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Management's Discussion and Analysis

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Operations

Business Environment

During the fiscal year ended March 2017(FY17/3), Japan's economy recovered at a moderate pace, with an increase in public spending as an economic measure, improvement in employment conditions and incomes on recovery in corporate earnings, and signs of an upturn in consumer spending around the end of the fiscal period.

In the food industry, the main business domain for the Nichirei Group, amid growing consumer inclination toward thrift, demand remained firm for home meal replacement (HMR) products such as side dishes owing to greater diversity in food needs. In the cold chain logistics industry, storage demand was steady centered on major metropolitan areas, though personnel and transport/delivery costs continued to rise as a result of the labor shortage.

Overview

Precisely assessing these changes in the business environment, the Nichirei Group contributed to the resolution of social problems through its business activities, and during the first year of the new medium-term business plan (FY17/3 – FY19/3), worked to further strengthen its core businesses with the aim of sustainable earnings growth and greater capital efficiency.

In the Processed Foods business, Nichirei concentrated on expanding sales of mainstay products produced at company-owned plants through enhancements to brand power and proactive promotional campaigns. We also continued with efforts for productivity improvements and cost reductions, and improved profitability. In the Logistics business, Nichirei steadily captured robust storage demand mainly in the Kanto and Kansai regions, and expanded earnings through greater operational efficiency, receipts of appropriate fees, and other measures.

Operating Results

Consolidated net sales in FY17/3 increased 0.8% from the previous fiscal year to ¥539,657 million, driven by the core businesses. Operating income rose 35.8% to ¥29,309 million, the result of continued earnings improvement in the Processed Foods segment, and positive performance in the Meat and Poultry Products segment. The operating margin was 5.4%, up 1.4 percentage points from a year earlier.

In terms of expenses, the cost of sales decreased 1.3% year on year to ¥448,516 million, with the sales cost ratio declining 1.8 percentage points to 83.1%. Selling, general, and administrative expenses rose 3.9% from a year earlier to ¥61,831 million, due mainly to increases in advertising and promotional expenses, and outsourcing costs.

Performance by Segment

Processed Foods

(¥ Million)

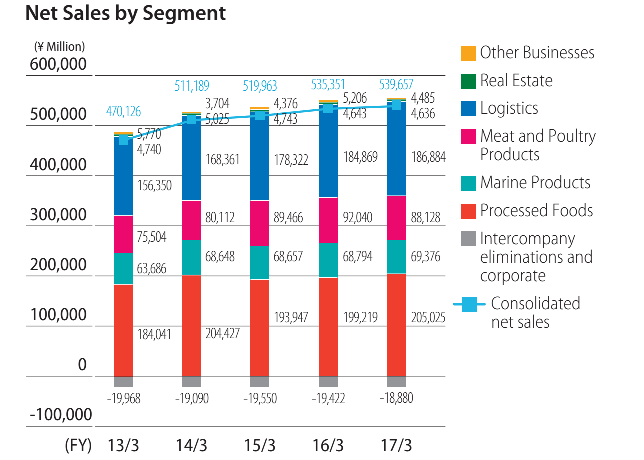
	FY16/3	FY17/3	Change (%)
Net sales	¥ 199,219	**¥ 205,025**	2.9
Operating income	7,959	**13,872**	74.3
Operating margin	4.0%	**6.8%**	

* Figures were calculated using the method of deducting sales promotion expenses from net sales at the time sales are recorded.

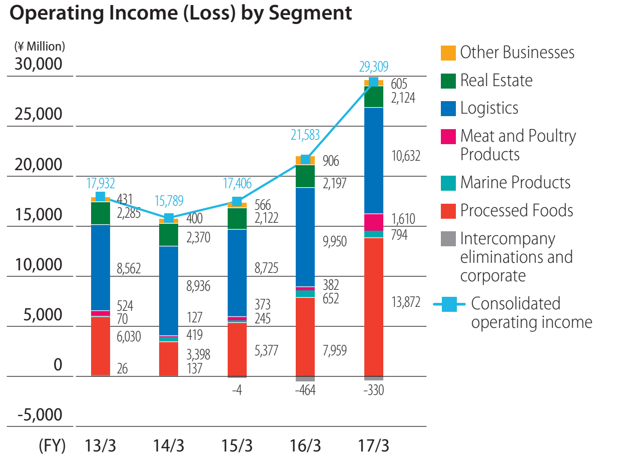
The business environment for the processed foods industry was marked by growing consumer inclination toward thrift, with firm for HMR products on account of greater diversity in food needs.

