Nichirei Corporation

President's Investor Meeting – Q&A Session

Date: June 10, 2022 (Friday)
Venue: Online format
Presenter: Kenya Okushi, Representative Director & President

General

Q. The current Medium-term Business Plan states that Nichirei will emphasize sustainability, and proactively make environment-related investments. How do you plan to link environmental action with enhancing enterprise value?

A. Measures for the environment and human rights is already one of the requirements for conducting business with foreign-affiliated customers. We anticipate a similar trend to emerge among other customers in the near future, and are making investments in preparation. There is also a possibility that Nichirei will be indirectly affected in a number of ways in terms of food material procurement. Nichirei has relied on overseas suppliers for much of its food material, which has provided cost benefits and other types of competitive advantage. However, because of the risk that we will no longer be able to maintain stable procurement, we are responding by rebuilding the supply chain.

Q. What is your method for utilizing return on invested capital (ROIC)? Is ROIC managed only at the managerial level, or subdivided more finely by employee?

A. ROIC is utilized not only at the management level, but also applied to each worksite. To achieve our target of ROIC of 9% or higher by 2030, we have set target figures for ROIC by business segment. We then use backcasting to set target figures for each business in the current business plan, and monitor the progress on a quarterly basis.

Q. Regarding the management of ROIC, do you adjust capital cost by business segment to achieve tight control? Also, when target figures are not reached, what sorts of determinations are possible?

A. We first determine the weighted average cost of capital (WACC) by business, then set a target ROIC for each business company. When the figures cannot be significantly improved within the business plan target ROIC, and there is no prospect for improvement going forward, management discusses the situation, including business continuity, and considers it as one of the determining factors for decision making.

Q. Regarding how best to view the balance between top-line growth and capital investment, you've explained that the current business plan is the peak for capital investment, and that around 70 to 100 billion yen in capital investment will be required in the next business plan. Because of the nature of your company's business, there is a tendency to prioritize capital investment when seeking top-line growth. How do you plan to improve ROIC while balancing these factors?

A. In terms of Temperature-controlled Logistics, adequate capital is required to build refrigerated warehouses. We have achieved steady growth up to now while making capital investments within the scope of depreciation cost. However, since the industry is expected to undergo significant structural changes when new work regulations come into effect in 2024, we decided to sharply increase warehouse capacity at a stretch with the aim of top-line growth. At the same time, the assets in which we invested up to now over the long term have depreciated considerably, so even with such large-scale investments, profitability will not suffer.

In Processed Foods, we secure capital efficiency by producing high-margin products at our inhouse centers. Going forward, from the standpoint of sustainability, we will need to switch to a trusted supply chain. We plan to implement price revisions during the current fiscal year to regain profitability, and transition to such changes.

Q. How do you feel about your company's share price and evaluation in the market?

A. We think that there are three main factors behind the recent slump in our share price. The first is operating profit in the previous fiscal year. Even after revising our forecast downward, the final figure was well short of the business plan. The second is that while the share prices of companies with a high proportion of overseas sales have remained firm, in the case of Nichirei, that result has not been fully expressed numerically. The third we feel is our failure to sufficiently explain our growth strategies for the mainstay Processed Foods and Temperature-controlled Logistics businesses.

In response to these issues, as per the current medium-term business plan, we will post positive business results, expand sales overseas, work to create new value, enhance earnings, and lower capital costs. In addition, we will pursue sustainability management to strengthen our business foundation. We will also further enhance our IR program, and provide more thorough explanations to stakeholders.

<u>**Processed Foods**</u>

Q. What is your thinking behind aiming for an operating margin of 8% in the future?

A. We expect the frozen food market in Japan to continue to grow. Nevertheless, while sales have been positive, this has seriously disrupted our profit structure. Restoring the profit structure to its original state is a priority matter, and we are steadily implementing price revisions. In addition to this, we plan to secure earnings through growth categories, as well as new categories.

Q. The yen has continued to weaken recently, bringing the risk of further expansion in material costs. Is it fair to assume that the plan to absorb these costs with price revisions has been successful? Also, in the next fiscal year, will the effects from price hikes fully contribute to earnings, leading to an improvement in profitability?

