Consolidated Financial Results Briefing for the FY2021/Main Questions and Answers

【Date】 13:30～14:30, May 13, 2021

【Format】 Zoom webinar

【Speakers】Kaoru Tanigawa, President
Yoshiya Miyabe, Senior Managing Executive Officer
Tetsuro Tsutano, Senior Executive Officer, Chief Officer, Finance, Accounting

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【Progress and future direction of business investment and revenue】

Q. You say you will increase profit attributable to owners of parent from 15 billion yen to 20 billion yen, a rise of 5 billion yen, over the remaining three years of the medium-term vision. Which segments do you expect will contribute the most to this profit growth out of Electronics & Devices, Foods, Meat & Grain, Steel, Materials & Plant, and Motor Vehicles & Aerospace?

A. Firstly, we expect revenue will recover to 15 billion yen this fiscal year because we anticipate recovery in areas that were affected by COVID-19 in the previous fiscal year such as the meat products business, food business, oil field tubing business, and motor vehicles business. We also think that our strength in areas such as DX and ICT solutions will contribute to revenue growth. Especially in the Electronics & Devices segment, growth areas we will focus in over the coming three years are the ICT solutions business in the sense of supporting DX, as well as the mobile business, where we will provide solutions associated with the rollout of 5G, and business related to semiconductors, which will become increasingly advanced. In the medium and long term, we plan to use the features of Electronics & Devices to digitally transform our distribution and other businesses, spreading the benefits of DX to all businesses across the Kanematsu Group and we intend to support the DX initiatives of our customers and business partners.

Q. You lowered your target for profit attributable to owners of parent from 25 billion yen to 20 billion yen. I would like to know what your original projections for organic growth and growth attributable to M&A were, what they are now and whether changes in these projections led you to lower the target to 20 billion yen? I recognize that Kanematsu is financially disciplined and its investment criteria are also stringent but I would like to hear your assessment, including these points.

A. Our initial target for profit attributable to owners of parent of 25 billion yen was based on the broad assumption of a 50/50 split between growth in existing businesses and growth driven by investment business. However, as things turned out, we struggled in a number of our existing businesses largely due to the effects of COVID-19. Investment activities were also affected by COVID-19, giving rise to deals where valuation was difficult or where valuation was lower and the counterparty withdrew. Some deals ground to a halt as soon as the COVID-19 pandemic started. We also make it a rule to invest appropriately and, partly because our bids tended to be high before COVID-19, in some cases we tendered a bid in accordance with our internal investment criteria and, as a result, a competitor won the bid and we lost the order. Achievement of profit attributable to owners of parent of 20 billion yen in 3 years also assumes a 50/50 split between organic growth and growth attributable to M&A and, on the investment side of things, the target takes into account return from investments that are already on the horizon.

Q. Explain both in qualitative terms and in quantitative terms, from the perspective of contribution to profit, those investments that have actually led to revenue and those investments that can be expected to reap rewards in the future, among the new business investments of 23 billion yen made during the first three years of the Medium-term Vision.

A. Page 19 and 20 of the briefing materials show the investments that have already been made and, among these, a key investment that contributed to revenue was an investment in the Electronics & Devices segment to make a card printer business company a wholly owned subsidiary. This investment contributed to revenue considerably from the first fiscal year. In the Foods, Meat & Grain segment, investment in a a processed food manufacturing company added value to our business and contributed to revenue. In the Steel, Materials & Plant segment, the acquisition of manufacturers specializing in metal sashesand an equity-method investment in a steel plate processing company contributed to revenue. Looking ahead, investments related to semiconductors are expected to give a big boost to revenue. The semiconductor market is currently hot and we believe that business investments in our areas of strength will significantly contribute to improvement in revenue. Meanwhile, in the meat products business, our market share will also increase as a result of integration of upstream processes such as primary processing and our profit margins will also improve. Furthermore, in the long term, we expect that areas such as plant-based meat and data distribution and business related to drive recorders which are essential for safety will contribute massively to revenue.

In quantitative terms, the investments of 23 billion yen made during the first three years include both acquisitions of companies and acquisitions of fixed assets. In a number of instances, we provided financing to the acquired companies, and the so-called business investment itself amounted to around 16 billion yen. The profit after tax on this investment bolstered profit by around 1.4 billion yen.

Q. The first three years of the Medium-term Vision are over and the environment surrounding general trading companies has also changed in various ways. Describe once again the company you aim to be and your vision for the company.

A. Basically, the priority initiatives set out at the time of formulation of "future 135" remain unchanged but we newly added "Pursue DX on a groupwide basis" and "Promote investments in business areas on the themes of environment, society, and safety, for achievement of the SDGs." These two themes are priority initiatives for the coming three years and represent the company we aim to be.

Take DX initiatives for example, our parent firm and our more than 100 group companies conduct business on a daily business in a wide range of fields and we believe that the knowledge and experience gained through this as well as our networks of customers and business partners are valuable assets. These assets can also be described as data. We are confident that we can use this data and digital technologies to predict the needs of customers and society and provide services accordingly and that by transforming our business model, we can increase our competitiveness. During the first three years of "future 135," we made progress establishing the infrastructure and resources needed to push ahead with DX and we believe that the last three years represent the phase when we will use this infrastructure and achieve DX on a groupwide basis.

As for our SDG initiatives, these are activities that are an extension of previous initiatives. For instance, our oilfield tubing business in the United States is currently being transformed into business for pipelines for EOR needed for the underground storage of CO_2. Meanwhile, investments such as the investment in a plant-based meat company made by our Foods, Meat & Grain team will contribute to sustainability. Through continued activities such as these to promote DX and achieve the SDGs, we will aim to remain fresh and relevant and keep improving our corporate value.

