CFO message

Our goal is to improve our corporate value by regaining the confidence of the stock market and linking our business, financial, and sustainability strategies.

Masahito Kataoka
Director and Managing Executive Officer

Financial overview of fiscal 2022

Fiscal 2022 brought dramatic changes in the external environment, such as soaring raw material costs and the sudden weakening of the yen. One serious issue was the fact that our business profit was significantly lower than predicted, necessitating repeated downward adjustment of our earnings forecasts. We addressed these issues by implementing price revisions and improving internal operations. However, the effect of these measures was significantly outweighed by fluctuations in the external environment, and there was a substantial downturn in profit.

This situation also impacted our asset and liability position, and the amounts shown in our balance sheet have been inflated by increases in raw material prices and other costs. Reduced profits and increases in working capital have meanwhile affected our cash flows, with the result that cash flows from operating activities were considerably below the level projected in our initial plan. Cash used for investing activities was lower because of a reduction in fixed asset acquisitions, but free cash flows were negative by a substantial margin. We have maintained our debt-to-equity (D/E) ratio at an appropriate level.

We see the achievement of a profit recovery as our first and most urgent priority for fiscal 2023, which we have positioned as a year for a turnaround that will restore the confidence of the stock market.

Our financial and investment strategies

Fiscal 2023 will be the final year of Medium-Term Management Plan 2023. There will be no major changes to our financial strategy of maintaining an optimal D/E ratio. However, we will carry out a review of our capital expenditure, which is expected to reduce the three-year total for Medium-Term Management Plan 2023 to around ¥30 billion. In fiscal 2023, we will keep investment to the minimum required to maintain and update facilities through a policy of rigorous selection and focusing.

We will secure funds for cash allocations in fiscal 2023 through a major improvement in cash flows from operating activities resulting from a business profit recovery, the peak-out of working capital, and other factors. We will also repay some of our interest-bearing liabilities. On the cash out side, we will curb capital expenditure, but we anticipate an increase in cash dividends.

I will next address our policies in preparation for the next medium-term management plan. Our policy in relation to capital expenditure will be to adjust our investment in scale expansion and growth areas to reflect priority areas under our overall business strategy. We will discuss our approach during the current fiscal year and start to execute investment in line with our strategy in the next fiscal year.

We will also review our existing assets. As part of our structural reforms, we will identify and review low-profit assets.

While recycling our assets, we will also need to strengthen our business fundamentals and improve our capital efficiency. With interest rates likely to rise, we see this as part of the normalization process after a prolonged period of abnormally low interest rates. Any rise in interest rates will also cause an increase in our weighted average cost of capital (WACC), which means that we will need to achieve returns that outweigh this increase. Until now, low margins have clearly been tolerated because of a WACC that reflected low risk-free rates. Going forward, we believe that it will be impossible to create corporate value without reflecting the possibility of future WACC increases in capital expenditure decisions.

We will keep ROIC above the WACC level by improving profitability and determining the appropriate scale of invested capital.

Key elements of our financial strategy for fiscal 2023

Fiscal 2022

Flow situation (profit and loss, cash flows)
- Increased demand for working capital
- Lower business profit
- Reduced investment capacity due to lower cash flows from operating activities

Stock situation (balance sheet)
- Maintenance of an optimal debt-equity structure
- Increased interest-bearing liabilities
- Rise in debt-to-equity ratio

Debt-to-equity ratio = interest-bearing liabilities / shareholders' equity

Fiscal 2023

Financial strategy
- Investment scrutiny and allocations to priority areas
- Normalization of existing invested capital (working capital, fixed assets)
- Maintenance of stable dividend growth

Anticipated benefits
- Increased investment capacity
- Future improvements in ROE and ROIC

Cash allocation and capital expenditure in fiscal 2023 (Projection as of March 31, 2023)

Cash allocations

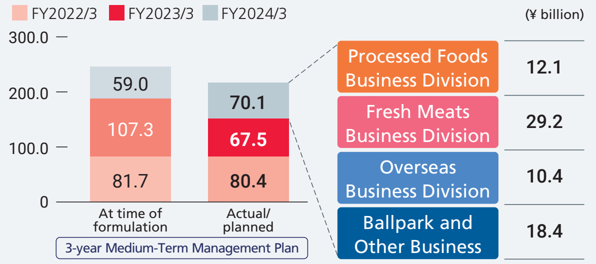
In FY2024/3, we will generate cash through an operating cash flow recovery and the improvement of capital efficiency

(¥ billion)

	Medium-Term Management Plan 2023 initial plan	Medium-Term Management Plan 2023 adjusted plan	2023/3 results	2024/3 plan
Cash flow from operating activities	227.2	119.5	11.3	74.8
Interest-bearing liabilities (repayments)	(23.6)	13.5	38.3	(21.8)
Cash generation/utilization of surplus funds	40.0	71.9	38.7	12.4
Source of funds	243.7	204.9	88.3	65.4
Capital expenditures	(204.2)	(182.1)	(82.3)	(55.4)
Cash dividends	(30.4)	(31.3)	(10.4)	(11.3)