In this business environment, Nichirei strengthened product

Net Sales by Segment



Operating Income (Loss) by Segment



development and promotions for mainstay categories such as rice and processed chicken products, and increased the operating rate at company-owned plants. Sales of both household-use and commercial-use products expanded as a result, with net sales in the Processed Foods segment rising 2.9% from the previous fiscal year to ¥205,025 million. Operating income rose significantly, up 74.3% year on year to ¥13,872 million, due mainly to revenue gains, enhanced production efficiency, and lower food material and procurement costs.

(a) Prepared Frozen Foods (Household Use)

Net sales increased 11.6% from the previous fiscal year as a result of consumer campaigns, television commercials, and other promotional activities that boosted sales of rice-based products such as *Honkaku-itame Cha-han* (Authentic Fried Rice), *Renji de Fukkura Paratto Gomoku Cha-han* (Plump and Crispy in the Microwave Mixed Fried Rice), and *Yaki-onigiri* (Grilled Rice Ball). We also expanded our lineup of everyday foods for the family dinner table with the launch of *Tokusei Menchi-katsu* (Special Minced Meat Cutlet) and other items in the *Takumi-Okazu Series*.

(b) Prepared Frozen Foods (Commercial Use)

Net sales increased 3.0% year on year, the result of implementing product measures emphasizing profitability, along with a focus on product development and sales activities in response to steady growth in the HMR market, with greater sales volume for mainstay processed chicken products, and *Honkaku Chuka Guzai Kiwadatsu Paritto Harumaki* (Authentic Chinese Exceptional Ingredients Crispy Spring Rolls), developed as part of the "exceptional taste" concept.

(c) Processed Agricultural Products

Net sales increased 1.8% year on year, due mainly to greater demand for frozen vegetables following price hikes for fresh produce caused by inclement weather, with steady growth in business volume for broccoli, green beans and other products in the *Sono Mama Tsukaeru* (Just Thaw and Eat) series.

(d) Overseas (Jan.–Dec. 2016)

Nichirei's U.S. subsidiary InnovAsian Cuisine Enterprises expanded sales of frozen foods to the U.S. Asian foods market, but net sales overall declined 6.7% year on year, due mainly to the effect of foreign exchange conversion from the strong yen.

Marine Products, Meat and Poultry Products

Marine Products

(¥ Million)

	FY16/3	FY17/3	Change (%)
Net sales	¥ 68,794	**¥ 69,376**	0.8
Operating income	652	**794**	21.8
Operating margin	0.9%	**1.1%**	

In the marine products industry, procurement costs for marine products in general remained high amid declining fishery resources and firm demand overseas, while consumption in Japan continued to decline with the deep-seated inclination among consumers toward thrift regarding food.

Net sales in the Marine Products segment rose 0.8% from the previous fiscal year to ¥69,376 million, with operating income up 21.8% to ¥794 million. This was due mainly to growth in business volume for octopus and other products resulting from strengthened sales to the restaurant and HMR markets and efforts to secure stable earnings, along with improved profitability for shrimp following diversification in procurement sources.

Meat and Poultry Products

(¥ Million)

	FY16/3	FY17/3	Change (%)
Net sales	¥ 92,040	**¥ 88,128**	-4.3
Operating income	382	**1,610**	321.0
Operating margin	0.4%	**1.8%**	

In the livestock industry, consumer preference for domestic products led to continued robust demand, with markets prices rising steadily due to the short supply of domestic products, mainly poultry and beef.

Net sales in the Meat and Poultry Products segment declined 4.3% year on year to ¥88,128 million, due mainly to cautious buying and focus on sales in consideration of profitability. Operating income, however, rose 321.0% to ¥1,610 million, mainly owing to improved profitability for imported chicken, and growth in business volume for processed chicken products to the HMR market.

