

3Q results and full-year FY17 projections at Toshiba

Results offered no surprises; revised company projections are slightly positive

- Underlying operating profit grew on the back of favorable memory business; substantial negative free cash flow largely in line with our expectation
- We have confirmed some new factors that are expected to improve shareholders' equity at end-FY17
- No change to the firm's policy to sell the memory business; focal point in credit valuation has shifted to improvement in profitability at the "New Toshiba"

Credit Memorandum JCRE421

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Underlying operating profit grew on the back of favorable memory business; substantial negative free cash flow largely in line with our expectation

3Q results offered no major surprises

1-3Q consolidated operating profit came in at Y49.5bn (down Y26.5bn y/y). This is based on the figures after reclassifying the semiconductor memory business (Toshiba Memory), which is to be sold, as a discontinued operation. On a pre-reclassification basis, operating profit came to Y361.9bn (up Y180.7bn). Backed by robust demand for smartphone-/data center-use items, the 1-3Q operating profit margin in the memory business was high at 36.9%, or 37.5% in 3Q alone. The business has continued to drive substantial growth in the firm's underlying operating profit. Looking at cash flow, we found that 1-3Q operating cash flow was a negative Y383.6bn. However, the figure came to a positive Y53.1bn excluding the impact of the payment of parent guarantees related to US-based Westinghouse Electric. Free cash flow stood at a negative Y446.2bn due to ongoing investment expenditures, centering on the memory business.

Confirmation of some new factors that are expected to improve shareholders' equity at end-FY17

Overview of revised company projections

The company's projection for full-year FY17 free cash flow is negative Y550.0bn, Y170bn worse than the previous projection as of November 2017. This can be largely explained by (1) the lump-sum payment of parent guarantees (negative factor) and (2) the sale of Westinghouse-related claims (positive factor), offering no surprises. The firm revised up its projection for shareholders' equity at end-FY17 to positive Y460bn, a Y1.21tn improvement from the previous projection. However, the main reasons were already known, including (1) equity financing via private placement and (2) gains on the sale of Westinghouse-related claims and tax benefits. This time, we note some new factors that are expected to improve shareholders' equity by (1) Y110bn, in line with the reversal of a portion of the valuation allowance for deferred tax assets (reflecting the removal of the going concern note) and (2) Y65.0bn in gains on the sale of the Visual Products business and tax benefits. For reference, the company's projection has not factored in the effect from the completion of the sale of the memory business (gains on the sale are estimated at around Y1tn), which Toshiba is aiming to wrap up by the end of FY17. Similarly, around Y200bn in potential tax benefits from the sale of Westinghouse Electric shares have not been included.

No change to the firm's policy to sell the memory business; focal point in credit valuation has shifted to improvement in profitability at the "New Toshiba"

Procedures regarding the sale of Toshiba Memory shares

Although the sale of the memory business has not been completed, the firm will almost certainly eliminate its negative net worth at end-FY17. In addition, visibility is clear for a recovery of shareholders' equity toward the past average level. However, President Satoshi Tsunakawa and CFO Masayoshi Hirata clearly mentioned that there was no change to the firm's policy to sell the memory business. This is the most reassuring factor in terms of credit valuation, in our view. Our focal point has shifted to improvement in profitability at the "New Toshiba." Excluding the memory business, the firm projects zero operating profit for FY17. Nevertheless, we do not think it is unreasonable to regard the "around Y100bn" level as being within the firm's capability, given the absence of restructuring costs and losses in the TV/PC operations. Regarding the thermal power generation-related business, which faces a severe business environment over the medium term (similar to competitors), we will watch for measures to improve profitability via reallocation of management resources.

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- In addition to the purchase price of a financial instrument, our company will collect a trading commission* for each transaction as agreed beforehand with you. Since commissions may be included in the purchase price or may not be charged for certain transactions, we recommend that you confirm the commission for each transaction. In some cases, our company also may charge a maximum of ¥ 2 million (including tax) per year as a standing proxy fee for our deposit of your securities, if you are a non-resident.
- For derivative and margin transactions etc., our company may require collateral or margin requirements in accordance with an agreement made beforehand with you. Ordinarily in such cases, the amount of the transaction will be in excess of the required collateral or margin requirements**.
- There is a risk that you will incur losses on your transactions due to changes in the market price of financial instruments based on fluctuations in interest rates, exchange rates, stock prices, real estate prices, commodity prices, and others. In addition, depending on the content of the transaction, the loss could exceed the amount of the collateral or margin requirements.
- There may be a difference between bid price etc. and ask price etc. of OTC derivatives handled by our company.
- Before engaging in any trading, please thoroughly confirm accounting and tax treatments regarding your trading in financial instruments with such experts as certified public accountants.

* The amount of the trading commission cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.

** The ratio of margin requirements etc. to the amount of the transaction cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.

When making an actual transaction, please be sure to carefully read the materials presented to you prior to the execution of agreement, and to take responsibility for your own decisions regarding the signing of the agreement with our company.

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