Capital expenditure * Accrual basis, including IFRS leases

¥30 billion reduction to ¥218 billion during the 3-year Medium-Term Management Plan



- Cash generation | Sales of businesses and cross-shareholdings
- Shareholder returns | Continual steady dividend growth based on a DOE ratio of 2.3%, with flexible buyback schemes as an option

Shareholder returns as part of capital policy

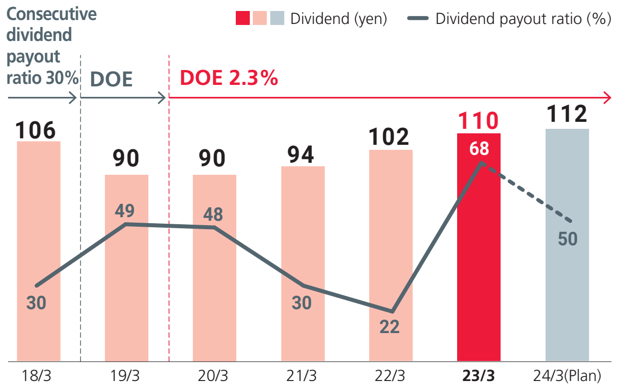
Shareholder returns are an important aspect of our management policy and form part of our capital policy, through which we work to achieve an optimal optimal debt-to-equity ratio and improve our medium- to long-term corporate value.

Our goal under this policy is to maintain steady dividend growth at the level needed to achieve a dividend-on-equity (DOE) ratio of 2.3%. Because of the characteristics of our business, our net profit tends to fluctuate in response to changes in the external environment, market prices, and other factors. However, shareholders' equity fluctuates more slowly, which means that we can return medium- to long-term equity growth to shareholders in the form of increased dividends. At the same time, the figure of 2.3% is not fixed, since we believe that it is also necessary to take the level of the payout ratio into consideration. Furthermore, our policy under the next medium-term management plan calls for the steady accumulation of free cash flows, which is expected to give us greater freedom in relation to cash allocations.

Our indicator for the optimal debt-equity structure is the D/E ratio, which we aim to maintain at around 0.5. Our D/E ratio was 0.49 as of March 2023 and is expected to fall to 0.46 in the fiscal year ending March 2024 because of a recovery in our business performance and the reduction of capital expenditure. Assuming that we achieve a certain level of profit growth, and that surplus dividends remain at their present level, we will need to pursue a capital policy that combines surplus dividends at the level needed to maintain an optimal debt-equity structure with share buyback programs.

Our surplus distribution in fiscal 2022 resulted in a dividend per share of ¥110, an increase of ¥8 over the previous year's figure. Based on our forecasts for fiscal 2023, we plan to increase the dividend by a further ¥2 to ¥112.

Changes in dividends and payout ratio



Note: Dividend amounts through the fiscal year ended March 31, 2018 have been retroactively adjusted to reflect the absorption-type stock split.

Price book value ratio

Our price book value ratio (PBR) has fallen below 1.0 and reached 0.8 as of March 2023. We attribute this primarily to a major decline in business profit, and reduced growth expectations due to delays in our overseas expansion. At the same time, we also need to address our low capital efficiency.

We take the market's appraisal very seriously. We will work to restore our business performance through short-term measures, while also linking our financial and business strategies. The achievement of our performance forecasts for the current fiscal year will be our most important priority.

In the medium- to long-term perspective, we believe that it will be necessary to create a roadmap for improving efficiency indicators, such as ROE and ROIC, through the improvement of business profitability and the normalization of invested capital. Our targets for the final year of Medium-Term Management Plan 2023 were ROE of 8% and ROIC of 6%. These are unlikely to be achieved because of the decline in profitability. We will consistently apply a three-axis approach encompassing not only sales and profits, but also invested capital, and we will explore efficiency improvement scenarios for our next medium-term management plan. We will also need to implement growth strategies. We will pursue returns by identifying growth areas and strategically allocating resources. We are confident that the steady implementation of this combination of short- and medium- to long-term measures will contribute to the improvement of our share price.

Reduction of cross-shareholdings (For details, see page 89)

In 2021, we adopted a policy that, in principle, we will not maintain cross-shareholdings. In accordance with that policy, we are now engaged in sale negotiations with the individual issuers concerned. Like the NH Foods Group, other issuers are increasingly seeking to divert their management resources toward growth investment. Many have also adopted the principles set down in the Corporate Governance Code. For these reasons, the negotiations are progressing relatively smoothly, and the reduction of cross-shareholdings is generally proceeding according to plan. We will continue to negotiate with issuers.