Logistics

(¥ Million)

	FY16/3	FY17/3	Change (%)
Net sales	¥ 184,869	**¥ 186,884**	1.1
Operating income	9,950	**10,632**	6.9
Operating margin	5.4%	**5.7%**	

In the cold chain logistics industry, storage demand remained firm mainly in urban waterfront districts due to an increase in import volume stemming from the strong yen, though personnel costs continued to rise amid the chronic labor shortage. In the transport industry, providers implemented such measures as shared delivery among companies in both similar and unrelated sectors.

In the Logistics segment, Nichirei concentrated on expanding cargo pickups by fully utilizing large-scale refrigerated warehouses in major metropolitan areas, and providing a comprehensive logistics service in regional areas combining storage and transport/delivery functions. Net sales increased 1.1% year on year to ¥186,884 million on the contribution from the new transfer center, with operating income up 6.9% to ¥10,632 million, due mainly to higher revenue in the domestic business and operational improvements, offsetting earnings decline in the overseas business owing to the effects of foreign exchange conversion.

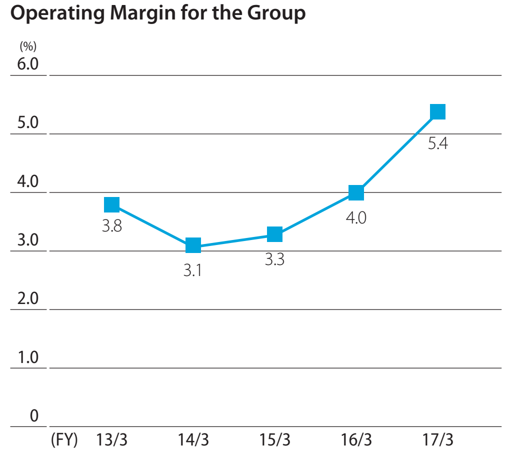
(a) Japan Business

Net sales in Japan rose 1.6% from the previous fiscal year to ¥150,657 million, due mainly to Nichirei steadily capturing robust storage demand mainly in the Kanto and Kansai regions, along with the contribution from new facilities in the transfer center business. Operating income increased 6.9% to ¥9,444 million amid increasing handling and transport/delivery costs, due mainly to measures for greater operational efficiency and receipts of appropriate fees.

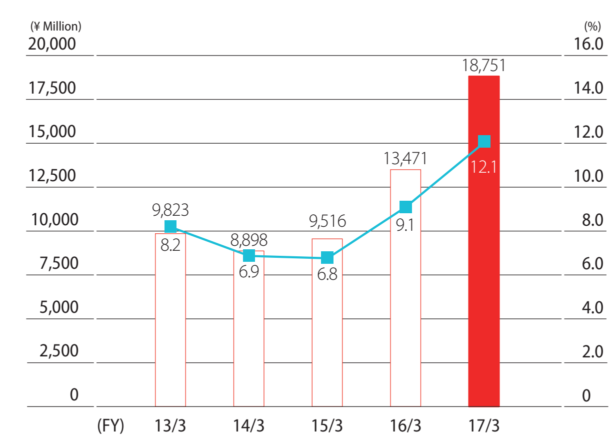
(b) Overseas Business

In Europe, Nichirei steadily captured transport demand including delivery services to retail outlets, and expanded cargo pickups for storage products such as dairy products, meat, and fruit juices. However, because of the effect of foreign exchange conversion from the weak euro and revisions to the customer makeup in Poland, net sales declined 5.5% year on year to ¥32,039 million, with operating income down 17.7% to ¥1,128 million.

