Nichirei Corporation

FY23/3 Financial Results Conference Call Q&A Session

Date and time: May 10, 2023, 15:00–16:20 (Online/Conference Call)
Presenters: Kenya Okushi, Representative Director, President & Chief Executive Officer
Kenji Suzuki, Director, Senior Executive Officer, Chief Financial Officer
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Group Overall

[Shareholder returns]

Q. What was behind the decision to raise the consolidated dividend on equity (DOE) ratio to 4.0% from 3.0%?

A. Shareholder returns has been a regular topic of discussion since the previous business plan. Considering our profit and capital level, we ultimately decided to enhance shareholder returns and increase capital efficiency. Nichirei considers dividends to be the primary means for shareholder returns, so we decided to increase the dividend. Up to now, Nichirei has steadily raised its dividend with a target DOE of 3.0%, and after considering the status of individual shareholders, our share price, and the returns offered by other companies, we raised the target DOE to 4.0%.

[Business portfolio challenges]

Q. Considering that your target of 7% return on invested capital (ROIC) is greater than the 4% weighted average cost of capital (WACC), what issues do you face for widening the spread?

A. The WACC is 4% for the corporate group overall, but we have also set WACC targets for each business segment. These are higher or lower depending on the business, such as a higher figure for the Bioscience business. The challenges in terms of spread are the Bioscience and Marine Products businesses. Although the Bioscience business posted strong results in the previous fiscal year, profitability in past years has been low, and the accumulation of certain inventory is an issue. In Marine Products, the current low profitability and excessive inventory are issues. The challenges for both businesses are profitability and capital turnover.

For other businesses, figures exceed the spread, so while this is not exactly positive, we aim to achieve our targets for FY25/3.

[Capital investment]

Q. Nichirei has been making considerable capital investments for some time. Has this capital investment established a competitive advantage? Also, what is the payback period for these investments?

A. Nichirei is planning a record high ¥47.0 billion in capital investment in FY24/3. We are making large-scale investments under the current business plan, which we expect will generate benefits during the next plan period.

In Processed Foods, for example, Nichirei has built new company-owned production facilities that will be the source for earnings going forward, including the GFPT Nichirei No. 2 Plant (Thailand), the Yamagata Plant (Japan), Kyurei (Japan), and Nichirei Sacramento Foods (U.S.). As a result of improved operating rates and stability, we expect to reap the benefits of these investments from around the end of the current fiscal period to the next fiscal year.

In Logistics, we are adapting facilities and functions in response to the sweeping regulatory changes that will come into effect in 2024. In particular, we anticipate an increase in costs to strengthen functionality in the Kanto and Kansai regions where cargo volume is greatest, as well as along the trunk line that connects them. We consider these regulatory changes to be an opportunity to gain new customers and generate earnings.

We believe that these measures will lead to improved profitability. We have managed to maintain the operating profit margin for Processed Foods, one of our main earnings drivers, at the 5% level over the last few years by adjusting prices in response to the cost increases during the Covid-19 crisis. In the final year of the business plan, we expect to reach operating profit of ¥18.4 billion, with a margin of close to 6%. The operating margin in the Logistics business is at the 6% level, but we expect this to rise once the current round of investment is complete.

[Overseas earnings]

Q. What is your view of the current state of business outside Japan? What is the rate of earnings on current sales, and what level do you aim to achieve in the future?

A. Going forward, our aim is a minimum operating margin of 5% on sales outside Japan, and to develop the business so that this figure is close to double digits. Currently, some of our subsidiaries are doing well compared to the domestic Japanese business with an operating margin of more than 5%, while others in which we’ve recently invested are below the 5% level because of the depreciation expense. Ultimately, however, our aim is for the overseas business to be a driver for both revenue and earnings.

Processed Foods

Q. The simplified ROIC target for the third year of the medium-term business plan is 12% or higher. Will this be revised in the future?

A. At this point we do not plan to change the target. The operating profit target for the corporate group overall has been set at ¥37.0 billion, of which the ¥18.4 billion from Processed Foods constitutes a large proportion. We aim to achieve the simplified ROIC target by meeting the operating profit target.

