Business Briefing September 2023 Q&A

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[Speakers]	
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<Q1>

According to slide 8 of the presentation materials, Wellness Ecosystem has a wide variety of different business clusters across various areas. For example, healthcare, animal solutions, and seeds are areas with high growth rates, but also high valuations. Please tell me about your approach here and also which areas you are prioritizing when it comes to allocating management resources for the creation of Wellness Ecosystem?

<Nakai>

Wellness Ecosystem may seem like a broad and generalized area, but each business unit focuses on the areas that it wants to develop as business clusters. Here we are highlighting the animal protein, agrochemicals, food services, and wellness business clusters, and how these areas form Wellness Ecosystem in the broader sense. The concept is to have a clear target, like with shrimp and chicken in the animal protein business cluster, and to own other businesses - in this case feed and animal health, and to own these businesses to our advantage to further add value to our core businesses. Rather than investing in and competing with major players in their respective industries, such as in seeds and animal solutions, the basic idea is to acquire businesses that contribute to the formation of our business clusters and use these businesses to our advantage. In order to avoid paying high prices for these acquisitions, we will make sure the economics of each deal makes sense when we look at each individual opportunity.

As for animal health, we acquired Sumitomo Pharma Animal Health (now Bussan Animal Health) and Ouro Fino Saúde Animal in Brazil. As we expand our presence in this space, providing the valuation is right, we would like to continue to do more deals like this in the future.

Regarding the allocation of management resources, we will allocate by defining focus areas for each business unit to realize the quantitative targets shown on slide 15, and we will accumulate invested capital and keep capital efficiency in mind. I feel that attention paid to management resources allocation and capital efficiency is higher now than it has been in the past.

<Q2>

Regarding the quantitative aspect, you explained that of the 170 billion yen increase in base profit as stated in the Medium-term Management Plan, the contribution from Wellness Ecosystem Creation, which is one of the Key Strategic Initiatives, is to be more than 30 billion yen, of which 20 billion yen will come from new investments. In today's presentation, it is stated that the animal protein business cluster will contribute more than 17 billion yen and that the food service business cluster and wellness business cluster will contribute more than 13 billion yen. Is my understanding correct that the “more than 30 billion yen” stated in the Medium-term Management Plan is a breakdown of these two business clusters? Also, please tell us the level of invested capital in FY March 2023 and FY March 2026 required to generate this profit.

<Nakai>

We prepared the figures in this document with the figures announced in the Medium-term Management Plan in mind. The Wellness Ecosystem is not simply the sum of the Nutrition & Agriculture Business Unit (within the Chemicals segment) and the three business units within the Lifestyle segment, but also include, for example, the drug discovery business utilizing DX and AI in the IT & Communication Business Unit, and investment in drug discovery ventures in the Corporate Development Business Unit. We are engaged in businesses related to wellness, which is a huge area in itself, and we will leverage our strengths here to achieve and further improve our quantitative targets.

Regarding the level of invested capital, we disclosed in Integrated Report 2023 that invested capital in the animal protein business cluster will increase from 240 billion yen in FY March 2023 to 380 billion yen in FY March 2026, but we have not disclosed details of invested capital outside the animal protein business cluster.

<Q3>

Management have spoken on how they have high expectations for Aim Services. Please tell us in detail what you think about Aim Services, such as areas of strength, future growth strategy, and how it differs from its competitors.

<Nakai>

Aim Services was a 50/50 joint venture with Aramark since the 1970s, and cooperation between management and shareholders were good. However, it is true that there were different views on corporate management methodologies, for example, Aramark favored extracting dividends, while for us, we wanted to reinvest in growth. The purpose of acquiring additional shares was to speed up the implementation of our company’s strategy and lead to further growth by making Aim Services a wholly owned subsidiary in April this year.

In terms of improving corporate value and growth strategy, the first thing for us to do is improve efficiency and productivity through digital transformation (DX) of on-site operations and management. Aim Services still hasn’t digitized many parts of its operations, and DX has not progressed in on-site operations, so we believe that there is a lot of room for efficiency improvements through DX and associated cost reductions. Even if DX related costs are incurred upfront, this will lead to medium- to long-term cost reductions, stronger competitiveness, and higher margins. The second point is to improve profitability by increasing the topline. Regardless of our industry, raw material prices, fuel and labor costs are currently rising, and we are in a situation where we need to revise prices for our customers. Aim Services has been negotiating prices with client companies for about a year, and these efforts have recently begun to bear fruit. The third point is the growth scenario. Our involvement will lead to medium- to long-term growth that requires initial investment, such as promoting overseas expansion and having a central kitchen in Japan, combining several offices, and becoming more cost competitive, so we will be taking action here. We have made the company a fully owned subsidiary with the aim of improving margins, improving profitability through cost improvements primarily in SG&A, and realizing sales growth by implementing various growth strategies. The results are steadily coming out, so I hope you'll look forward to next fiscal year’s results.

<Q4>

I estimate that the invested capital in Wellness Ecosystem Creation will be about 2 trillion yen. I have the impression that in this area, there is a concentration of businesses with low IRR, but in spite of that, I feel that for FY March 2023, ROIC of 5% which includes one-time gains is low. You have talked about the businesses that you will focus on, but conversely, is there any room to raise ROIC by cutting problematic businesses? Also, please tell us whether some businesses with low profitability are dragging things down, or whether low profitability is spread evenly across the board.

<Nakai>

In Wellness Ecosystem Creation, we will increase ROIC from an average of 3% to over 5% during the Medium-term Management Plan. 5% may seem low, but this is just the target for now as we look to continue to increase ROIC.