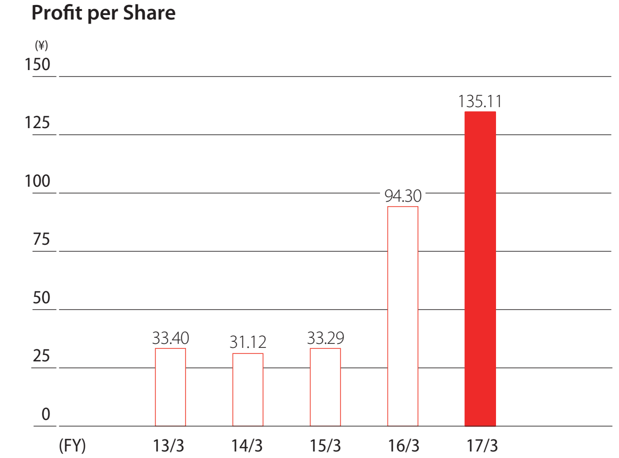
Operating Margin for the Group



Profit Attributable to Owners of Parent & ROE



Profit per Share



Note: The figure for 16/3 reflects the amount after the stock price consolidation conducted on October 1, 2016.

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Real Estate

(¥ Million)

	FY16/3	FY17/3	Change (%)
Net sales	¥ 4,643	**¥ 4,636**	-0.1
Operating income	2,197	**2,124**	-3.3
Operating margin	47.3%	**45.8%**	

Nichirei conducted renovation and seismic control improvement projects, and worked to strengthen competitiveness in leased office buildings. However, as a result of a temporary decline in the occupancy rate due to tenant turnover, net sales declined 0.1% year on year to ¥4,636 million, with operating income down 3.3% to ¥2,124 million.

Other Businesses

(¥ Million)

	FY16/3	FY17/3	Change (%)
Net sales	¥ 5,206	**¥ 4,485**	-13.8
Operating income	906	**605**	-33.2
Operating margin	17.4%	**13.5%**	

Nichirei's bioscience business recorded steady growth in sales for molecular diagnostic drugs, but sales of rapid diagnostic drugs and biomedicine raw materials were sluggish. As a result, net sales in the Other Businesses segment decreased 13.8% to ¥4,485 million, with operating income down 33.2% to ¥605 million.

Other Income and Expenses

The net value of other income and expenses in amounted to net expenses of ¥1,491 million, compared to net expenses of ¥982 million in the previous fiscal year. This was due mainly to increase the loss of the retirement benefit plan revised, and decrease the gain on sale of investment securities.

Profit before Income Taxes and Net Income

As a result of the aforementioned, profit before income taxes in the fiscal year ended March 2017 rose 35.0% from the previous fiscal year to ¥27,818 million. Profit attributable to owners of parent increased 39.2% to ¥18,751 million.

Profit per share increased to ¥135.11, up from ¥94.30 in the previous fiscal year. Of note, Nichirei implemented a 1-for-2 reverse stock split on October 1, 2016. Profit per share has been calculated assuming the subject reverse split was conducted at the start of the previous fiscal year.

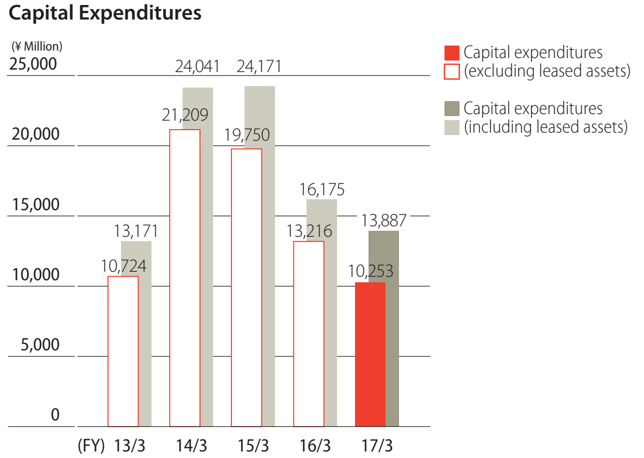
Capital Expenditures (Including Leased Assets)

Capital expenditures decreased 14.1% from the previous fiscal year to ¥13,887 million. Expenditures mainly comprised expanded production facilities in Thailand (Processed Foods), expansion of the sorting building at the Sendai Distribution Center in Miyagi Prefecture (Logistics), and expansion of processing facilities at the Kagoshima Soo Distribution Center in Kagoshima Prefecture (Logistics).

