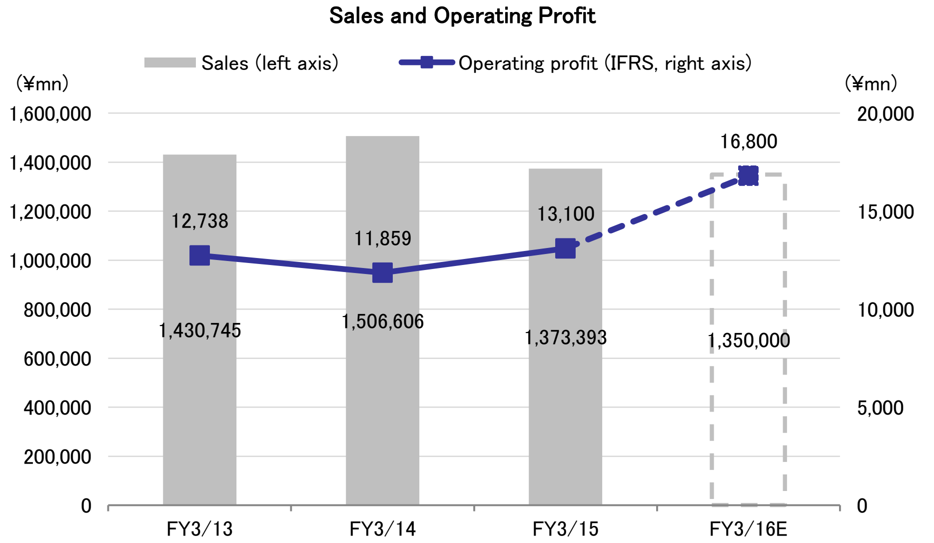
FY3/16 was the first year of the current two-year medium-term business plan called Moving 2016 –Sowing seeds for tomorrow. This is a year ahead of the full liberalization of retail electricity sales. In essence, Itochu Enex believes it got off to a safe start in Q1 FY3/16, posting record gross and operating profits. That said, we cannot be upbeat on such external factors as crude oil prices and the weather. It will be crucial to calmly keep tabs on the situation from Q2, particularly in the second half of the fiscal year.

Itochu Enex has made the electricity business central to its medium-term growth scenario. This is because while it expects that demand for petroleum product and LP gas will inevitably decline as the population ages and declines, it believes that new power producer and supplier (PPS) enterprises like itself can suddenly expand business opportunities once retail sales of electricity are fully liberalized from April 2016.

The strengths of Itochu Enex's electricity business are that it has its own base load power sources and maintains an integrated structure encompassing everything from power production to sales to LP gas distributors and many end-users, as well as industrial energy customers. The company plans to enhance its demand and supply adjustment capabilities by forming a balancing group with other PPS's (user PPS's) by drawing on its strengths to function as a leader while cultivating households, small shops, and other low-voltage users.

Check Point

- Itochu Enex posted record Q1 gross and operating profits
- The company is fully leveraging the strengths of its comprehensive energy business
- After excluding external factors, earnings are improving in real terms, as planned



Detail of Q1 FY3/16 Results

Itochu Enex posted record Q1 gross and operating profits

(1) Overview of Business Performance

In Q1 FY3/16, Itochu Enex (8133) posted sales of ¥284,999mn (-15.2% YoY), revenue of ¥191,056mn (-15.8% YoY), gross profit of ¥20,537mn (+19.7% YoY), profit from operating activities (hereinafter, operating profit) of ¥2,758mn (+69.0% YoY), profit before tax of ¥2,620mn (+55.6% YoY), and net profit attributable to owners of the parent (hereinafter, net profit) of ¥1,339mn (+75.6% YoY). While revenues were down, earnings soared, with the company posting record Q1 gross and operating profits.

