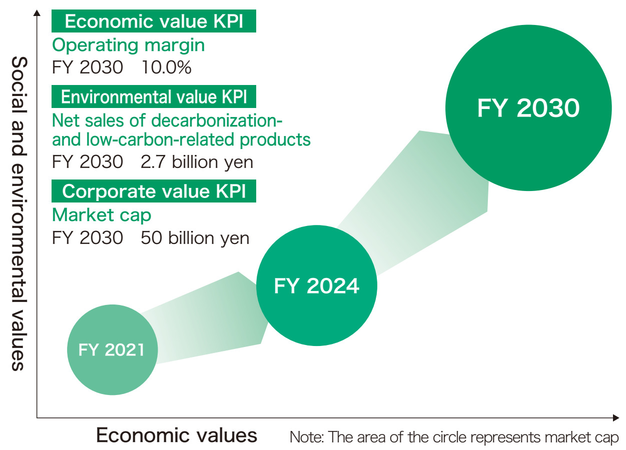
Key Points of Value Creation Process

Realization of the value creation process is necessary for the Nikko Group to fulfill its long-term vision of "Making the world a resilient and gentle place" based on the Group's raison d'être and mission of "Update the social infrastructure by leveraging engineering that is one step ahead of others." To this end, we have to appropriately grasp the social issues and changes in the industry, achieve the medium-term plan and solve the materiality through business activities in the inputs where our strength lies, and realize the outcomes, which are social, environmental, and economic values, from the output. The key to solving materiality lies in sustainability transformation (SX) initiatives that would synchronize the two social sustainability-related items (establishment of recycling-oriented society and realization of carbon neutrality) and the two items (creation of new customer values and human resource development and improvement in job satisfaction) related to the Group's sustainability to enable value creation in the medium to long term. Further, in addition to outcomes that can be created through business activities in short term, we will identify those that need to be created in medium to long term after output and consider their relationship with management capital.

Image of corporate value improvement towards 2030



Note: The area of the circle represents market cap

Input (business foundation)

- In terms of financial capital, Nikko Group had an equity ratio of 61% as of the end of FY 2022 with net cash of about 4.6 billion yen. The Group has been pursuing active capital investment and sales of cross-shareholdings as shareholder return measures for the past few years, and net cash has been declining from 10.3 billion yen five years ago. Net assets have increased by 1.3 billion yen from five years ago to 31.6 billion yen, significantly slowing down from the increase of 5.9 billion yen in the five-year period prior to that.
- In manufactured capital, we have been carrying out capital investment exceeding depreciation since FY 2013, and has significantly increased the capital in waterproof boards and other growth areas and AP manufacturing and sales base in Thailand among others since FY 2018. The acquisition of Ube Kohki and Matsuda Kiko is also part of our efforts to strengthen manufactured capital. As a result, property and equipment as of the end of FY 2022 more than doubled to 11.8 billion yen from 5.3 billion yen five years ago.
- In terms of human capital, Nikko Group had 1,064 employees as of the end of FY 2022, which is an increase from the 807 employees at the end of FY 2017. However, further enhancement is necessary to achieve the long-term vision target. We aim to achieve the KPIs in our human resource development policy and internal environment development policy in FY 2023 so as to evolve human capital management.
- As for intellectual capital, we are thinking of something extra in the future, in addition to the four core technologies we possess, and leverage that for business model reforms and to realize the outcomes. R&D expenses for FY 2022 was about 0.6 billion yen, and have doubled over the past five years. We are expecting expenses in excess of 2.5 billion yen in the medium-term plan and will further accelerate it.
- As for social and relationship capital, we will leverage our strengths including Akitsu-kai and Tombo-kai to become a solution partner of the customer as advocated by Nikko Group. We will also strengthen the supply chain taking into account the anticipated business expansion.
- With respect to natural capital, we will work to expand the net sales of carbon neutrality-related products to not only reduce CO_2 emissions of Nikko Group but also contribute to reductions at our customers. In outcome, based on the forecast of an increase in sales of warm mix (foamed) equipment in FY 2023 to 55 units (19 units in FY 2022), we consider it important to develop combustion technology for decarbonized fuels such as ammonia and hydrogen burners for AP.

