Message from the CFO

Accelerate future growth by using a financial strategy focusing on improving capital efficiency through risk analysis and ensuring growth potential.

Director and Managing Executive Officer
Director of Corporate Strategy Center
Takehiro Okamoto

Results for the fiscal year ended November 2023, the final year of the Medium-term Management Plan

Diversification of the four businesses promoted the strengthening of the complementary relationship to strike a revenue balance, enhancing management stability.

We set targets for the fiscal year ended November 2023, the final year of the 2nd Medium-term Management Plan under the medium- to long-term RN 130 Vision at: sales of at least 127 billion yen; operating income of at least 11.5 billion yen; net income attributable to owners of parent of at least 7.8 billion yen; and ROE of at least 7%. These targets were not achieved, except ROE, as sales resulted in 113.5 billion yen; operating income 11 billion yen; ordinary income 11.6 billion yen; net income attributable to owners of parent 7.6 billion yen; and ROE 7%. These results are due to the impact of the COVID-19 pandemic, the review of our business portfolio, the rise in raw material prices and energy and logistics costs caused by the depreciation of the yen, and other reasons. However, operating income of paramount importance hit a fresh high for the second consecutive year. I believe we have moved toward establishing a strong earnings foundation.

This outcome is attributable to the Textile & Clothing Materials business (whose operating income increased 2.8% year-on-year), where items were narrowed down to ones with high margins and the manufacturing section saved manpower and enhanced efficiency, and to the Human & Future Development business (whose operating income increased 15.2% year-on-year), where the profitability of owned real estate was enhanced, and inefficient assets were reduced. Conversely, the Industrial Machinery & Materials business (whose operating income decreased 18.7% year-on-year) experienced a delay in starting the full-scale operation at the facility to produce high-performance filters in China, in which we had invested. However, it completed the business integration of Ambic and Fuji Corp., and laid out the groundwork to make the nonwoven fabric and felt business grow into a pillar to yield significant profits in the future. The Consumer Goods & Services business (whose operating income decreased 41.8% year-on-year) faced a difficult situation in terms of profit due to fiercer competition in the e-commerce market, the rise in purchase prices, logistics costs, advertising, and other expenses. However, it acquired three e-commerce companies through M&As and took other measures, which provided a road map for increasing profit in the future. We analyzed that under the 2nd Medium-term Management Plan, the diversification of the four businesses promoted strengthening the complementary relationship to strike a revenue balance, enhancing stability against market fluctuations.

Financial condition from the viewpoint of increasing capital efficiency

Although the capital efficiency varies across the four businesses, it has been moving toward steady improvement, in addition to improved financial soundness.

Financial soundness has improved in terms of financial affairs, with an equity ratio of 68.1% and net cash of a little less than 20 billion yen. On the other hand, we have faced a continued need to improve capital efficiency, and we have been striving to improve it by using operating margin, ROE, ROIC, and CCC (cash conversion cycle)*1 as management indicators.

Operating margin increased from 8.6% for FY2020, before the start of the 2nd Medium-term Management Plan, to 9.7% for the final year of the Medium-term Management Plan. Notably, the Human & Future Development business increased it from 17.2% to 21.6% by taking measures such as the redevelopment, re-redevelopment, and sale of unprofitable real estate, and the Textile & Clothing Materials business increased it from 7.1% to 10.6% by ensuring manpower-saving and higher efficiency in the manufacturing section and reducing unprofitable items.

ROIC of each business division for the previous fiscal year was 6.8% from the Textile & Clothing Materials business (up 2.0% from FY2020), 22.8% from the Human & Future Development business (up 9.5% from FY2020), 4.5% from the Industrial Machinery & Materials business (up 1.0% from FY2020), and 2.9% from the Consumer Goods & Services business (down 3.9% from FY2020). Although the results vary across the four divisions, the overall ROIC improved and resulted in 5.9% (up 1.5% from FY2020).