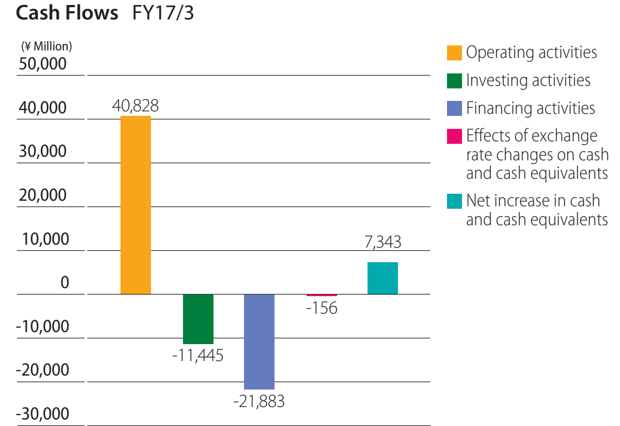
(¥ Million)

	FY16/3	FY17/3	Change (%)
Processed Foods	¥ 5,443	**¥ 4,022**	-26.1
Marine Products	244	**268**	9.8
Meat and Poultry Products	269	**188**	-30.1
Logistics	8,896	**7,590**	-14.7
Real Estate	500	**450**	-10.0
Other	183	**612**	234.4
Adjustments	638	**754**	18.2
Total	¥ 16,175	**¥ 13,887**	-14.1

Capital Expenditures



Cash Flows FY17/3



Liquidity and Capital Resources

Net cash provided by operating activities in the fiscal year ended March 2017 amounted to ¥40,828 million, an increase of ¥3,795 million from the previous fiscal year. This was due mainly to ¥29,105 million in profit before income taxes, and ¥16,057 million in depreciation and amortization, against working capital expenditures stemming from the increase in sales (notes and accounts receivable–trade, inventories, notes and accounts payable), and income taxes paid.

Net cash used in investing activities amounted to ¥11,445 million. This was due mainly to ¥8,963 million in expenditures for the purchase of property, plant and equipment.

Net cash used in financing activities amounted to ¥21,883 million, an increase of ¥1,531 million from the previous fiscal year. This was mainly due to a ¥4,601 million decrease in long-term loans payable, and ¥12,446 million in purchase of treasury stock and cash dividends paid.

Free cash flows amounted to ¥29,382 million, an increase of ¥6,847 million from the previous fiscal year.

As a result, the balance of cash and cash equivalents at the end of the year amounted to ¥20,512 million, an increase of ¥7,343 million from the previous fiscal year.

Balance Sheet

Total assets at the end of March 2017 amounted to ¥346,195 million, an increase of ¥7,697 million from the previous fiscal year.

Current assets totaled ¥146,273 million, an increase of ¥6,890 million from the previous fiscal year. This was due mainly to a temporary increase of ¥7,343 million in cash and cash equivalents stemming from the increase in free cash flow.

Non-current assets totaled ¥199,921 million, an increase of ¥807 million. This was due mainly to a ¥4,283 million decrease in property, plant and equipment to ¥145,129 million, stemming from depreciation of capital investments made from the previous fiscal year, and the effect of exchange rate fluctuations. Investments and other assets totaled ¥48,114 million, an increase of ¥5,045 million. This was due mainly to an increase in the market value of investment securities.

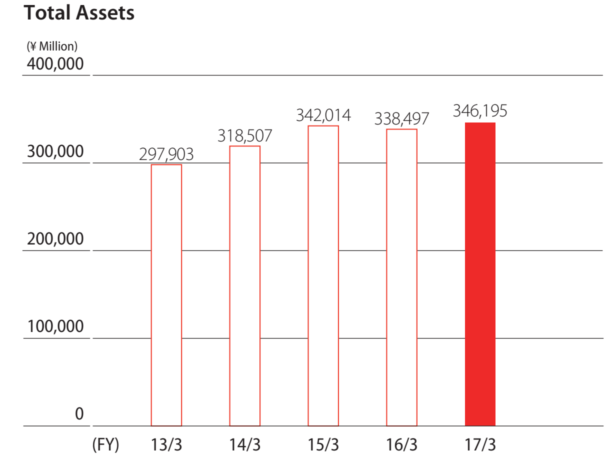
Total liabilities amounted to ¥181,447 million, a decrease of ¥1,526 million from the previous fiscal year. This was due mainly to a decline of ¥4,878 million in interest-bearing debt stemming from repayment of long-term loans payable, offsetting an increase of ¥3,384 million in accrued expenses.