Business activities (business process)

Upon moving from input to business activities, we will add something extra to Nikko Group's four core technologies for mixing, heating, control, and material handling to achieve business transformation and scale expansion leveraging technology, which form the gist of the medium-term management plan, ultimately leading to solving materiality. Specifically, business transformation means strengthening of operation and maintenance services led by subscription service of mainstay maintenance service. Scale expansion leveraging technology points to expansion of AP-related business to ASEAN market with the Group's manufacturing and sales base (NIC) in Thailand at the center, strengthening of environmental products and waterproof board business, and lateral deployment of products and markets including acquired businesses. As maintenance service accounts for about 60% of the net sales of AP- and BP-related businesses, we believe evolution here is important from the value chain perspective.

Output (business value)

In output, it will be necessary to realize business transformation and scale expansion leveraging technology so as to achieve the financial targets (50 billion yen in net sales, 3 billion yen operating income, etc.) for FY 2024, the final year of the medium-term plan. However, for the time being it is the period for sowing seeds primarily for securing human and intellectual capital, for establishment of the business foundation, and therefore we believe it is important to put the alignment in order for achieving the 2030 Vision.

Outcome (creation of social values)

Our business activities that will lead to social and environmental value creation include support for early restoration from natural disasters and co-existence with local communities. In support for early restoration from natural disasters, recovering from intensifying natural disasters, such as large typhoons, severe rainstorms, and earthquakes, starts with quick recovery work of the Group's damaged plants. In FY 2022, Nikko-manufactured plants suffered damage at 60 places, which was a decrease from the 72 places in FY 2021. We will continue to collaborate closely with customers and focus on early restoration and will work to expand the social and relationship capital in the short-term. As part of coexistence with local community, the Nikko Business Foundation has been offering scholarships that do not require repayment to domestic and overseas students enrolled in universities and technical junior colleges in Hyogo Prefecture and to students from Hyogo Prefecture studying in the Kinki region. The foundation also provides grants to researchers who conduct research on technology development in the laboratories of the universities and technical junior colleges in Hyogo Prefecture and to researchers who reside in Hyogo Prefecture and work for universities outside the prefecture. We expect such efforts to lead to stabilization of social and relationship capital in the medium to long term.

Our business activities that will lead to value creation after output include contribution to disaster prevention and mitigation, establishment of recycling-oriented, environmentally friendly society, and contribution to realization of decarbonized society. From the perspective of the contribution to disaster prevention and mitigation, the Group recognizes waterproof boards as something indispensable for protecting people from intensifying floods resulting from extreme weather. While demand for waterproof boards fell in FY 2022, it will contribute both in the short term and long term to financial capital, social and relationship capital, and natural capital. For the establishment of recycling-oriented, environmentally friendly society, we recycle almost all of the asphalt waste (more than 99%), and about 75% of the asphalt mixture we use in new road pavement works is recycled mixture collected as pavement waste. Going forward, we are expected to use the domestically developed AP recycling technology in China, where there is large demand, and also in the ASEAN region in the future. Regarding recycling of plasterboards, the amount of plasterboard waste is expected to reach 2 million tons in Japan in 2025 and exceed 3 million tons in 2039 as the residential buildings built during the rapid economic growth period enters the demolition stage. There is little capacity at final disposal sites and disposal costs are soaring mainly in large cities. In this field, contributions can be expected from financial capital, intellectual capital, social and relationship capital, natural capital, and a wide range of management capital in the medium to long term. Contribution to realization of decarbonized society is an important outcome which the Group should achieve in the medium to long term. It is necessary to draw up technological and business roadmaps including collaboration with customers and various businesses and implement them, and not just limited to reduction of CO_2 emissions at the Group. Warm mix (foamed) equipment has been shown to reduce CO_2 emissions in the short term, and demand for hydrogen and ammonia burners for fuel transition is anticipated in the medium-term. While it is expected to have a negative impact of a short-term increase in costs including R&D and personnel expenses, it is likely to have a positive impact on the Nikko Group in the long run including intellectual capital and social and relationship capital as well as a ripple effect on natural capital.

Future the Group wants to realize: Making the world a resilient and gentle place

At the Nikko Group, we believe that the corporate identity we formulated will lead to "Making the world a resilient and gentle place," which is the future we want to realize under our long-term vision, along the three axes of customers, employees, and future, with our mission "Update the social infrastructure by leveraging engineering that is one step ahead of others" at the core.