We will endeavor to enhance Nikke Group's corporate value on the Prime Market by continuing to promote sustainable business management, with diversification at the core of our growth strategy.

Director, Managing Executive Officer, and
Director of Management Strategy Center

Takehiro Okamoto

Revenue increased last fiscal year, and we recorded our highest ever net profit

The fiscal year ended November 2021 was the first year of the 2nd Medium-term Management Plan (FY2021-FY2023) under Nikke Group's RN 130 Vision, a medium- to long-term vision that ends in FY2026. Our efforts to diversify the business bore fruit amid the COVID-19 pandemic. Specifically, we were able to achieve year-on-year increases in sales, operating income and net profit attributable to owners of parent, partly due to the Consumer Goods & Services business successfully capturing stay-at-home demand and price revisions in the Textile & Clothing Materials business. Net profit attributable to owners of parent, in particular, reached the highest level ever, boosted by the posting of gains on negative goodwill of more than 7.2 billion yen as extraordinary income arising from the acquisition of Fuji Corporation as a wholly-owned subsidiary.

Improve capital efficiency

Our financial strategy is based on the policies of integrity, profitability, capital efficiency, growth potential, and stable returns to shareholders. Capital efficiency and growth potential, in particular, are key challenges. We are endeavoring to improve capital efficiency through the use of ROIC for our internal investment criterion and as our measure of investment efficiency for each business segment. Our cost of capital in terms of WACC*[1] is approximately 4-5%, so our minimum requirement for ROIC is 5% or higher, and our target is 8% or higher. Last fiscal year, ROIC was approximately 6% based on operating income after tax. The Human & Future Development business was the highest at over 16%, while the Textile & Clothing Materials business was only around 6%. The reason why ROIC was so high in the Human & Future Development business was that we have focused on doing business ourselves using the real estate that we hold, rather than just leasing real estate. For example, we run our own businesses using our commercial facilities, golf driving ranges, indoor tennis court facilities, nursing care business, franchise business, solar power sales business, etc. We have also separated the company that engages in business operation from the company that owns the real estate for the purpose of revenue management, with business operations evaluated based on profits after paying rent to the division that owns the real estate. The low ROIC in the Textile & Clothing Materials business was mainly attributable to low inventory turnover. We are rebuilding mechanisms to thoroughly implement inventory management, including at Group companies. Last fiscal year, we recorded ROE of 8.4%, well above the target for the final fiscal year of the 2nd Medium-term Management Plan, which is 7.0% or above. However, this was significantly boosted by the recording of gains on negative goodwill as extraordinary income. Even during the period of this Medium-term Management Plan, we have decided to change our internal ROE basis to operating income after tax, aiming to achieve a stable level of 7.0% or more even after excluding non-operating and extraordinary income or loss. ROE and ROIC have become well understood within Nikke Group as efficiency indicators.

I think our next step should be to use measures such as EBITDA*[2] to compare and consider the Group's profitability globally, to appeal to foreign investors. We consider the Company to be undervalued in light of current EV/EBITDA*[3] of 5 or less. This is due to the low level of the market capitalization component of EV. Upon analysis, we think that this is most likely a result of the perception among investors and other stakeholders that our diversification strategy makes the Company's business difficult to comprehend, as well as their consciousness of a conglomerate discount. Diversification will continue to be the pillar of our growth strategy, but we will aim to enhance corporate value in the medium and long term through selection and concentration, and by constructing an attractive business portfolio.

*1 WACC refers to the weighted average cost of capital.

*2 EBITDA refers to earnings before tax, plus interest expenses, plus depreciation.

*3 EV/EBITDA ratio is equal to the sum of market capitalization, net interest-bearing liabilities, and minority interests, divided by the sum of operating income and depreciation.
For example, where the selling company has a market capitalization of 400 million yen, interest-bearing liabilities of 20 million yen, cash and deposits, etc. of 40 million yen, operating income of 40 million yen, and depreciation of 10 million yen:
• EV = (400 + 20 - 40) million yen = 380 million yen
• EBITDA = (40 + 10) million yen = 50 million yen
• EV/EBITDA ratio = 380 / 50 = 7.6.
This indicates that it would take 7.6 years to recover the cost of acquiring this company.

