Message from the Director in Charge of Finance

Supporting the New Medium-Term Management Plan 2025 through financial policy and optimal resource allocation to increase corporate value

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Reviewing the first year of the MTP 2025

Net sales and profits decreased in FY2023

In FY2023, the yen weakened due to expectations of long-term monetary tightening in the U.S. and Europe, while crude oil prices continued to rise amid the worsening tension in the Middle East. Meanwhile, price competition for commodity chemical products in the Japanese and Asian markets intensified more than expected due to sluggish domestic demand in China and an oversupply of Chinese products. In the automobile industry, it took time to clear excess inventory within the supply chain, and production slowed in 4Q due to quality compliance issues. As a result, we faced an extremely tough business environment.

Net sales and profits for FY2023 fell far short of the initial plan. Specifically, net sales were 159.5 billion yen (a decrease of 8.8% year on year), operating profit was 4.88 billion yen (a decrease of 39.8% year on year) due to a rise in depreciation costs associated with the operation of a new core system, ordinary profit was 8.18 billion yen (a decrease of 17.5% year on year), and profit attributable to owners of parent recorded a loss of 8.5 billion yen (a profit of 5.68 billion yen in the previous fiscal year) due to an extraordinary loss of 12 billion yen associated with business structural reforms.

Extraordinary loss related to withdrawal from the superabsorbent polymer business (SAP business)

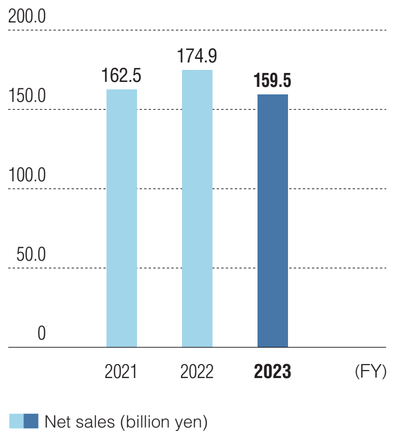
On March 25, 2024, we announced that, as part of the structural reforms set out in the MTP 2025, we would withdraw from the superabsorbent polymer business (SAP business) and the surfactant and other chemical production business in China. We are now in negotiations to transfer all of our equity interests in San-Dia Polymers (Nantong) Co., Ltd., and are in the process of dissolving three companies: SDP Global Co., Ltd., SDP GLOBAL (MALAYSIA) SDN. BHD., and Sanyo Kasei (Nantong) Co., Ltd.

We estimated an extraordinary loss of up to 20 billion yen as costs associated with these structural reforms, of which 12 billion yen was recorded for FY2023. However, the impact of this loss on our financial base was limited. Structural reform costs expected to incur in FY2024 have been factored into our earnings forecasts, and we intend to settle all structural reform costs as far as possible during FY2024.

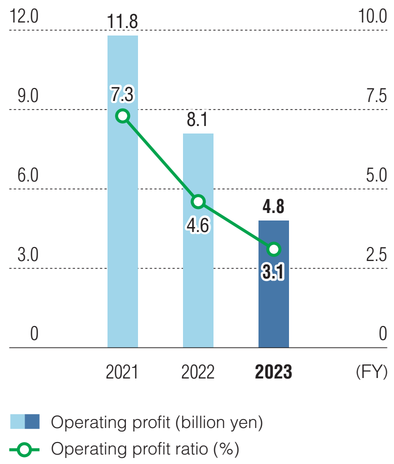
Free cash flow increased

Although the FY2023 financial results showed a large net loss, the impact on cash flow was minimal since a large portion of the loss was covered by reserves. Free cash flow for FY2023 increased significantly to 13.55 billion yen (an increase of 0.67 billion yen in the previous fiscal year). This is because, under Monozukuri Transformation which began in FY2023, we have worked more actively to decrease our working capital and improve our production site efficiency through inventory reduction, which has begun to show effects.

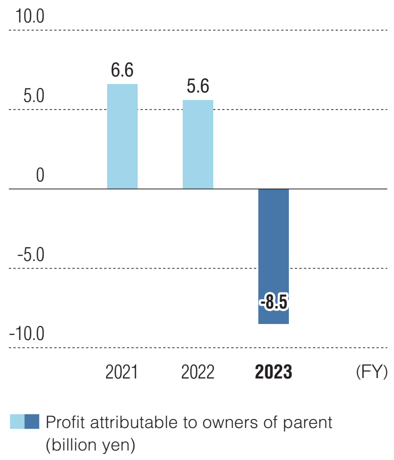
▶ Net sales



▶ Operating profit / Operating profit ratio



▶ Profit attributable to owners of parent



Toward achieving the numerical targets for FY2025

Although it will not be easy to achieve the operating profit target of 15 billion yen for FY2025 set out in the MTP 2025, we will not change our basic policy or the issues to be addressed, and remain committed to achieving the target.