Overview of Results for Q1 FY3/16

(¥mn)

	FY3/14	FY3/15	FY3/16		
	1Q	1Q	1Q	Progress rate	Full year (E)
Sales (Japanese GAAP)	330,939	335,972	284,999	21.1%	1,350,000
YoY	-	1.5%	-15.2%	-	-1.7%
Revenue	217,360	226,788	191,056	-	-
YoY	-	4.3%	-15.8%	-	-
Gross profit	16,400	17,155	20,537	-	-
YoY	-	4.6%	19.7%	-	-
SG&A expenses	14,023	15,586	17,922	-	-
YoY	-	11.1%	15.0%	-	-
Operating profit	2,504	1,632	2,758	16.4%	16,800
YoY	-	-34.8%	69.0%	-	28.2%
Profit before tax	2,535	1,684	2,620	17.2%	15,200
YoY	-	-33.6%	55.6%	-	25.1%
Net profit attributable to owners of the parent	1,207	763	1,339	16.3%	8,200
YoY	-	-36.8%	75.6%	-	49.0%

Although Q1 results seem excellent at first glance, in our view one should refrain from optimism about the future. The direct reason is that as demand for many of the company's products is heavier in the second half of the year, Q1 results account for a small percentage of full-year totals. Also, nobody can accurately predict the weather, which greatly affects the company's performance. On top of that, oil prices are currently weak, another factor that detracts from optimism about the company's performance prospects. So, we consider it reasonable overall to conclude that the company got off to a safe start with its Q1 results. We will keep close tabs on developments.

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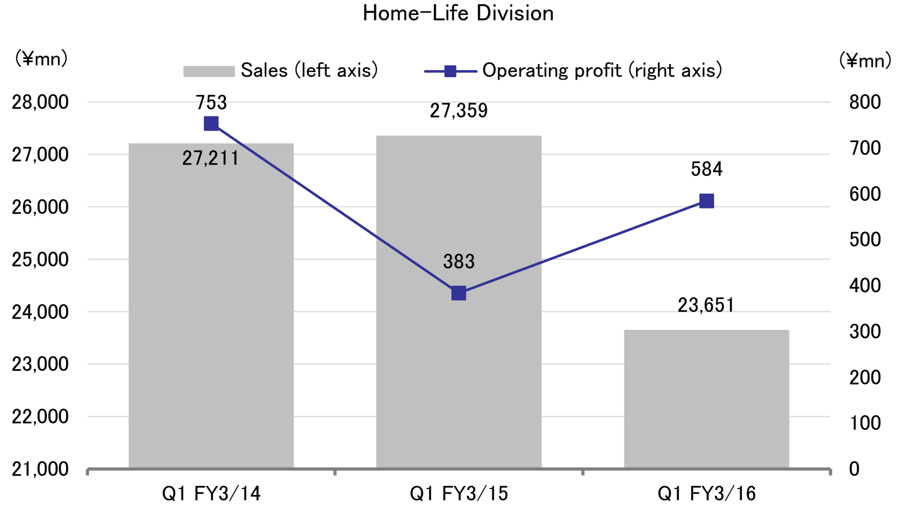
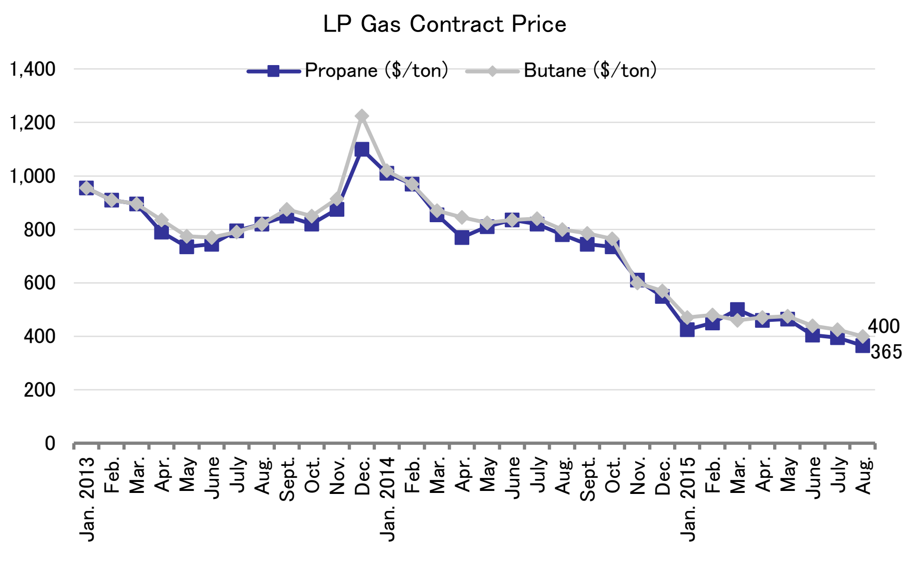
(2) Home-Life Division Business Performance and Plan

The Home-Life Division reported sales of ¥23,651mn (-13.6% YoY) and operating profit of ¥584mn (+52.5% YoY).