Q. What is the status of recovery in sales volume following the price hikes in February?

A. For household-use products, sales volume in the previous fiscal year was on a par with that of the year before, so the effect of price revisions constitutes a large proportion of our forecast for a 6% increase in revenue in the current term, and we are not anticipating significant growth in sales volume. In general, sales volume temporarily declines immediately after a price revision, followed by gradual recovery. In this case, since the price revisions in February 2023 were relatively large, we expect that recovery will take longer than that following the revisions in August and September 2022. In addition, the shortage of eggs used as food material is a concern, and the view from our business partners and experts is that the effects could last for some time. We have been told by the industry that restoration to the previous procurement volume could take as long as a year. Nichirei is allocating the eggs it is able to procure to its mainstay product of fried rice, and planning measures such as temporarily suspending sales of certain other items. As such, we are not aggressively planning for growth in sales volume overall. At the same time, the market continues to gradually expand, so we are not concerned about a decline in demand.

For commercial-use products, we are planning for growth in sales volume, forecasting an increase of around 2% for the current fiscal year. The commercial-use market overall has mostly returned to pre-covid levels, with the restaurant market also back to pre-covid conditions overall. However, some sectors of the market, such as restaurant bars, are still in the recovery stage, and we expect the impact from closures and worker shortages to continue for the present. At the same time, fast food is driving the market, with differences appearing among market segments. While the focus has been on pre-covid levels, demand for processed foods is also rising among welfare facilities, which we see as the largest growth area going forward. Nichirei will increase its share of this market by strengthening development and sales of value-added products such as health-oriented items, and products that address labor shortages.

Q. The Asian foods markets in North America has an image of being fiercely competitive. Please review once more the strengthens and competitive advantage of InnovAsian Cuisine.

A. The high rate of growth at InnovAsian Cuisine since acquisition is due mainly to 1) the establishing of a solid relationship of trust with the major retailers who are the main customers, including personal pipelines, and 2) recognition of InnovAsian Cuisine's quality, product strength, and development capabilities amid a changing ethnic makeup and the varied food culture of America.

Going forward, to further enhance these strengths, we plan to fully utilize the rice production facility at our new subsidiary Nichirei Sacramento Foods, and incorporate Japanese technologies from the development stage.

Q. The plan for InnovAsian Cuisine this fiscal year seems conservative. What are your thoughts on the profit margin going forward?

A. The business plan takes into consideration inflation risk in the U.S., and the operating rate for Nichirei Sacramento Foods, which was made a subsidiary from a joint venture. We have envisioned the possibility that if sales volume decreases due to inflation, the operating rate at the plant will also decline, leaving us unable to secure profit from either sales or manufacturing. Ensuring that sales to major retailers remains firm is a priority matter, so we have allocated a fairly large amount for promotional expenditures to increase sales. As such, while we expect profitability to decline in the current term, there is still room for improvement in the figures depending on the circumstances in the U.S. economy.

Going forward, considering the past profitability rate for InnovAsian Cuisine, we are aiming for a margin of around 5 to 8 percent. Adding production earnings at Nichirei Sacramento Foods to this figure, we aim to reach the 10% level in the future.

Q. Can we assume that top line growth for high value-added personal use (single serving) items will contribute to earnings?

A. Yes. The Yamagata Plant manufactures products with a high marginal profit ratio, so a rise in sales contributes to earnings.

<u>Logistics</u>

Q. You stated that the ROIC target for the Logistics business is 7.3%, but will this change when the book value figure for invested capital, which is the denominator in this equation, is replaced with the market value?

A. The book value has been used for the ROIC calculation, so when the value of assets is recalculated at market value, since some lots were acquired a while ago, this will result in a decrease in ROIC. However, this will not have a significant impact on the figure.

Q. What are the factors behind the improvement in overseas operating profit in the Logistics business during the three-month Q4 period in the previous fiscal year?

A. The main factors are the collective implementation of fee revisions for major customers in Q4, and a change in Q4 of depreciation service life at our subsidiary in Poland. One-time extraordinary factors such as the reversion of expenditures amounted to 300-400 million yen. When these are spread out over the full fiscal year, performance in Q4 was not exceptionally positive.

Bioscience Business

Q. Performance in the Bioscience business has improved recently due to the spread of Covid-19 and influenza. However, the poor results in past years seems to indicate structural problems.

A. The immunochromatography (rapid diagnostic agents) business was a major contributor to results in the previous fiscal year, but going forward we think that the actual nature of the business will be stable earnings from the molecular diagnostic agents business on which we are now focusing.

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Note: This document is not a complete record of the Q&A session, and has been edited by Nichirei Corporation.