WHERE WE’RE GOING
Message from CFO

Achieving a sustainable growth cycle through disciplined balance sheet and cash flow management

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Greatly expanding our positive core cash flow and strengthening our financial standing

For this year, the first fiscal year of MTP 2020 (the year ended March 31, 2019), we endeavored to achieve the disciplined balance sheet and cash flow management we set as the basic policy of MTP 2020. The scope of our positive core cash flow expanded more than planned, partly due to cash recovery from planned asset replacement occurring ahead of schedule. We put great emphasis on increasing profitability while recovering cash, so in that respect, I believe we made a favorable start during this first fiscal year. Over MTP 2020, we expect to make investments and loans totaling ¥300.0 billion. By continuing to make growth investments while replacing assets, we will maintain a positive cumulative core cash flow\(^1\) over the 3-year period of the plan.

In terms of balance sheet management in the first fiscal year, that basic approach of simultaneous growth investment and asset replacement enabled us to increase ROA; we continued to accumulate quality assets through investment and loans while recovering cash through asset replacement on largely the same scale. Additionally, our initiatives to reduce interest-bearing debt and strengthen our resistance to interest and exchange rate fluctuations bore fruit, and we achieved net DER of 0.95 time. This was much lower than our target value of 1.5 times or lower, which we established after taking market changes and other uncertainties into account.

We see ourselves as currently strengthening our financial standing while continuing some degree of new investment. However, recent factors such as the trade friction between the U.S. and China have made the future financial environment unclear, so we will be paying even more attention to inventory and managing credit exposure.

Note 1: Core cash flow = Core operating cash flow (excluding changes in working capital from operating cash flow) + Investing cash flow (including asset replacement) - Dividends paid

Establishing a system to increase the value of past investment and finance projects

Although we expected to make investments and loans worth ¥110.0 billion in this first year of the MTP, we actually lent and invested ¥91.0 billion. This was due to cases where we withdrew from financing at the deliberation stage due to perceived low profitability, or where recording of investments was pushed into the next fiscal year. In that sense, we are still largely on track to achieve our goal of ¥300.0 billion in cumulative investments and loans over the 3 years.

In order to continue growing, we need to both build up a certain level of assets, as well as thoroughly explore and carefully examine the risks and profitability of individual projects, including existing businesses. The members of the Finance & Investment Deliberation Council discuss issues from a variety of standpoints, and as the chairman of the council, I endeavor to stay objective at all times and make decisions carefully.

In order to increase the profits from managing operating companies we have acquired and raise their value even higher, we also attach great importance to our work on...
post-merger integration (PMI). In April 2018, we established the M&A Management Office to help the business divisions manage their operating companies more smoothly.

Naturally, the business division takes the lead in executing business strategies for their operating companies, but after acquiring a business, the M&A Management Office steps in, working together with that business division’s controller office to formulate a concrete plan to achieve the division’s growth strategy. In order for us to move towards more reliable earnings and efficient investment, we believe it is extremely important to have a dedicated organization from the corporate side be deeply committed to the project. Going forward, I want them to share the know-how gained from PMI cases throughout the company so that we can raise the proficiency of our business operations even further.

I consider one of my most important missions to be improving capital efficiency by reducing capital costs, among other measures. We estimate our company’s capital costs to be 7–8%, as we announced for the first time in May 2019. By communicating closely with our investors and disclosing proper information, we will work to minimize the knowledge gap between us and investors so that our share value will be accurately evaluated. I believe this will lead to a reduction in our risk premiums.

It goes without saying that to raise the share value, we will need to achieve an ROE that exceeds our capital costs and further expand our equity spread. As the macro environment grows increasingly uncertain, we will have to judge our future investments and loans more carefully than ever before. We will aim to increase ROA through portfolio management characterized by new investments with a focus on profit efficiency and disciplined cash flow management; asset replacement which aims to replace underperforming assets with truly high-quality ones; and an in-depth examination of our business cycle. I am confident that maintaining this kind of financial discipline while building a cycle that continuously creates high-quality profits will lead to ongoing growth for our company.

### Disciplined Balance Sheet and Cash Flow Management

- **Capital efficiency**
  - Improving asset quality and increasing share value

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### Disciplined Balance Sheet and Cash Flow Management

**MTP 2017**
- ROA 2.5%
- ROE 10.0%

**MTP 2020**
- ROA 3% or above
- ROE 10% or above

**Basic Approach**
- Improve ROA through ongoing asset replacement and accumulation of quality assets
- Expand total equity and improve ROE
- Keep net DER to below 1.5 times
- Improve ratings to enhance funding quality

**BS/CF Management**
- Manage growth investments and shareholder returns with cash generated via operating activities and asset replacement (Core CF>0)
- Asset management focused on asset and business value increases, risks, and returns
- Expand total equity by controlling goodwill, etc. and increasing resilience to interest/foreign exchange rate fluctuations

Create quality profits and cash flows out of quality assets via ongoing BS management and realize a growth model through effective CF management.