Interest-bearing debt totaled ¥89,778 million, with the ratio of interest-bearing debt to cash flow at 2.2 years, an improvement of 0.4 years from the end of the previous fiscal year.

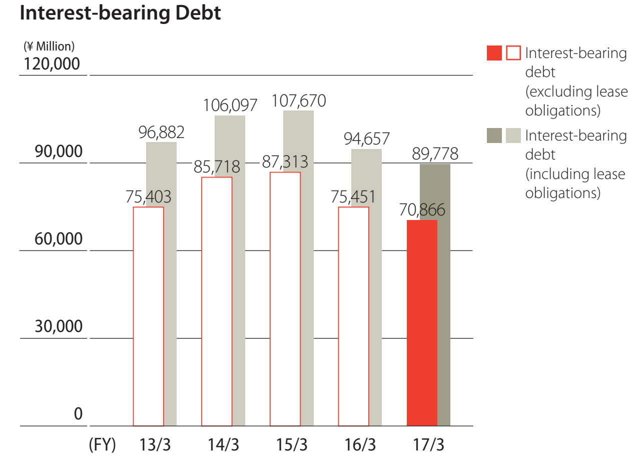
Total net assets amounted to ¥164,747 million, an increase of ¥9,223 million from the end of the previous fiscal year. Shareholders' equity* totaled ¥159,141 million, with an equity ratio of 46.0% of total assets, up 1.6 percentage points from the previous fiscal year. The debt-to-equity (D/E) ratio, excluding interest-bearing debt from shareholders' equity, was 0.6 times, same as the previous fiscal year. Calculated excluding lease obligations from interest-bearing debt, the D/E ratio was 0.4 times, down 0.1 points from the previous fiscal year.

*Shareholders' equity = net assets – non-controlling interests

Total Assets



Interest-bearing Debt



Significant Risk Factors Impacting Operating Results

Significant risk factors we can determine as of the end of March 2017 that could affect investors' investment decisions, of which some involve possible future developments, include the following:

(a) Food safety issues

One of our primary businesses is the importation of food products and materials from outside Japan. If safety or other issues arise in connection with imported food, such as avian flu, BSE, agricultural chemical residue or antibiotics, for example, the Nichirei Group could have difficulty procuring stable supplies of key products or materials needed for its Processed Foods, Marine Products, and/or Meat and Poultry Products business. In addition, if these problems lead to a reduction in the volume of food imports, then the volume placed into refrigerated warehouses in the Logistics business may decline. In these ways, the emergence of food safety problems could have a material impact on the Group's results.

(b) Fluctuations in prices of merchandise or materials, or in other costs

In the Marine Products business, we import our main products (e.g., shrimp, crab and octopus) from around the world. Prices of these products are affected by worldwide demand, harvest sizes, and other factors, while at the same time domestic market prices for marine products are affected by the amount of fish caught off the coasts of Japan and domestic demand, etc. In the Meat and Poultry Products business, market prices for both domestic and imported meat and poultry can become very volatile in reaction to events that dramatically affect supply and demand, such as import bans imposed in response to food safety issues or the imposition of emergency import restrictions ("safeguard measures"). In the Processed Foods business, in which we convert the materials mentioned previously as well as other materials into finished products, we work hard to improve production efficiency and to continually lower our cost of sales, but we are affected by fluctuations in crude oil and grain markets, and in the purchase prices of other materials. Thus, fluctuations in the prices of merchandise or materials, or in other costs, could have a significant impact on the Group's results.

(c) Product recalls

With the goal of earning customer trust in our products and services, the Nichirei Group has been working to establish a comprehensive quality assurance system that covers everything from product development and raw materials procurement to production and sales. With product safety and reliability as our highest priorities, we are establishing a solid trace-back system that allows us to track down the origin of raw materials and setting up a team of quality and production control specialists. Despite such precautions, a major product recall stemming from claims against our products could have a significant impact on the Group's results.