ROEs for the past five fiscal years were at levels higher than 7%, and capital efficiency has steadily improved. By steadily implementing the growth strategy of the 3rd Medium-term Management Plan to achieve the ROE target of 8%, we will strive to achieve the target capital efficiency as early as possible.

By contrast, CCC of 163 days is 13 days longer than the previous fiscal year. This was caused by strategic stock building in the Textile & Clothing Materials business, where it takes almost one year from purchase to the collection of sales proceeds. We have been working to create a better cash flow by improving commercial distribution and enhance efficiency by using digital transformation to visualize the process from purchasing raw materials to managing production, stock, and sales.

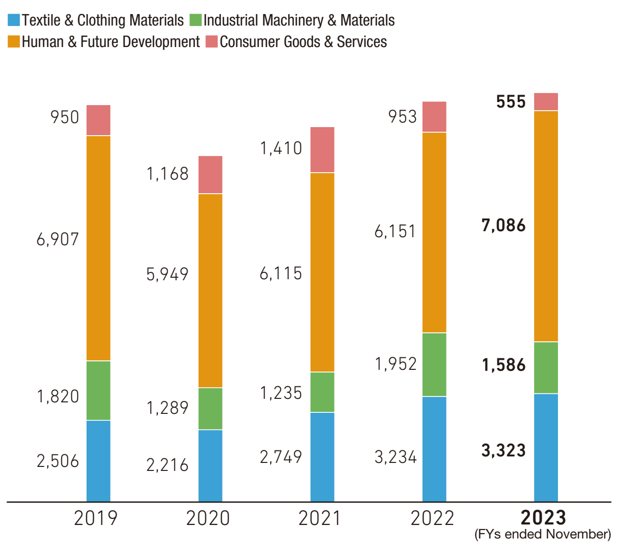
Financial strategy to focus on improving capital efficiency and ensuring growth potential

We set the target ROIC at 5%–8% for the time being, considering the capital efficiency of the four businesses.

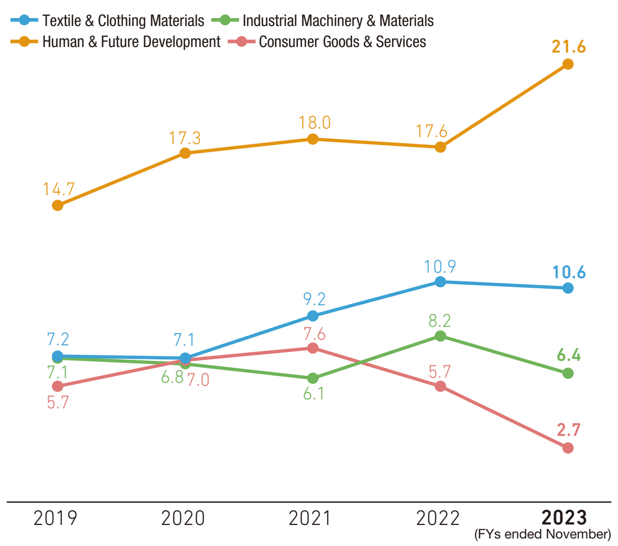
We regard improving capital efficiency and ensuring growth potential as key issues, and under the 3rd Medium-term Management Plan (FY2024–FY2026), we will enhance profitability by making growth investments to reach 8% or higher ROEs. We set growth investment limits as follows: approximately 29 billion yen for capital and R&D investments and approximately 20 billion yen for M&As and alliance investments, totaling approximately 50 billion yen. This allows us to strike a balance between internally induced growth and externally induced growth. Our financing plan is as follows: 39 billion yen from operating cash flow over the three years of the Medium-term Management Plan and 20 billion yen from bonds and borrowings. We will maintain the credit rating of A for bonds, which we use as a financial discipline guide. We use ROIC as a criterion for investment by devising a calculation

*1 CCC: Abbreviation for cash conversion cycle, which means a certain number of days from the input of money to the collection of money. The lower the value, the higher the efficiency.
[Formula] CCC = Days Inventory Outstanding + Days Sales Outstanding − Days Payable Outstanding

Operating income by segment (million yen)



Operating margin by segment (%)



method and set it at a minimum of 5% and a target of 8% for both capital investment and M&A investment. Investors ask us that our ROIC values seem to have been set low. One of the reasons is the difference in capital efficiency across the four businesses of our company, depending on the characteristics of each business, and we intend not to change those values for the time being.