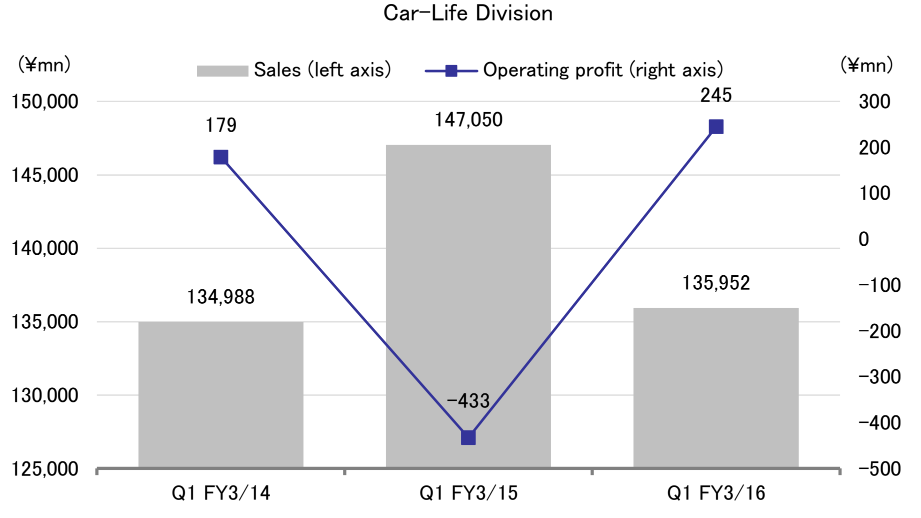
The Home-Life Division focuses on selling LP gas (propane) through a subsidiary's direct sales network that serves around 340,000 households and through about 1,900 distributors that supply approximately 740,000 households, for a total of over 1,000,000 households around Japan. With such a large customer base, Itochu Enex naturally maintains LP gas inventories that are subject to monthly fluctuations in crude oil prices. Every month, the company buys LP gas from primary distributors at import price based on contact price (CP) which is announced monthly by Saudi ARAMCO., The moving average inventory cost (cost of sales) is calculated every month after including carry-over stock. At the same time, the company includes a margin in its sales price of LP gas purchased from primary distributors. Since CP are linked to crude oil prices, when crude oil prices decline, the cost of sales becomes relatively high, squeezing anticipated profits, sometimes resulting in losses.

As costs of inventories were relatively high at the end of March this year, there was a negative inventory impact in Q1. This was minor, however, compared with the previous corresponding period. The difference emerged in increased operating profit. Sales volumes of LP gas were unchanged YoY.



(3) Car-Life Division

The Car-Life Division reported sales of ¥135,952mn (-7.5% YoY) and operating profit of ¥245mn (compared with an operating loss of ¥433mn in Q1 FY3/15).