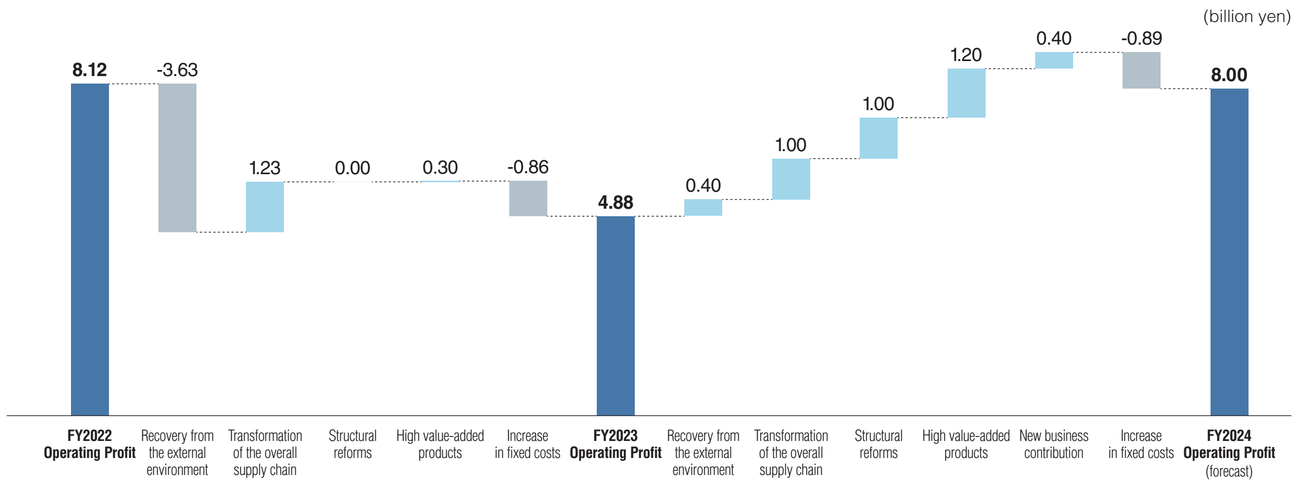
After our withdrawal from the SAP business, the importance of the automotive-related industry is increasing for us. Fortunately, it is on a recovery track, with demand for our products improving. To restore and enhance profits, we will focus on completing our ongoing initiatives under the MTP 2025, including accelerating Monozukuri Transformation and structural reforms throughout the supply chain, expanding sales of high value-added products, and getting new businesses on track quickly. We will strive to achieve an operating profit of 3 billion yen for the first half of FY2024 and 8 billion yen for the full year, aiming to achieve an operating profit of 15 billion yen for FY2025. We believe that our operating profit ratio, ROE, and ROIC will also improve through structural reforms.

Investment policy

Investment in high value-added products

Based on the plan to increase profits by expanding sales of high value-added products in the MTP 2025, we have actively invested in production capacity expansion. To build a business portfolio that is not biased toward one market, we are also strengthening our sales efforts and product development to open markets outside the automobile-related industry.

▶ Operating profit forecast



(Note) Fixed costs included in high value-added products are calculated based on FY2022.

Another important issue is investment in facility renovation to improve production efficiency at existing factories to ensure the safe and stable production of high-quality products. To renovate facilities for labor saving and automation, a considerable amount of capital is required.

Operating cash flow for FY2023 increased by 19.81 billion yen. In the MTP 2025, we aim to generate an operating cash flow of 70 billion yen over three years, intending to use the earned cash to cover capital expenditure for facility renovation and other purposes.

Investment in new businesses

Having shifted the direction of the entire business toward two areas, carbon neutrality and contribution to improve QOL, we are concentrating our resources on products that are expected to provide high added value through our technological capabilities. Some businesses are already seeing results, while others are expected to achieve a certain level of sales volume. We plan to develop these businesses into future profit drivers. For investment in new businesses, we aim to build an asset-light structure that allows us to move swiftly through collaboration, joint ventures, and investment, rather than large-scale M&As.

R&D Investment

We adequately staff the R&D section to nurture researchers' ideas. However, it is not sufficient to simply increase R&D expenses. We need to determine whether the R&D topics are in line with the company's direction, and assess their prospects for commercialization. It is also important to carefully examine their content and manage their progress by setting milestones. Therefore, it is important to communicate clearly to R&D staff about the business direction that the Sanyo Chemical Group is focusing on and what is required in R&D.