As an investment target, we are looking at the nonwoven fabric and felt business of the Industrial Machinery & Materials business, and we intend to make it grow into the third thickest pillar after the domestic uniform business and real estate business. The Human & Future Development business will invest in the development of real estate such as the south side of the Nikke Colton Plaza, the old site of the Nikke Ichinomiya Office, the old site of the former Fuji Corp. Itami Plant, and the old site of company housing, and the Textile & Clothing Materials business will invest in the plant equipment for manpower-saving and higher efficiency. The Consumer Goods & Services business will invest in projects related to the e-commerce business.

Financial risks such as exchange rate, capital investment, M&A, investment securities

Determination of financial risks depending on economic trends and business environment is an unavoidable management issue.

The revenue of the uniform business, one of our main businesses, is significantly affected by the prices of raw materials and exchange rates, as it imports wool tops, a raw material, from abroad. Therefore, we try to purchase raw materials from more than one supplier and globally procure them to stabilize procurement. We hedge exchange rate risk mainly by making a forward exchange contract, and we make a three-year forward exchange contract only for raw materials for uniforms, whose sales volumes and unit prices are particularly stable. We successfully controlled the settlement rate at 130 JPY/USD last fiscal year. As for the fiscal year ending November 2024, we must bear in mind the impact of rising commodity prices, unstable exchange rate fluctuations, the situation in the Middle East, concerns about the future of the Chinese economy, and other factors.

We also have to consider the future impairment risk involved in capital investment, acquisition through M&As, and the holding of investment securities. As for capital investment, we thoroughly check the effect of investment and the appropriateness of the number of years as a time period for collection at the time of investment. As for M&As, we thoroughly estimate synergistic effects and post-acquisition profit at the time of acquisition. We also make it a condition that the assessed value of goodwill is set at not more than five times the target company's operating income to curb the rising acquisition prices. The balance of investment securities at the end of the previous fiscal year was 22.4 billion yen, a year-on-year increase of 0.4 billion yen. The main reason is the increase in unrealized gains due to buoyancy in the stock market. Pursuant to the 2nd Medium-term Management Plan, we reduced 42 brands of cross-held shares by 2.2 billion yen (on a book-value basis). Should the stock market drop 50%, our equity ratio will be maintained at 66%, and its financial impact will be insignificant. However, the existence of "silent shareholders" under the pretext of being a stable shareholder may, from the viewpoint of governance, lead to the risk of inappropriate management or management that is contrary to the interests of other general shareholders. We will continue to handle the reduction of cross-shareholdings carefully.

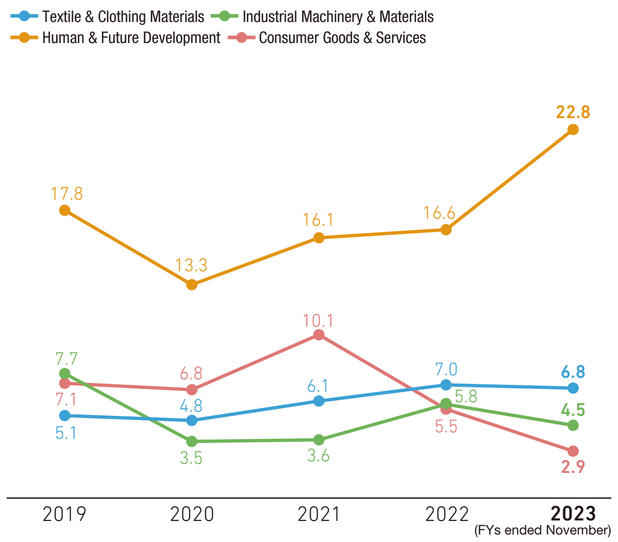
Future business outlook and returns to shareholders

Although revenue and profit should decrease for the fiscal year ending November 2024, we will strive to achieve the goals by proceeding with investments under the 3rd Medium-term Management Plan.