【Individual businesses】

Q. Kanematsu has a strong focus on DX compared with other trading companies and I think this could translate into all kinds of related business especially for Kanematsu Electronics. Where do you think the strengths of Kanematsu Electronics lie as a subsidiary of a trading company compared to specialist system integrators?

A. As you can see from our revenue structure, the Kanematsu Group is strong in the DX field, which used to be called the electronics industry. As for the differences between us and specialist system integrators so-to-speak, I think we have the huge advantage of being able to access and approach all kinds of industries because we are a trading company. I think there may be potential to increase revenue related to DX by diversifying into and leveraging areas that have been particularly slow to embrace DX such as agriculture.

Q. How have the cheap plans and other online products introduced by major carriers affected the mobile devices sales business? Describe the relationship between carriers and distributors and other aspects between them such as the division of business and communication.

A. Our Group company Kanematsu Communications operates stores nationwide as a mobile phone distributor. In the future, we estimate that online sales will probably account for around 20% of total mobile phone sales and we expect that in-store retail sales of mobile phones will also drop by 20% accordingly. However, distributors are exploring new businesses that take advantage of their stores across Japan and carriers are also supporting them in this. Meanwhile, as 5G becomes more widespread, Kanematsu Communications is seeing an increase in proposals of solutions using mobile phones in its corporate operations and we are confident that this will lead to the creation of new business and the creation of value. It communicates effectively with carriers and implements various initiatives as a distributor based on an understanding of carrier strategies.

Q. I assume that the transactions with government agencies in the Motor Vehicles & Aerospace segment are steady business and yet for the fiscal year ending March 31, 2022, you forecast year-on-year declines in both operating profit and profit attributable to owners of parent. Describe the status and future outlook of the business.

A. This fiscal year will be a slack period for contracts and, with business with government agencies playing a large part, we project lower profit. This business is influenced by government budgets and this fiscal year it just so happened that there was no budget for business related to our Group. We have some idea of the budget after this fiscal year and believe that this slump will be limited to this fiscal year only and that stable revenue can be expected from next fiscal year onwards.

【Views on balance sheet, cash flows and shareholder returns】

Q. Am I right in understanding that your medium-term targets of a payout ratio of 30~35% and profit attributable to owners of parent of 20 billion yen are an indication of your intention to increase the amount of dividends during the Medium-term Vision from the current level of 60 yen to around 80 yen?

A. Since our target payout ratio is 30-35%, if net profit attributable to owners of parent increases, the amount of dividend itself will also approach 80 yen as a result. We believe that increasing profit attributable to owners of parent and returning profit to shareholders is an important theme.

Q. During the first three years of the Medium-term Vision, finances improved partly because strict financial discipline and investment criteria caused investments to be postponed. How will you approach the balance sheet, including the net debt-to-equity ratio, returns and free cash flow moving forward?

A. As shown on page 18 of the briefing materials, our balance sheet has improved considerably and the equity ratio reached 25.8%. Our net debt-equity ratio is 0.3 times whilst other trading companies have ratios of 0.6~1.0 times, and if anything, we have an extremely low level of debt.

Over the coming three years, cash flow produced by operating activities will be around 15~20 billion yen a year and we therefore plan to make investments within this range but even if our investments exceed this range, there will be no problem with our finances. In terms of financial soundness, we have no plans to increase the equity ratio any further or reduce the net debt-to-equity ratio any further and we believe we have reached the stage where we will focus on increasing ROE, as an indicator of efficiency, to the target level of 10~12% whilst increasing the net debt-to-equity ratio slightly from its current level. We plan to draw on our assets more for investment, without reducing the net debt-to-equity any further in the future.

Q. If you achieve your target for net profit attributable to owners of parent of 20 billion yen, ROE will be slightly above 10%, but assuming investment did not progress as planned, you could use the leftover cash to purchase your own shares and aim for ROE at the higher end of the 10~12% range. Is this an option?

A. If investment did not progress as planned, we would divert the funds to shareholder returns. However, our aim is to achieve the "future 135" target for profit attributable to owners of parent of 20 billion yen and to make investments whilst balancing our finances and our intention at the present time is, therefore, to push ahead with business activities for achievement of these goals.

【Governance (parent-subsidiary listings)】

Q. I understand that your increased equity interests in Kanematsu Sustech and Kanematsu Electronics, both of which are listed companies, are huge in terms of contribution to profit attributable to owners of parent. At the same time, given the harsh criticism of listed subsidiaries from the viewpoint of governance, I would like you to reaffirm Kanematsu's stance.

A. I cannot discuss this in detail due to considerations such as insider information but I am aware that revisions to the Corporate Governance Code are planned and governance requirements in the case of parent-subsidiary listings will also become stricter. We see this as a matter of great interest for management and are currently in the process of considering various options.

【Development of young employees】

Q. Looking at the recruitment page on the Kanematsu website, I feel that Kanematsu is a company where young employees apply new ways of thinking to business. What is management's approach to the development of young employees including the delegation of work to young employees and the fresh ideas that young employees come up with?

A. Under our Kanematsu University training program, we train young employees throughout their first 10 years with us, teaching them the basics of management and business. I feel that by about their 10th year they have grown into very effective workers. We have also embarked on a process whereby I as President listen to presentations of proposals made by young employees and decide whether or not to move forward with them. The data distribution project, for example, is a project which was proposed by a young employee who had been with us around five years at the time. We actively take up projects proposed by young employees and develop them into businesses.