In order to increase ROIC, we are progressing with the asset recycling of businesses with low profitability across the company. In Wellness Ecosystem, our policy is to raise the ROIC of the entire portfolio by recycling businesses with low profitability while incorporating new assets with high ROIC, such as the animal protein businesses, and we are thoroughly implementing this policy within each business unit. Although we do not disclose the percentage of low profitability businesses, the situation differs from business unit to business unit. As a general rule, if a business unit has a lot of small investments with low profitability, the business unit Chief Operating Officer will reduce the number of those businesses this year or next year, so the percentage of low profitability businesses will decrease throughout the company as well.

<Q5>

Wellness Ecosystem Creation is a broad area and it is difficult to see what business model development is central to it. Volatility was a topic of discussion at the recent briefing on the shrimp business in Ecuador. Some businesses are linked to market conditions, such as upstream feed ingredients and animal protein, while others are downstream businesses, such as Aim Services, and others are developed by owning a platform such as IHH and linking adjacent businesses to them. Which business models have which strengths where are you trying to grow, and what is the direction regarding this?

<Nakai>

This is a very difficult question to answer and please forgive me for explaining in broad terms.
Regarding food, the key point is that by connecting upstream protein and feed which corresponds to that, we are earning revenue at different parts of the value chain, while hedging the volatility of each individual business. For example, the animal protein value chain leads to food, which in turn leads further to downstream. Even if the products are not directly connected, we manage risk by holding each business area under a bird's eye view.
In addition, each business area has a different way of getting into business. Aim Services has been in business since the 1970s and we have increased our influence by increasing our equity in the company. For healthcare, although our presence is significant today, we invested in IHH because we had to take a big step when we first entered the market. As the Key Strategic Initiatives and origins of each business are different, it is not possible to determine a specific business model, but on the other hand, we believe that this kind of flexible development is indeed the business model of a trading company. In the future, we may be involved in businesses that we do not currently envisage, but the area we are targeting is the formation of business clusters in Wellness Ecosystem, which I explained today, and we would like to take steps from this perspective.

<Q6>

I am aware that IHH has made a solid start to the current financial year. On the other hand, since they have announced an aggressive growth strategy, please explain the progress of that growth strategy in terms of whether they are meeting the milestones.

<Nakai>

IHH is a publicly listed company, so I will refrain from explaining individual businesses from our perspective, but it has been delivering solid results. The performance of the core business has been solid, with a recovery in medical tourism post-COVID, plus local patients have been returning to the hospital. We are also implementing straightforward growth measures, such as implementing the recycling of non-core assets, including the sale of the medical college in Malaysia, and increasing the number of patients by adding more beds in each region. It is difficult to mention the future performance of IHH, but we are very excited about IHH's earnings ability.

<Q7>

With regard to prevention, there have been developments over the past few years, such as Welltus and the acquisition of Hokendohjinsha, which I believe were also emphasized in an IR presentation, but I have the impression that there have been no core business developments or meaningfully positive results from a quantitative perspective. Where do you see the core of your business with regard to prevention in the future, and what quantitative targets do you have in mind?

<Nakai>

Prevention has been our target area for several years. First, we invested in the American supplement company Thorne HealthTech, got it listed in the US, and then expanded its business into Asia. Thorne HealthTech entered the market as an evidence-based supplement manufacturer for prevention, and later we sold our shares in the company in a sale that is expected to generate a sizeable capital gain. In the course of Thorne's expansion in Asia, we invested in a traditional Chinese medicine business called Eu Yan Sang. In Asian countries, people are more familiar with traditional Chinese medicine than supplements, and the same concept of an evidence-based prevention business is now being used to expand Eu Yan Sang's business. Thorne became profitable, and we intend to expand Eu Yan Sang further in the future.

In addition to traditional Chinese medicine and supplements, Aim Services also aims to provide value-added food to nursing homes and hospitals and to supply food that contributes to good health, thereby targeting prevention. As the boundary between prevention, hospitals, and food services is becoming blurred, we will grow our businesses as we are doing with those mentioned above. We intend to select the pipeline in the field of prevention after Aim Services and Eu Yan Sang, while keeping an eye on valuation and profitability.

<Q8>

Please let me confirm the path to increasing ROIC from 3% to 5%. Could you explain the quantitative assumptions behind the plan, whether your intention is to increase the proportion of high ROIC projects in the portfolio, as was the case with the recent shrimp farming project in Ecuador, or to reduce the number of low profitability projects in the portfolio through exits.

<Nakai>

In order to improve ROIC, we explained today that, in addition to continuously improving the profitability of existing projects, we will increase the number of profitable new projects and reduce low profitability businesses. In the areas of food and retail, in addition to improving profitability, which is the numerator component in the ROIC calculation, we are also working on reducing invested capital, which is the denominator component. The logistics and trading business is also a pillar of earnings for these business units, which requires a large amount of working capital. In the Medium-term Management Plan presentation material, it is stated that the Lifestyle segment will reduce its invested capital by approximately 100 billion yen, which will also be achieved by reducing its working capital. For example, our share of coffee bean imports to Japan is approximately 40%, and in order to maintain this share and respond to customer needs, we need to provide services by holding inventories at various locations, but we have already reduced these inventories to a considerable extent and are conducting our logistics business with an awareness of improving ROIC. We are basing today's explanation on our confidence that we can achieve a 2 percentage point improvement in ROIC, including through asset recycling and reduction of working capital in the logistics and trading business.

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