(d) Risks involving long-term assets

In the Logistics business, the Nichirei Group owns many refrigerated warehouses, which are different from ordinary warehouses and require substantial capital expenditures. The recent expansion of highway networks and increased pace of consolidation in the food-delivery business have made such facilities in certain areas less important to shippers and thereby made it more difficult to secure cargo. In addition, a slump in warehousing demand as shippers reduce inventory levels could lead to increased price competition and a consequent deterioration in our earnings. In the Processed Foods business, Nichirei owns production facilities in a number of areas and has been improving productivity and product quality in response to a challenging operating environment stemming from a slump in sales, the obsolescence of plants and equipment, and demand for higher product quality. The consolidation of unprofitable facilities and the disposal of fixed assets, as part of our efforts to use capital more efficiently in all our businesses, could have a significant impact on the Group's results.

(e) Securities price risk

We own securities issued by companies we do business with for strategic business purposes. We make changes to our securities holdings as needed, based on our business strategies, efforts to improve the quality of our assets, and other factors. All of the investment securities as of the end of current fiscal year are classified as available-for-sale securities. Losses associated with write-downs for impairments in their value could be incurred and affect the Group's results as a result of fluctuations in the values of those securities with market prices because of trends in the economic environment and corporate earnings, and in the values of those securities without market prices because of changes in the financial condition of the issuer.

(f) Exchange-rate risks

Insofar as one of our primary businesses is the importation of food products and materials from outside Japan, we face exchange-rate risks in our business transactions denominated in foreign currencies. To minimize these risks, we hedge by using currency exchange forward contracts, coupon swaps, and other types of derivatives. Nevertheless, exchange-rate fluctuations could have a significant impact on the Group's results.

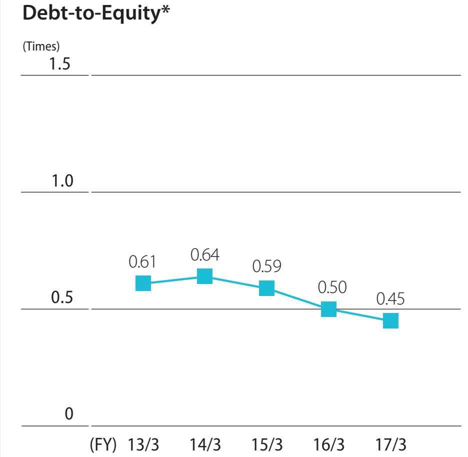
(g) Changes in laws and regulations

In carrying out its domestic operations, the Group is subject to the Food Sanitation Law, the Warehouse Business Law, and other laws and regulations. In addition, in carrying out its overseas operations, the Group is subject to the laws and regulations of those countries. If unexpected laws and regulations are newly enacted, the Group's financial results could be materially affected.

(h) Information system security

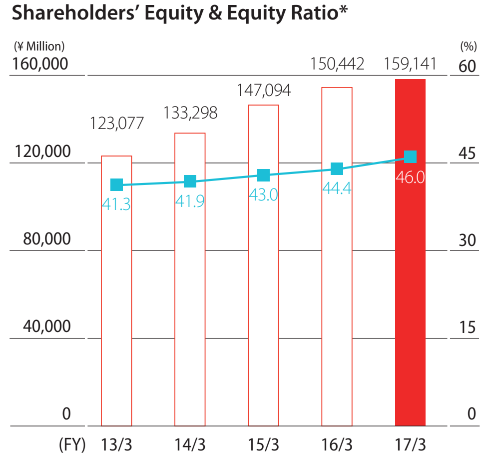
The Group has developed appropriate system management procedures, but the management of operations could be adversely affected if system problems arise. The Group takes comprehensive actions to defend against computer viruses and manage information, but if unforeseen virus attacks hinder the management of operations or unauthorized access by outsiders to confidential company data and personal information results in costs and/or a loss of public credibility, then the Group's financial results could be materially affected.

Debt-to-Equity*



*Calculated using interest-bearing debt excluding lease obligations

Shareholders' Equity & Equity Ratio*



*Shareholders' equity = net assets - non-controlling interests