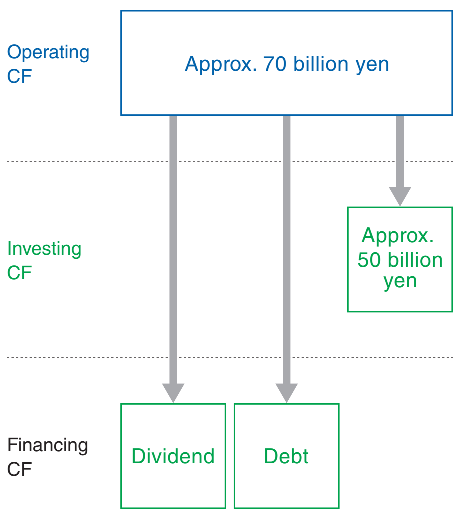
Monozukuri Transformation

Monozukuri Innovation Center

In FY2023, the entire company focused on Monozukuri Transformation. In particular, with a focus on improving production sites, we established the Monozukuri Innovation Center in July 2023. Researchers visit production sites to review manufacturing processes and formulations and improve the work environment through automation or other means. Although only part of the improvements were seen in the FY2023 financial results, progress is definitely being made. We will roll out these on-site reforms throughout the supply chain, from purchasing to sales.

▶ Cash flow / Investment policy

Targets for FY2023–FY2025



Operating CF

EBT: 37 billion yen
Profit increase due to high value-added products and basic products (Continuing intensive expenditures in R&D: 17 billion yen)

Depreciation: 34 billion yen
ERP system renewal and CAPEX

Working capital reduction: 5 billion yen
Cash generation by Monozukuri Transformation

Miscellaneous including taxes: -6 billion yen

Investing CF: Investment plan of 50 billion yen over three years

Growth from core business (high value-added products): 5 billion yen
Production capacity increase in response to strong demand and emerging markets

Reformation of existing businesses: 35 billion yen
Process optimization through Monozukuri Transformation and facility renovation/automation

New growth path (growing businesses): 10 billion yen
Strategic investment in M&A and commercialization of new products focusing on CN and QOL business

Reduction of cross-shareholdings: a decrease of several billion yen

Cash conversion cycle (CCC)

We also focused on improving the CCC. Using digital transformation, we made inventory more visible and strengthened its management, resulting in significant inventory reduction.

We also addressed the issue of having a large number of different packaging styles and contents at product shipment. There were various packaging styles with different container shapes, sizes, and labels for the same product, and we had a large inventory of containers for around 3,000 different products. We will consolidate packaging styles to cut container inventory while reducing the burden on product filling work and increasing efficiency, which will lead to cash generation.

Management indicator: ROIC

In the MTP 2025, we have set an ROIC of 7.0% as one of the KPIs, aiming to achieve 10% by 2030. We need to pay more attention to the balance sheet, not just the P&L, and incorporate it into business operations and decisions. It is therefore necessary to visualize and follow ROIC by business unit or major product group. However, we often use a single facility to produce products that span multiple businesses, which makes it difficult to separate investment amounts and fixed assets for each business and product group. We cannot leave this issue unattended. We intend to start by visualizing ROIC by business unit or major product group in a simple manner.

Capital policy

The equity ratio at the end of FY2023 remained at a high level of 67.6%. If large-scale investment projects, such as factory rebuilding or M&A, arise in the future, it is highly likely that interest-bearing debts will be used depending on the content and scale of the projects.

In addition, the investments and loans in the MTP 2025 are planned to be funded from operating cash flow.

Cross-shareholdings

We review individual cross-shareholdings on an annual basis, and are gradually selling shares that we have determined are no longer meaningful to hold. In FY2023, as a result of selling the appropriate shares, we recorded a gain on sale of investment securities of over two billion yen.

Dividend policy

One of our key management issues is returning profits to shareholders. While considering resource allocation necessary for sustainable growth, including investing in employees, safe facilities, and future growth, and reinforcing the corporate base, we aim to increase shareholder returns in the medium to long term, targeting a consolidated payout ratio of over 30%. We will also consider share buybacks as an option.

Although we registered a loss in FY2023, we prioritized stable dividends and maintained the annual dividend per share at 170 yen, taking into account a significant improvement in free cash flow.

To all investors

Although I have talked directly with institutional investors via financial results announcements and on other occasions, I would like to increase these opportunities still further. As the Director in charge of finance, I would like to actively engage in dialogue with you to explain our sustainable growth scenario and financial policy, and to hear your requests and opinions.

The Sanyo Chemical Group has embarked on a journey under the banner of reforming its business portfolio and transitioning to a new business model. Although we are still in a trial-and-error process, we hope to accelerate this transformation through dialogue with stakeholders.