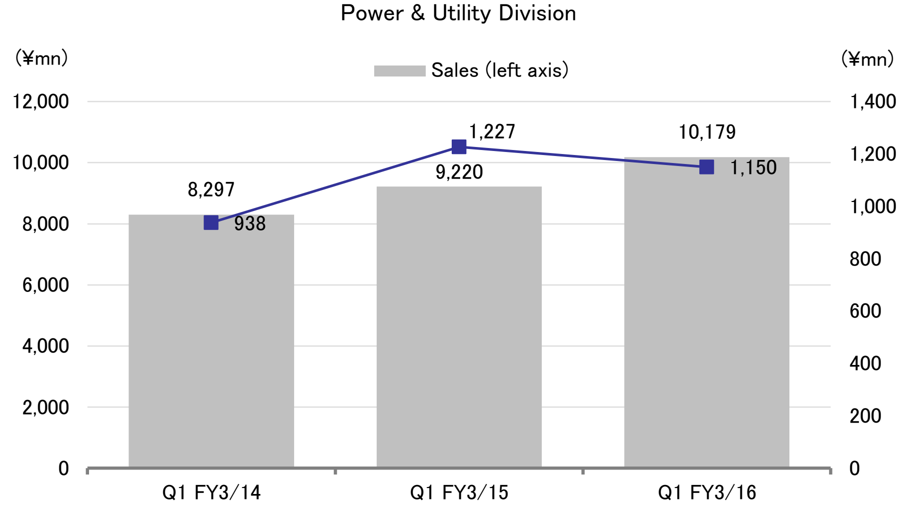


The Car-Life Division benefited from lower crude oil prices, with a decrease in gasoline prices driving sales volumes up. It is worth noting, however, that this business area continues to experience structural issues. They include a growing number of hybrid and other vehicles and an aging population that consume less gasoline. In our view, higher sales volume was not just because of lower gasoline prices but also because in the previous corresponding period there was a volume decline amid a demand backlash from a consumption tax hike.

Reduced costs and the abovementioned sales volume increase were key factors in an operating profit turnaround for the division.

(4) Power & Utility Division

The Power & Utility Division reported sales of ¥10,179mn (+10.4% YoY) and operating profit of ¥1,150mn (-6.3% YoY).



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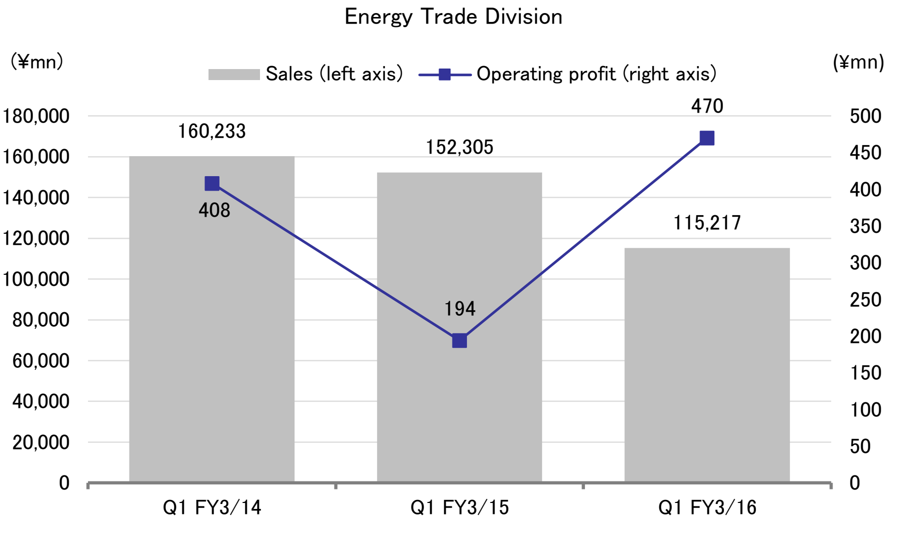
Sales rose in Q1 because the company generated more power, as facilities became operational. They were a wind farm in Tainai, Niigata Prefecture, that went on line in October 2014, and a coal-fueled power plant built in Hofu, Yamaguchi Prefecture, that started running in March 2015. Both these new and existing facilities have continued operating without problems at this stage.

An extraordinary factor caused segment earnings to decline. In the previous corresponding period, income from insurance payments following a generating equipment failure added around ¥200mn to segment operating profit. After excluding that factor, we estimate that Q1 earnings rose around 10%. Also during the quarter, the Power & Utility Division benefited from favorable weather conditions in its business of supplying heat to office buildings and redevelopment areas, boosting revenues and earnings YoY on solid demand for heat for air conditioning.

(5) Energy Trade Division

The Energy Trade Division reported sales of ¥115,217mn (-24.4% YoY) and operating profit of ¥470mn (2.4 times higher with Q1 FY3/15).



The main factor in lower sales compared to the previous fiscal year was plunging prices of petroleum products linked with crude oil prices. That said, a decline in asphalt business demand in Q1 was disappointing. That was because the company has a leading domestic market share, and had anticipated a demand turnaround for this year.