A. The price revisions implemented in the previous fiscal year have steadily gone into effect recently, and are producing results. At the same time, since March this year the yen has weakened sharply, and remains below the level of 130 yen to the U.S. dollar. As such, since our initial forecasts were based on an assumed exchange rate of 122 yen to the dollar, the additional cost will be around 3 to 4 billion yen. As we mentioned during the results presentation in May, we are holding discussions with clients aimed at price revisions in August (for household-use products) and September (for commercial-use products) to incorporate the effects of this cost increase. Of note, we expect that the negative effects of higher costs will appear first during the first half, but from the second half, the positive effects from price revisions will emerge, leading to a restoration in earnings. During the next fiscal year, even if the exchange rate remains at a similar level, the risk will evaporate.

Q. Nichirei's determination to implement price revisions is clear, but at the same time, it seems prudent to also consider the risk of falling short of operating profit targets.

A. Prices are rising not only for frozen food, but consumer goods in general, including other food items. Considering the good taste and convenience of frozen food, we expect customers will accept a certain degree of price increase.

Q. For the next medium-term business plan, what are your thoughts regarding factors that draw a line between differentiation from the competition, and competitive advantage?

A. Up to now, Nichirei has separated categories such as rice products and processed chicken products according to the food material. Recently, however, products more like regular meals have emerged.

Major companies have begun to take small steps into the market, and while there are needs from elderly care facilities and other institutions for meals rather than individual items, very few companies are able to meet this demand. Nichirei has begun to pursue measures in this area, but it requires equipment that is adaptable rather than for mass production, so we plan to shift our approach to investment. Also, because Nichirei has a lineup of food material that includes vegetables, rice, meat, and fish, and more developed sales channels than its competitors, we believe this gives us an advantage in being able to work with customers on a broad range of measures.

Q. Does Nichirei have any strategies for reducing volatility and improving profitability at its subsidiary in Thailand?

A. GFPT Nichirei (Thailand) produces processed chicken products mainly for the Japanese market. Operations declined in the previous fiscal year due to the difficulty of securing workers as a result of covid-19, with a considerable deterioration in profitability. Operations up to now have been labor-intensive, but we plan to introduce greater automation to reduce volatility. Since pricing for the Japanese market is difficult, we plan to increase exports to Europe and China, where the interrelation between economic trends and product prices is comparatively strong.

<u>Temperature-controlled Logistics</u>

Q. How does Nichirei plan to leverage its competitive advantage in the logistics industry when new work regulations come into effect in 2024?

A. Regulations on working hours will formally be applied to truck drivers from fiscal 2024. The Work Style Reform Act went into effect for a wide range of industries in 2019, and following a six-year grace period, restrictions will now be legally applied. The background to these changes is that working conditions for drivers in the transport industry have been far from positive, and this has become a major social issue. Nichirei plans to make large-scale investments in response to these changes. Improving the working environment for drivers is the primary consideration, and there are some competing companies that will be unable to adapt. Nichirei will have the upper hand in terms of acquiring the logistics business that will become available, as well as with pricing that other companies are unable to match, which we believe we can leverage into earnings.

Q. Considering the advantage of conducting business both overseas and in Japan, is there any potential for crossover, such as adopting successful examples from overseas in Japan, or implementing success stories from Japan overseas?

A. Overseas, there are many companies that earn profit by providing a single function, such as storage or transport. Nichirei was also such a company in Japan at one time, but as customer needs for cohesive services increased, and we found that we could expect appropriate fees for meeting those needs, Nichirei shifted its course in that direction. Similar demand exists in Europe and Asia, so we plan to utilize the expertise we have acquired in Japan. At the same time, in overseas markets, particularly Europe, Nichirei is responding to demands for sustainability, an area in which many countries are ahead of Japan. We have acquired various types of knowledge in this field, and are able to bring that knowledge back and apply it in Japan.

Q. What is the status of Nichirei's efforts for an asset-light business model?

A. Currently, within the framework of a logistics platform for frozen foods, Nichirei is taking the lead to coordinate an optimal logistics function, working to efficiently deliver goods to customers. Compared to other companies, Nichirei has many logistics centers, and has built a transport and delivery network that serves as a base for its business. Nichirei only builds the framework and handles the coordination, and in some cases utilizes the assets of other companies, partially or in whole. Since the company's facilities will be candidates for scrap-and-build programs in the future, we plan to carefully consider if holding on to those properties as company assets is the best option.

Q. Nichirei is forecasting the negative impact from higher electricity costs to be 700 million yen in the current term. Is this the net amount after the offset from price revisions?

A. That is correct. Since oil prices remain high, we will continue to carefully observe future trends and respond accordingly.

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