Growth investment

Regarding the challenge of growth potential, during the three years covered by the 2nd Medium-term Management Plan, our growth investment plans include capital investment and R&D investment totaling 25 billion yen and M&A investment of 20 billion yen. Investment during the fiscal year ended November 2021 was subdued, with capital investment of 3.5 billion yen and M&A investment of 2.5 billion yen. However, for M&A, the core of our growth strategy, we have an increasing number of projects underway in the Consumer Goods & Services and Industrial Machinery & Materials businesses, with six or seven projects currently under consideration. We have boosted the number of employees in the Business Development Department, the section responsible for M&A, to bolster our progress on M&A projects this fiscal year.

Regarding capital investment and R&D investment, Mr. Nagaoka, who was newly appointed as President this fiscal year, has expressed his intention to aggressively expand investment, including capital investment to develop new products and enhance production efficiency, and investment in SDGs initiatives, energy-saving measures, and the development of manufacturing and sales bases necessary for cultivating new customers. As CFO, I intend to accelerate these measures from a financial perspective. The relationship between the CEO and CFO is generally one of "attack" and "defense." As the CFO, I will fulfill my duty to keep the president in check. But also as a director, rather than just the head of the finance department, I will provide the CEO with information and advice to facilitate management decision-making. I will actively collect information and work together with him especially for our M&A growth strategy. This policy is unchanged from the time of the previous president.

The CFO's check-and-balance function

Business diversification will remain at the center of Nikke Group's growth strategy. The merits of diversification include risk hedging and synergies. Last fiscal year, the Textile & Clothing Materials and Human & Future Development businesses faced a drop in revenue, mainly due to the impact of COVID-19, but this was offset by a significant increase in revenue from the Consumer Goods & Services e-commerce business. We also made Fuji Corporation a wholly-owned subsidiary. With its entry into Nikke Group, we aim to improve revenue by implementing measures such as mill consolidation, intra-Group OEM, and joint purchasing and sales.

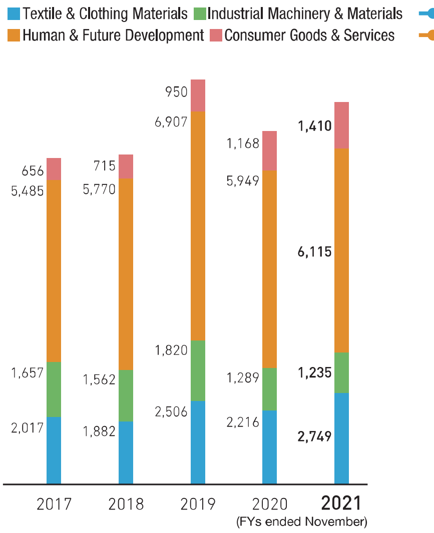
At the same time, diversification may also lead to inefficiencies and governance risks. I therefore consider the check-and-balance function to be an important duty of the CFO. Especially in the case of M&A, business departments tend to become over-enthusiastic, and we keep the takeover price from skyrocketing through measures such as the internal criterion setting the "price of goodwill" paid on acquisition at a maximum of five times the target company's estimated operating income, and making M&A conditional upon ROIC of 8% or more. Diversification also tends to make the profitability of individual businesses harder to gauge, so wherever possible, we divide individual subsidiaries by business to clarify the profitability of each business. In some cases, the increase in the number of subsidiaries leads to the duplication of costs associated with administrative divisions and the like, but we consider these costs necessary.

Regarding our dividend policy, we aim for a payout ratio of 30% and a dividend on equity ratio (DOE) of 2%, premised on stable dividends with no dividend cuts. In the fiscal year ending November 2022, we plan the acquisition of up to three million treasury shares (4.07% of the total number of issued shares) to bring about an improvement in capital efficiency. Treasury shares will total 15.7 million shares (18.3% of the total number of issued shares) after this acquisition. Therefore, we are aware of the need to consider canceling some of them, but we currently intend to continue to utilize treasury shares for purposes such as share exchange for the M&A we conducted last year, as well as restricted stock compensation.