Operating profit improved dramatically YoY, reflecting such factors as distribution advances and reviews of inefficient transactions. As mentioned above, although the asphalt business suffered from lower crude oil prices and sales volumes, other major product groups all boosted earnings by ¥100mn to ¥200mn YoY, overcoming the lower profitability of the asphalt business to increase segment operating profit.

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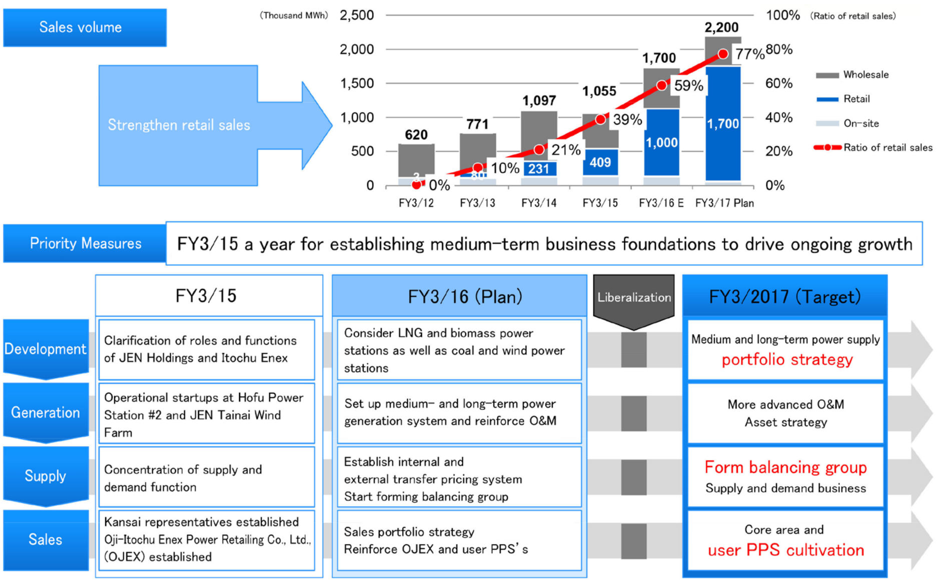
Topics

The company is fully leveraging the strengths of its comprehensive energy business

(1) Preparations for liberalization of electricity business

Itochu Enex has made the electricity business pivotal to its medium-term growth strategy. This is in light of the planned full liberalization of retail sales of electricity in April 2016, which would make it possible to engage in sales for contracts of less than 50 kW with households and small shops. A key objective of the company's medium-term business plan is to deliver sustained growth from its electricity business by taking full advantage of its strengths as a comprehensive energy enterprise.

Full Liberalization of the Electricity Market and Business Development of the Power & Utility Division

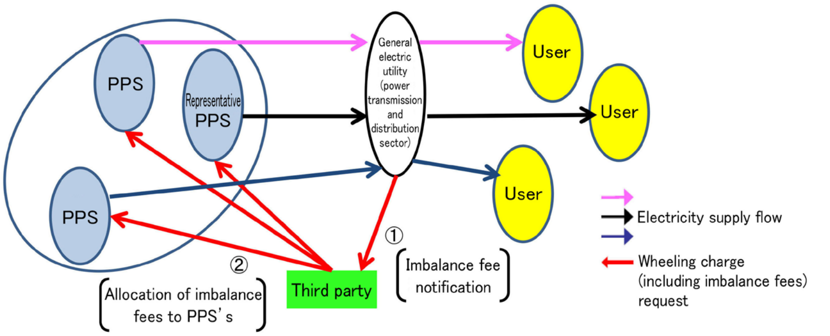


Source: Itochu Enex Group Medium-Term Business Plan briefing materials

A key consideration for the power supply business is the ability to accommodate fluctuations in electricity demand. Despite being a leading PPS, Itochu Enex faces difficulties going it alone in handling such fluctuations, and will likely face even greater difficulties when retail electricity sales start. A balancing group system exists to alleviate demand and supply imbalances. This is also referred to as a representative contractor system, where several PPS form a group to respond collectively to a power supply imbalance (if there is an imbalance). Leaders of balancing groups would front negotiations and contracts with general electric utilities (power companies) while directing power supply and demand adjustments with other PPS's within balancing groups.