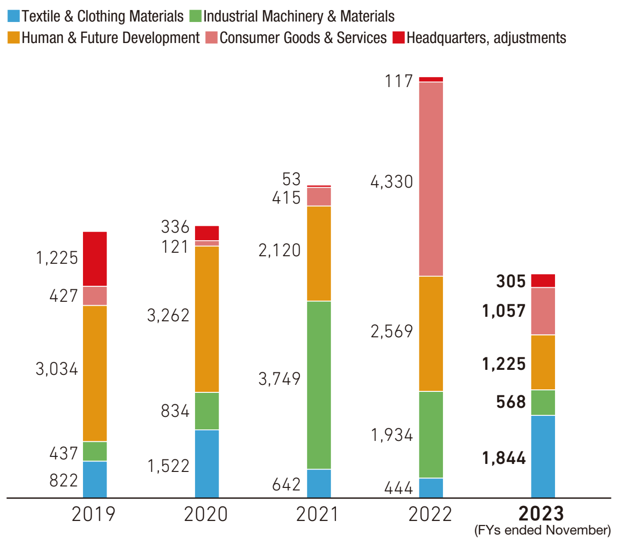
The performance for the fiscal year ending November 2024, the initial year of the 3rd Medium-term Management Plan should have decreased revenue due to the Human & Future Development business's downsizing of the franchise business and mobile phone sales business and the existence of proceeds from real estate sales in the previous fiscal year. However, we expect the same level of profit as the previous fiscal year for reasons such as increased overseas textile sales in the Textile & Clothing Materials business, the business integration effect of Ambic and Fuji Corp. in the Industrial Machinery & Materials business, and the M&A effect of the e-commerce business of the Consumer Goods & Services business. The 3rd Medium-term Management Plan focuses on growth investment and prioritizes the allocation of resources to the following three: (i) investment in product development, streamlining, and energy-saving equipment, (ii) investment in expanding our customer base, and (iii) investment in human resources. For the final fiscal year ending November 2026, the Plan projects sales of 130 billion yen; operating income of 13 billion yen (operating margin of 10%); net income attributable to owners of parent of 8.8 billion yen; and ROE of 8% or higher. If these targets are achieved, sales and profit will reach the highest values, and the most important key to making this happen is the progress of investments. As M&A transactions particularly require time to negotiate terms, we keep five or six transactions under specific review at all times.

Dividends to shareholders for the previous fiscal year marked the fifth consecutive increase. Pursuant to the 2nd Medium-term Management Plan, we acquired 4.83 million shares of treasury stock (6.1% of the issued shares) and retired 10.2 million shares. Under the 3rd Medium-term Management Plan, we will gradually increase the dividend payout ratio based on a stable dividend policy from the current standard ratio of 30% to 35%, scheduled for the fiscal year ending November 2026, the final year of the Medium-term Management Plan.

