ITOCHU's Choices in a New Era for General Trading Companies

I think that employees who work at general trading companies have certain habits in common. They are always aware of other companies in the same industry, and when a project emerges they tend to act before a competitor takes the project. With that state of mind, they often jump in without calmly conducting a corporate value evaluation. Formerly, general trading companies were prone to "buy high," and all of the companies conducted management with similar, all-round business portfolios. That became apparent around the time of the resource boom, when all the companies went on shopping sprees for resource interests. However, that era marked the close of the resource boom, which ended with the recording of large-scale impairment losses by each general trading company.

Moving forward, we will enter a competitive environment in which general trading companies compete on the basis of their individual characteristics. This will be a new era for general trading companies. In this era, the successful companies will be those that have rapidly established business models to compete in fields in which they have strengths.

ITOCHU will maintain its presence in the resource business on a scale that is appropriate for its size. However, I think it is a management mistake to take an easygoing approach that "resource prices will recover in due course." Looking at the example of crude oil, when the price increases to a certain extent, then shale oil will make a comeback. In other words, there is a price ceiling. Moreover, heretofore long-term contracts with resource purchasers have supported aggressive investment in interests and become the foundation for stable earnings. Moving forward, however, in place of these contracts there will likely be an increase in spot transactions as purchases are made on the market when necessary.

The fields on which ITOCHU will focus in the new era are clear. These are the non-resource fields, centered on consumer-related businesses, such as textiles, food, and general products, in which we lead the industry. To generate earnings in these fields, we will have to focus on China, which has a population of approximately 1.4 billion, and on Southeast Asia, which is posting notable growth. To open up those markets, we will need partners with strong market positions, the CP Group and the CITIC Group are the best partners for ITOCHU. The CP Group has built a wide-ranging overseas Chinese network and has deep roots in local markets in China and Southeast Asia, while the CITIC Group has extensive connections with the Chinese government.

The next few years will be a transitional period in which the general trading company industry undergoes significant change. However, ITOCHU anticipated this and has stayed one step ahead in preparing for it. Consequently, when our rivals are winding up the resource boom and developing their strategies for the future, we will stay one step ahead by maintaining our strategic focus on the fields where we have decided to compete through our alliance with the CP Group and the CITIC Group.

Taking Steps While Continually Looking Ahead

Our drive to stay one step ahead led to substantial cash collection in FYE 2016.

PrimeSource, a building material company in North America, was a top earner in the U.S. general products business, generating aggregate earnings of approximately ¥75.0 billion. However, the investment efficiency was gradually declining. Accordingly, we considered the active M&A market in the U.S. to be an excellent opportunity, and we decided to sell our shares in PrimeSource. Through this sale, we collected approximately ¥110.0 billion in cash. In addition, Nacional Minérios S.A. (NAMISA), an iron ore production and sales company in Brazil, was merged with the mining division of Companhia Siderúrgica Nacional (CSN), which owns the neighboring Casa de Pedra mine. Through this merger, we successfully acquired one of the world's most competitive assets. In these ways, we rapidly generated multiple benefits, such as the collection of approximately ¥70.0 billion in cash and a reduction in resource exposure.

⇨ Page 43 Pursuing Risk Management and Asset Efficiency

Clearly, it is irrational to take advantage of favorable market conditions to collect funds by selling an asset and then to immediately invest in a comparatively expensive asset, simply because management leaders want to post record-setting results during their tenure or because the market pressure for capital efficiency is too great. Companies are not limited to specific accounting periods or specific leadership tenures. Rather, I think that the correct management approach is to look ahead, hold cash, and invest when superior assets have become inexpensive. Accordingly, I have given instructions to remain calm and select projects based on rigorous standards, even if that means holding back on plans.