Itochu Enex seeks to form its own balancing group and tackle the challenges of full electricity retailing as the leader of such a group. That is because PPS's in balancing groups, particularly user PPS's (without their own power production capabilities) function as sales networks for group leaders. Important strengths of Itochu Enex are that it maintains gas sales subsidiaries serving numerous LP gas customers and has its own base load power sources, which are essential to supply power stably. The company is drawing on these strengths to cultivate and secure user PPS's that can become members of its balancing group.

Balancing Group (representative PPS system) Overview



Source: Ministry of Economy, Trade and Industry materials

(2) Impact of oil industry restructuring

On July 30 this year, Idemitsu Kosan Co., Ltd. (5019), and Showa Shell Sekiyu K.K. (5002) announced that they would start preparations to merge with each other. At this stage, it is hard for us to tell whether such integration will be positive or negative for Itochu Enex.

Itochu Enex does business with primary wholesalers (refineries) as a top wholesaler, and would have a top transactions share with an integrated Idemitsu and Showa Shell or JX Holdings (5020). So, while one could say that Itochu Enex has strong negotiating position with these primary wholesalers it could also be subject to strong pressures from them.

One positive scenario would be that a decline in the number of primary wholesalers owing to industry restructurings would create a more robust industry order. In that case, primary wholesalers through gasoline stations could stand to secure appropriate margins, with Itochu Enex also reaping the benefits of that situation. The negative scenario could be that a decline in the number of primary wholesalers would strengthen their price negotiating positions, which could shrink the margins of a wholesaler like Itochu Enex as it is caught between primary wholesalers and retailers. As mentioned earlier, it is hard to determine at this juncture which circumstance might arise. That said, it may take some time for changes to materialize because the merger between Idemitsu Kosan and Showa Shell would necessitate an antitrust review. We can say that there will be almost no impact on FY3/16 results.

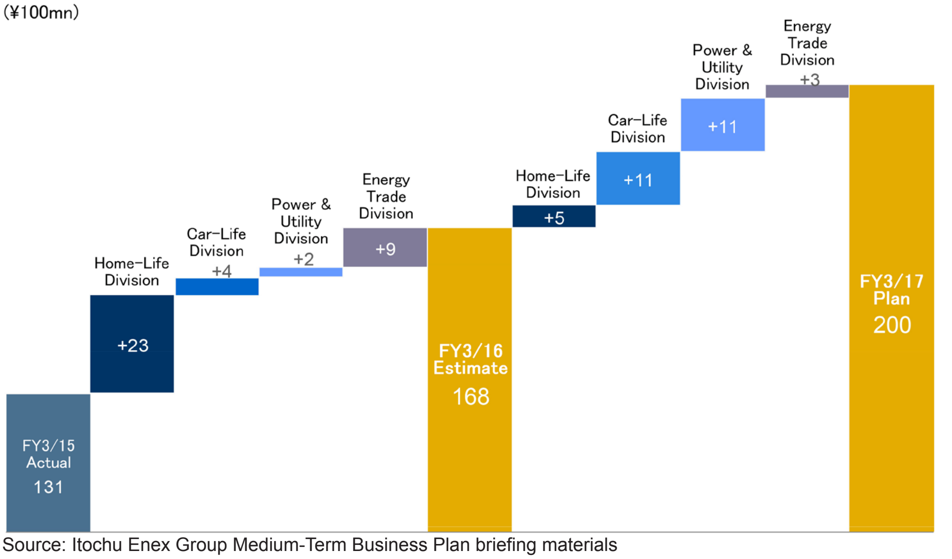
Performance Outlook

After excluding external factors, earnings are improving in real terms, as planned

For FY3/16, Itochu Enex is forecasting sales of ¥1,350,000mn (-1.7% YoY), operating profit of ¥16,800mn (+28.2% YoY), profit before tax of ¥15,200mn (+25.1% YoY), and net profit of ¥8,200mn (+49.0% YoY). Itochu Enex has not revised its initial forecasts.