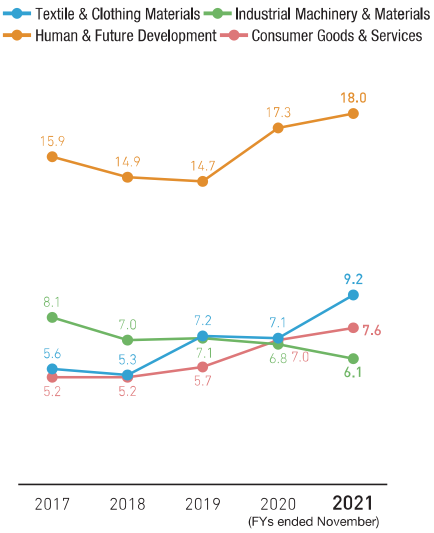
Meanwhile, recent years have brought a rise in hostile takeover bids, with four such bids in 2019, five in 2020, and seven in 2021, even as an increasing number of companies abolish takeover defense measures. There is no guarantee that Nikke Group will avoid being targeted by one of these hostile purchasers. The purpose of the “Response Policy for the Large-Scale Purchase of Nikke Shares (Takeover Defense Measures)” is to ensure sufficient information and consideration period and, in some cases, to ensure time to negotiate with the large-scale purchaser, to enable shareholders to make an appropriate decision in the event of a hostile takeover attempt. The re-adoption of this policy is proposed every three years for approval by the Company’s shareholders at the Ordinary General Meeting of Stockholders. We have adopted a mechanism whereby a special committee composed of three independent external officers considers whether countermeasures should be invoked and whether it is necessary to confirm the will of shareholders, and reports its recommendations to the Board of Directors. In this way, from a governance perspective, the takeover defense measures are prevented from being used to maintain or secure management control.

To conclude, I would like to note that we have transitioned to the Prime Market from April this year. Prime Market companies are subject to higher standards of governance, and are required to achieve sustainable growth and the medium- to long-term enhancement of corporate value with an emphasis on constructive dialogue with investors. As CFO, I will endeavor to secure the trust of the capital market by disclosing information as appropriate, over and above the requirements of laws, regulations, and other rules, as Nikke Group pushes ahead with sustainable business management.

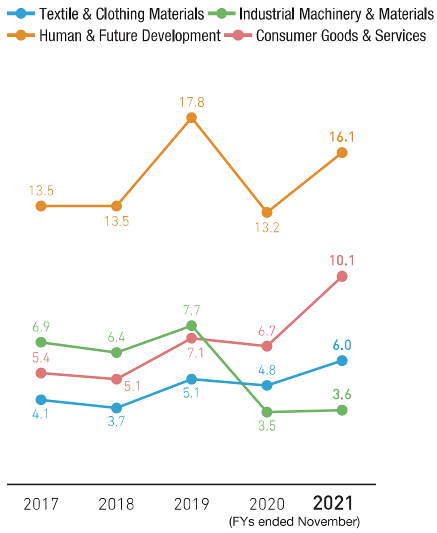
Operating income by segment (million yen)



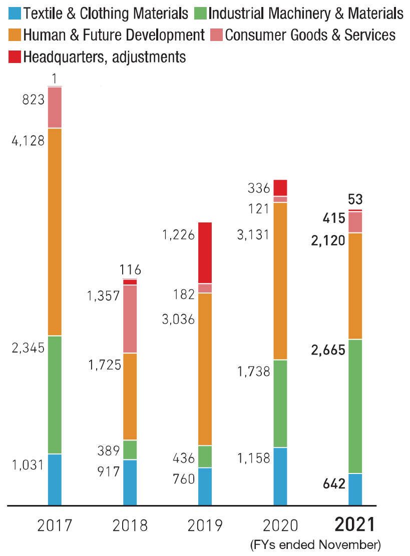
Operating margin by segment (%)



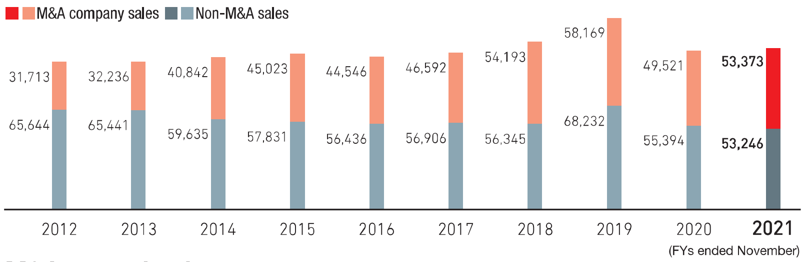
ROIC by segment (%)



Capital investment / M&A (million yen)



M&A sales (million yen)



M&A operating income (million yen)