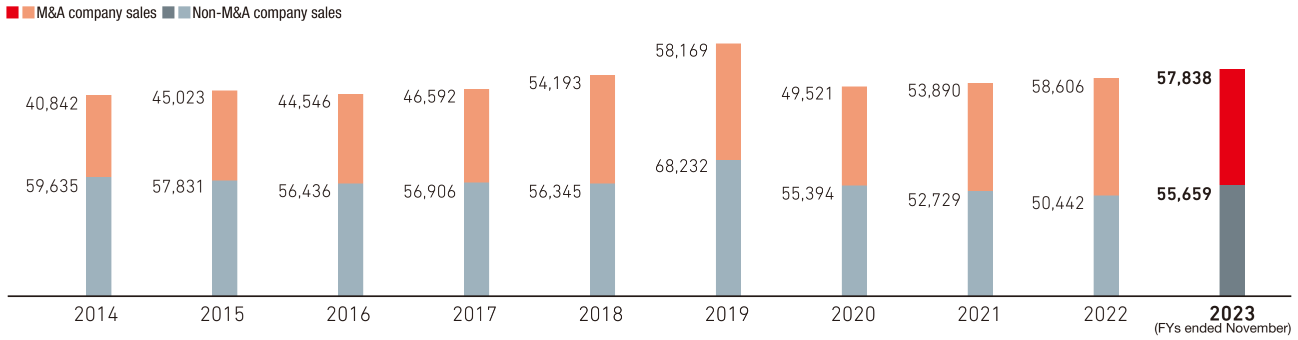
ROIC by segment (%)



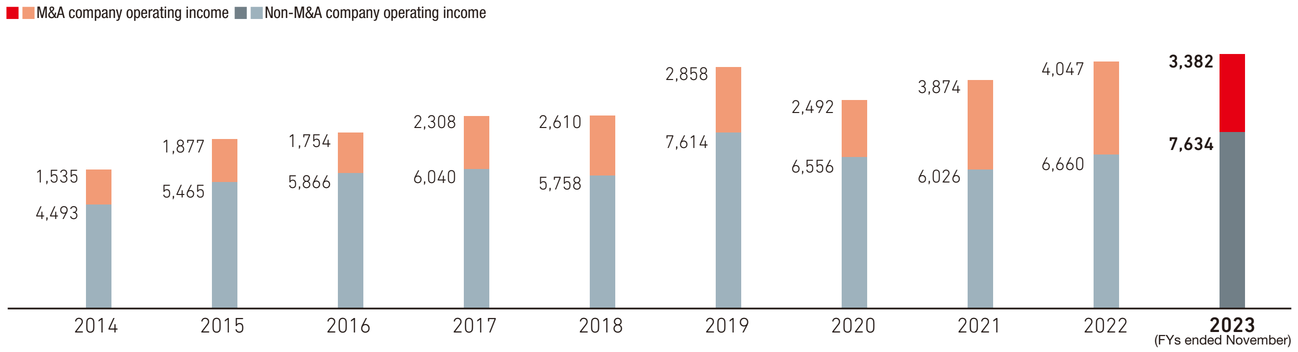
Capital investment / M&A (million yen)



M&A company sales (million yen)



M&A company operating income (million yen)



Measures against the P/B ratio of less than 1x

Under the new Medium-term Management Plan, we will emphasize communication with investors and strive to disclose sufficient information, such as descriptions of the stability and sustainability of revenue streams.

We made growth investments, acquired treasury stock, increased dividend distribution, and took other dividend-related measures under the 2nd Medium-term Management Plan. Our P/B ratio resultantly increased to 0.9x, which is still less than 1x. This may be partly due to the stock market assuming a higher cost of capital than our 7% ROE. Pursuant to the 3rd Medium-term Management Plan, we will work toward sustained growth through equipment and R&D investment, investment in human resources and M&A investment, and reviewing our business portfolio, and we will strive to achieve an 8% or higher ROE for the final year.

On the other hand, we have uniform and real estate businesses with stable profitability and competitiveness, and we recognize that considering these businesses, the cost of equity and the weighted average cost of capital (WACC*2) are about 5% and 4%, respectively. There is a gap from the 7% or higher cost of capital assumed by the market, and we need to narrow it. For this, we emphasize communication with investors and will strive to disclose sufficient information, such as descriptions of the stability and sustainability of revenue streams, and will also work on strengthening corporate governance to gain more trust.

*2 WACC: WACC is a typical calculation method of the cost of capital and refers to the weighted average of the cost of borrowings and the cost of equity financing. WACC is an abbreviation for Weighted Average Cost of Capital, which represents how much it costs to raise one yen of money.