The operating profit forecast is ¥3,700mn higher than for FY3/15. Still, much of that increase is on the assumption that the inventory impact (around ¥3,000mn, primarily for the Home-Life Division) from a fall in oil prices in the previous term will be absent in FY3/16. So, in that light the forecasted increase does not seem excessively bullish.

Analysis of Operating Profit (Chart from briefing materials)



Source: Itochu Enex Group Medium-Term Business Plan briefing materials

The downward oil price trend seen in Q1 has continued since the start of Q2. While the inventory impact was several hundred million in Q1, this was apparently much less than in the previous corresponding period. Near-term oil price levels would suggest that the inventory impact could also be significant in Q2. There is a concern that if such a situation continues it could throttle the ¥3,200mn earnings growth factor mentioned above, with the company missing its operating profit target. Still, it is too earlier in our view to take this concern into account. That is because sales volumes tend to be heavier in H2 than in H1, and the inventory impact amount would contribute to earnings growth if oil prices again rise in H2. In that case, the company could absorb the impact of a negative inventory impact from Q1. It is also worth mentioning that weather factors greatly affect demand in H2, having a great impact on results. In our opinion, it is necessary to let some time pass before discussing upsides and downsides for the company’s performance.

The Power & Utility Division is maintaining a steady pace of revenue and earnings growth. The Car-Life Division seems to be enhancing its revenues and earnings by cutting costs, enhancing operational efficiencies, and reinforcing the car-life value chain to create synergies. The Energy Trade Division has improved its earnings in key product areas outside the asphalt business. It is thus noteworthy that on an effective basis after excluding such external factors as weather and oil prices the company is enhancing earnings in keeping with or faster than the planned pace.

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Income Statement

(¥mn)

IFRS	FY3/13	FY3/14	FY3/15		FY3/16		FY3/17
	Full year	Full year	Q1	Full year	Q1	Full year (E)	Full year (E)
Sales (Japanese GAAP)	1,430,745	1,506,606	335,972	1,373,393	284,999	1,350,000	1,370,000
YoY	-	5.3%	1.5%	-8.8%	-15.2%	-1.7%	
Gross profit	69,666	71,599	17,155	85,720	20,537	-	-
Gross profit margin ratio	4.9%	4.8%	5.1%	6.2%	7.2%	-	-
SG&A expenses	55,668	57,862	15,586	71,184	17,922	-	-
SG&A expenses/sales	3.9%	3.8%	4.6%	5.2%	6.3%		-
Profit (loss) from tangible assets, intangible assets and goodwill	-914	-1,460	-208	-1,825	-41		-
Other - net	-346	-402	271	389	184		-
Total other expense	-56,928	-59,724	-15,523	-72,620	-17,779	-	-
Operating profit	12,738	11,875	1,632	13,100	2,758	16,800	20,000
YoY	-	-6.8%	-34.8%	10.3%	69.0%	28.2%	
Profit before tax	12,234	13,844	1,684	12,155	2,620	15,200	-
YoY	-	13.2%	-33.6%	-12.2%	55.6%	25.1%	-
Net profit	7,393	8,050	943	6,529	1,573	-	-
YoY	-	8.9%	-33.5%	-18.9%	66.8%	-	-
Net profit attributable to owners of the parent	6,470	7,124	763	5,503	1,339	8,200	10,000
YoY	-	10.1%	-36.8%	-22.7%	75.6%	49.0%	
Net profit attributable to non-controlling interests	923	925	180	1,026	234	-	-

EPS (¥)	57.26	63.05	6.75	48.71	11.85	72.57	-
Dividend (¥)	16.00	20.00	-	22.00	-	24.00	-
Equity attributable to owners of the parent per share	791.42	833.20	-	862.30	-	-	-

Balance Sheet

(¥mn)