Pursuing a sustainability strategy alongside our financial strategy

In April 2023, I was given responsibility for sustainability promotion in addition to my existing role as chief financial officer. I believe that my mission is to improve corporate value by pursuing both financial and sustainability strategies. Neither policy will yield the desired results alone, and both will need to be linked to our business strategy.

As I have already described, we will develop our financial strategy according to our business strategy. Convergence with our business strategy is also a basic feature of our sustainability strategies, and we will continue to strengthen that linkage while prioritizing measures to address risks. Environmental action will also influence our financing activities. In addition to our past financing methods, we will also consider raising funds through sustainability bond issues.

In addition to my duties as chief financial officer, I am also responsible for dialogue with investors. There are increasing opportunities for dialogue with people in the responsible investment sector. We will quickly reflect input from that dialogue in our sustainability policies.

Companies today need to work along both the financial and non-financial axes to improve their corporate value. I believe the combination of these roles under the same officer brings benefits on both sides, since I am able to speak with authority about our policies and strategic directions in both areas when I participate in dialogue.

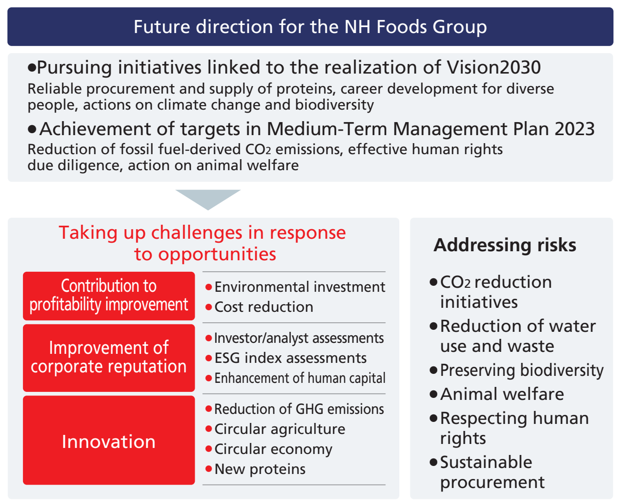
Sustainability management —current situation and policies

Sustainability initiatives are an essential aspect of corporate management. In recent years, the range of issues has expanded to include climate change, human rights, human capital, and biodiversity, all of which require new initiatives in addition to our past efforts. We need to take action in these areas, because we recognize that while failure to address any of these issues would have a negative impact on corporate value, by taking action we can create business opportunities. We will continue to monitor change carefully, so that we can identity risks that could affect our business and opportunities that could lead to corporate growth, while considering key policies and pursuing initiatives.

In fiscal 2023, we will continue to work toward the realization of Vision2030 through actions in various areas, including the reliable procurement and supply of proteins, career development for diverse people, and action on climate change and biodiversity. We regard biodiversity as especially important, since the Group's business depends on the bounties of nature. The current fiscal year will be the starting point for significant initiatives in this area. We will also carry out analyses and assessments in preparation for disclosure in fiscal 2024.

We will continue to work toward our targets for 2030, including the target for reducing emissions of fossil fuel-derived CO_2. Initiatives relating to individual goals will be expanded with the aim of heightening the probability that those targets will be achieved.

Choosing the best way forward



Under the next medium-term management plan, we believe that it will be necessary to expand our environmental investment budget, which is outside of our normal investment framework. We will consider and implement environment investments based on assessments of investment targets from the perspectives of both risks and opportunities.

Building a sustainable future for the NH Foods Group

One area in which there are particularly high expectations toward the Group is the improvement of sustainability as a company engaged in the livestock business. As a food manufacturer, we obviously need to reduce food losses and the use of plastic for packaging and other purposes. We will need to further expand our efforts and set group-wide targets for the reduction of plastic use.

We are also aware of issues relating to livestock farming. We need to reduce animal-related GHG emissions and improve the stability of access to feed supplies. Action is also needed in relation to changes in livestock breeding environments due to climate change, and a shortage of workers in the Japanese livestock industry. Another important issue is animal welfare. We will not be able to address and resolve these issues without innovation, which will depend to a large degree on external collaboration and co-creation.

In the current fiscal year, we will take up important challenges in the fresh meats category, including the establishment of carbon-neutral farms and circular livestock farming.

We see measures to address livestock-derived emissions of methane and other greenhouse gases as a vital priority. We are currently pursuing research into the reduction of these emissions in collaboration with external entities, including Japanese and overseas universities. We plan to accelerate our efforts toward the development of various approaches to the elimination of this problem.

The achievement of our 2030 target for the reduction of CO_2 emissions will require increased efforts to lower emission levels. In fiscal 2023, we introduced internal carbon pricing (ICP), which is used as reference data for capital expenditure decisions.

Respect for the bounties of nature is a core value for the NH Foods Group. As Japan's biggest supplier of proteins, we recognize our obligation to play an active role in the solution of various livestock-related issues. We will continue to build sustainable business supply chains by working to find solutions for sustainability issues.