# Risks and Opportunities

Nikko identifies risks that could significantly impact the business activities in the future and pursues the development of a corporate culture resilient to crisis by grasping and managing those risks. The key risks currently recognized by the management as likely to significantly impact the consolidated companies' financial status, operation results, and cash flow are listed below. By recognizing these risks, we believe that it is necessary for us to strive to avoid the occurrence of such situations, and respond to them if they occur.

| Related risks and opportunities | | Details of risks and opportunities |
|---|---|---|
| (1) Risks related to the asphalt plant (AP)-related business in Japan | Risk of insufficient differentiation with competitors | **Risk** The asphalt plant market in Japan is an oligopoly where two companies, Nikko and another company, together account for almost 100% of the market. Nikko's market share exceeds 70% and our position as the top manufacturer has not changed for a long time. However, our ability to showcase our differentiation to customers may weaken if we fail to carry out sufficient product development or if the other company develops a meticulous maintenance structure equivalent to ours.<br>**Opportunity** The Company will pursue differentiation by developing new products that contribute to realizing carbon-neutral society and $CO_2$ reduction and through business model reform of the maintenance service business to secure our position as the overwhelming top manufacturer. |
| | Risk of overseas manufacturers entering the Japanese market | **Risk** In recent years, no foreign manufacturer has entered the asphalt plant market in Japan, but Chinese and Korean manufacturers are gradually acquiring technical prowess and they may be planning to enter into the Japanese market. If foreign manufacturers enter into the Japanese market, the competition among manufacturers may intensify.<br>**Opportunity** It is difficult for a foreign manufacturer without a sufficient maintenance structure to enter into the Japanese market. Therefore, if a customer, who purchased a product from a foreign manufacturer, realizes the excellence in our after sales service, we can expect it to boost our rating among customers. |
| | Risk of shrinking market due to reorganization of road pavement industry | **Risk** Major road builders are going through active reorganization, which may develop into reorganization of the road pavement industry in the future. If integration of asphalt plants advances due to the industry reorganization, the market may shrink.<br>**Opportunity** If shipment from a plant increases because of integration, we can expect the amount spent on capital investment to increase in total. |
| (2) Risk related to Nikko's technological innovation not catching up with the initiatives for reducing environmental burden | | **Risk** Asphalt plants primarily use fossil fuels as energy source. About 1.5 million tons a year of $CO_2$ is estimated to be emitted in Japan for manufacturing asphalt mixture, and 70% of the emissions are thought to be from Nikko-manufactured plants based on the market share. If the push towards reducing environmental burden globally advances faster than expected, there is a possibility that our technological innovation cannot keep pace with it.<br>**Opportunity** In close collaboration with road pavement companies, who are the customers, Nikko is working on early social implementation of technological innovations such as combustion efficiency improvement and shifting of heat source at asphalt plants (carbon-neutral fuels, electrical heating technology, etc.), improvement of transportation efficiency through innovation of mixture transportation method, collection of $CO_2$ emitted by asphalt plants, and $CO_2$ absorption using ready-mixed concrete. |
| (3) Risks related to the overseas business | Risk of intensifying competition in the high-end AP market in China | **Risk** In the asphalt plant market in China, Nikko has secured a certain position in the high-end model category and we are steadily recording sales and profits every year. In recent years, however, Chinese companies in general have gained technological capability and there is a possibility of many Chinese manufacturers entering the high-end model market in the future leading to intensified competition.<br>**Opportunity** So far, the rivals in the high-end market are two European companies and one or two top Chinese companies, and the competition is not very tough. As competing companies in the high-end model market increase, the market itself is expected to expand. |

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| (3) Risks related to the overseas business | Risk of failing to achieve sales in accordance with the plan in the ASEAN market | **Risk** As part of the growth strategy, we established a manufacturing subsidiary in Thailand in FY 2020 and invested more than 1.0 billion yen in the factory. The premise of this investment is that we can stably sell asphalt plants every year in Thailand and other ASEAN countries. However, if our plants are not able to sufficiently gain the trust of customers in Thailand and other ASEAN countries contrary to the plan and sales volume falls short of the plan, the factory would post loss, resulting in risk of impairment of the factory.<br>**Opportunity** The ASEAN market is not yet large enough for two European companies, Nikko's competitors, to invest resources. Hence, competition with European manufacturers is not intense, and we can expect to capture the market early on. |
| (4) Risk of reduction in public investment budget | | **Risk** In the past, when the Democratic Party of Japan replaced the Liberal Democratic Party, "from concrete to people" became a slogan and many of our customers shifted to limit capital investment. As a result, our sales declined significantly. In the future, if a party that holds up a policy to reduce public investment forms the government, our customers may shift to curb investment like they did during the previous Democratic Party of Japan regime.<br>**Opportunity** The Fundamental Plan for National Resilience received a budget of 15 trillion yen for five years and there is little possibility of customers rushing to curb investment and we can rather expect expansion of investment. |
| (5) Risk regarding securing of human resources to engage in on-site operations | | **Risk** With our business model, we carry out the entire process from plant manufacture to installation on site and offering of maintenance service all in-house. In recent years, manpower shortages has made it difficult to hire on-site workers such as maintenance service staff and construction work staff. If we are unable to hire the required number of on-site workers, it may become difficult to maintain a competitive edge with our business model.<br>**Opportunity** In maintenance service, we can solve the issue of securing human resources by promoting labor saving through systemization of maintenance services using IoT, etc. |
| (6) Risk of spread of COVID-19 | | **Risk** If an employee gets infected with COVID-19, he or she must stay away from operations temporarily. As our products are designed according to the order and then manufactured, it may significantly affect delivery to customers, especially if an employee in a technology division is infected, design work will be suspended for a certain period of time. Further, in overseas operations, if the spread of COVID-19 in countries where we have operations restricts social activities, it may become difficult to carry out sales activities there. In particular, if the infection spreads in China, Thailand, and Taiwan, where the Nikko Group has business bases, it may have a direct impact.<br>**Opportunity** The Japanese construction industry, in general, has not had any significant direct impact from the COVID-19 pandemic and has been performing solidly, and we expect minimal impact on the industry also in the future. |
| (7) Risks related to increases in material prices | | **Risk** As the global economy tries to recover from the worldwide COVID-19 pandemic amid widespread price increases caused by supply restrictions, logistics constraints, etc., the prices of fuels such as crude oil and natural gas rose markedly due to the Russia-Ukraine situation, resulting in accelerated price increase. The prices of the materials Nikko purchases also continue to rise, and the Group's profitability may worsen if this situation continues into the future.<br>**Opportunity** Nikko reflects the material price increases in the quotations for AP and BP customers and this is expected to lessen the impact on profits in the future. Nikko is raising the price of modular conveyors sold by its agents, which has been largely accepted by customers. |
| (8) Risks related to the Russia-Ukraine situation | | **Risk** Nikko has suspended business with Russia. The impact of the suspension of business with Russia is negligible, as they were limited to parts transactions worth several tens of millions of yen a year in recent years. However, there is a possibility of capital investment plans at Nikko's customers getting affected by the increases in crude oil prices due to the Russia-Ukraine situation and the changes in the global economy.<br>**Opportunity** Even if the price increases in crude oil, etc. and changes in the global economy affect customers' capital investment plans, etc., it is unlikely to result in a significant decline in sales, as net sales in service maintenance, which is stable, account for more than 60% of AP and BP net sales. |

Note: Items (7) and (8) were newly added in FY 2021.