IFRS	FY3/13	FY3/14	FY3/15
Current assets	189,196	188,193	157,708
Cash and cash equivalents	18,062	14,251	16,184
Trade receivables	136,578	140,289	98,449
Inventories	18,134	18,655	27,794
Non-current assets	126,697	132,839	171,351
Investments accounted for by the equity method	6,032	5,927	10,551
Other investments	8,925	7,349	8,924
Property, plant and equipment	57,655	66,988	88,836
Intangible assets	10,999	10,280	23,474
Total assets	315,893	321,032	329,059
Current liabilities	161,738	159,201	149,443
Short-term bonds and borrowings	14,745	11,499	14,208
Trade payables	124,046	125,655	104,564
Non-current liabilities	56,500	58,268	66,669
Non-current bonds and borrowings	26,158	27,099	26,746
Total equity attributable to owners of the parent	89,424	94,144	97,432
Common stock	19,878	19,878	19,878
Capital surplus	18,737	18,737	18,743
Retained earnings	54,086	59,378	62,223
Other components of equity	-1,527	-2,098	-1,661
Treasury stock	-1,750	-1,750	-1,751
Non-controlling interests	8,231	9,419	15,515
Total equity	97,655	103,563	112,947
Total liabilities and equity	315,893	321,032	329,059

Statement of Cash Flows

(¥mn)

IFRS	13/3期	14/3期	15/3期
Cash flows from operating activities	22,754	17,530	34,336
Cash flows from investing activities	-24,930	-12,556	-20,410
Cash flows from financing activities	4,759	-8,859	-12,115
Net increase (decrease) in cash and cash equivalents	2,583	-3,885	-12,115
Cash and cash equivalents at the beginning the period	15,436	18,062	14,251
Effect of exchange rate changes on cash and cash equivalents	43	74	122
Cash and cash equivalents at the end of the period	18,062	14,251	16,184

Shareholder Returns

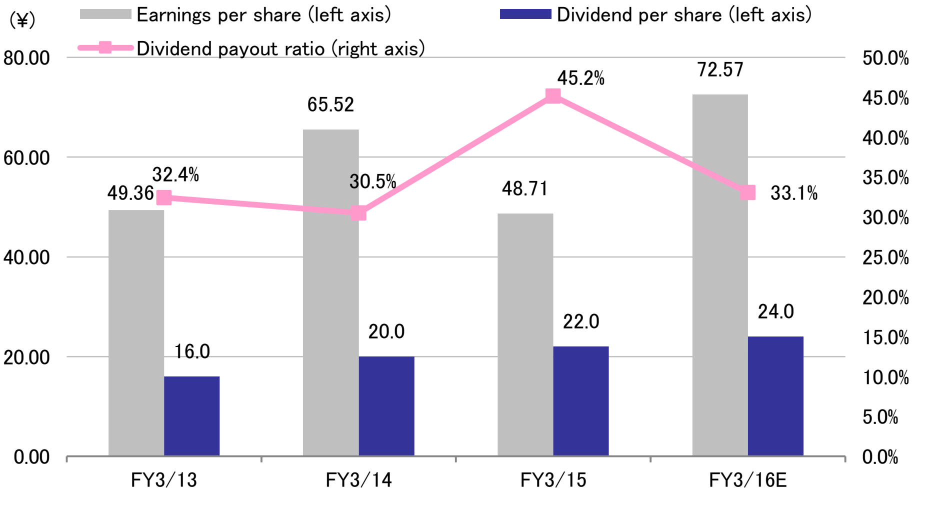
Ample potential to expand shareholder returns in keeping with earnings growth

There have been no particular changes since the end of Q1 in management's basic stance on shareholder returns or monetary amounts.

The basic policy on such returns is to maintain a dividend payout ratio exceeding 30%. In FY3/15, the company increased the annual dividend by ¥2 per share, to ¥22, comprising interim and year-end dividends of ¥11 each. We assume that the company raised dividends that year despite a lower Y-o-Y net profit because of management's stance on emphasizing shareholders and its confidence that the company could return to an earnings growth path from FY3/16.

For FY3/16, the company is forecasting a dividend of ¥24 (interim dividend: ¥12, year-end dividend: ¥12), reflecting a projected 49.0% Y-o-Y increase in profit to ¥8,200mn. This represents a dividend payout ratio of 33.1% based on projected earnings per share. The company has not announced a dividend forecast for FY3/17, however it has clearly indicated a policy of maintaining the payout ratio of 30% or more. We therefore believe that shareholders to expect shareholder returns to expand in line with profit growth.

Earnings Per Share (¥), Dividends Per Share (¥), and Dividend Payout Ratio (%)



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