In the next medium-term plan, we will focus on revenues and cash flow creation to ensure we are on the growth track to achieve operating margin of 10%, ROE of 10%, and market cap of 50 billion yen in the long-term vision.

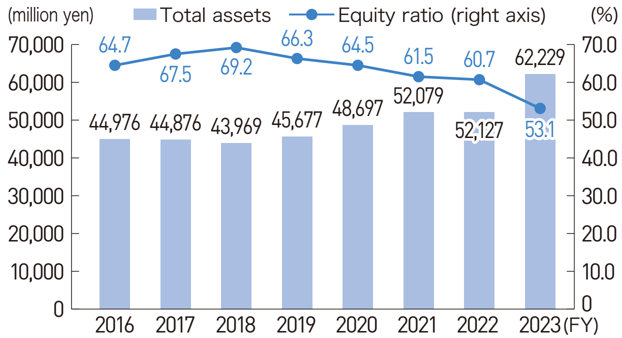
Director and Vice President

Hiroshi Fujii

Q What are the basic financial and capital policies of Nikko Group and your mission as the person in charge of financial affairs?

Earlier, Nikko Group had held back on investments as we emphasized financial safety, but now we are actively going ahead with investments while maintaining safety. This policy has become particularly conspicuous in the last few years. Equity ratio was 53.1% at the end of FY 2023, down from the level exceeding 60% previously, but this is due to the large increase in total assets with

◆ **Trends in net assets and equity ratio**

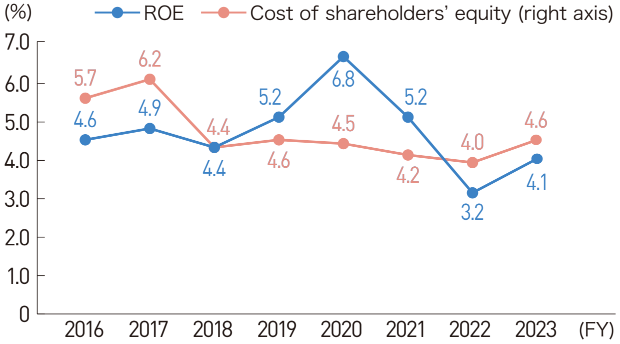


net assets remaining unchanged. The Company is not in an industry that requires large-scale investments every year. Going forward, we will closely examine investments with 50% as the lower limit for equity ratio. We are aiming for return on investments that exceeds cost of shareholders' equity (a little less than 5%).
As the person in charge of finance, my mission is to not curb investments on the grounds of financial governance. I do not want to obstruct the path being taken by Nikko Group (long-term vision, medium-term plan, etc.) citing financial constraint-based negative factors. However, financial discipline is important. So, while focusing on it, we will make that known to everyone in the Company.

Q What is your assessment of the FY 2023 performance? ROE stayed at 4.1%. What had the biggest impact? Also, what is your view of FY 2024?

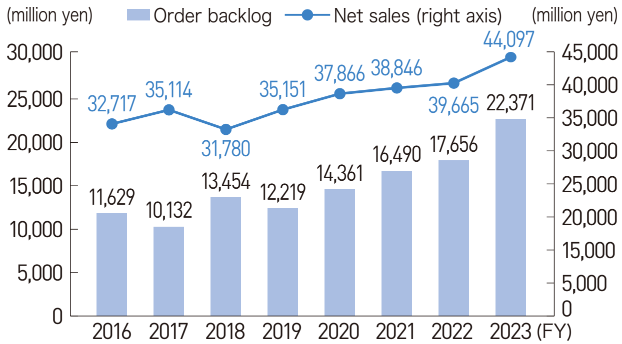
Regarding the performance for FY 2023, ROE staying at 4.1% and cost of shareholders' equity going below 4.6% were points that I regretted as the person in charge of finance. We have positioned this medium-term plan as the period to pursue investments, but ROE dipping below 5% was unexpected.
One of the reasons for that was the impact of the increased losses at an AP-related subsidiary in Thailand. The operating loss at the Thai subsidiary came to 0.55 billion yen. The subsidiary is 70% owned by Nikko, with a local partner holding the remaining 30%, and started the AP-related business in 2020, but we made it into a wholly owned subsidiary in FY 2023 due to differences of opinion with the local partner. In particular, our views differed regarding inventory risk. Our policy was to continue production while maintaining stock even without orders, whereas the partner strongly wished to avoid risk, which led us to dissolve the joint venture. We wasted three years, and I think this was the most unfortunate aspect. However, new order intake at the Thai subsidiary was strong and at a record high, so we expect profitability to improve in FY 2024.

◆ Trend in ROE and cost of shareholder equity



Also, though it is outside the Company's main business, in extraordinary income, profit from sales of strategically held shares came to 68 million yen, declining by about 500 million yen from FY 2022. We had been actively selling strategically held shares, but we expected sales of remaining such shares to be difficult given the relationship with the business partners. At the same time, total assets rose by about 10 billion yen in one year to 62.2 billion yen. The main factors behind this increase are that we were able to procure early on both 5.2 billion in cash and deposits and 5.0 billion in loans payable. After entering the new fiscal year, these funds are being replaced into inventory.
We are expecting net sales of 48.0 billion yen (up 9% year on year), operating income of 2.6 billion yen (up 32%), net income attributable to owners of parent of 1.7 billion yen (up 30%), and ROE of 5.1% for FY 2024. Order backlog as of the end of FY 2023 was up 27% year on year, with the order backlog increasing further as of the end of the first quarter of the current fiscal year. Given these factors also, I would like to close in on the targets for the final fiscal year of the medium-term plan of 50.0 billion yen in net sales and 3.0 billion yen in operating income.
As for the AP-related business in Japan, we are expecting an increase in demand from the rebound of road pavement companies, which had curbed their capital investment temporarily due to rising asphalt cost. In the BP-related business, the price of ready-mixed concrete rose, and the investment level in the industry is high. The Company has secured a 40% share of the market, and we are also expecting increase in maintenance sales. Especially, demand is expanding in the maintenance service business whose profitability is high in both AP- and BP-related businesses, and this is a factor behind increased profits. The Thai business is expected to post operating loss again in FY 2024, but with order backlog, the loss is expected to narrow. Further, AP-related order intake is recovering in China led by recycling demand.

◆ Trend in order backlog and net sales

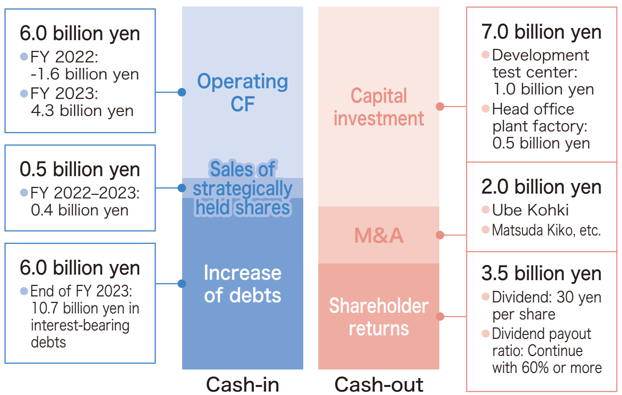


Q FY 2024 is the final fiscal year of the Medium-Term Management Plan. Taking its progress into account, what are the numerical targets and financial and capital strategy you are considering for the next medium-term plan?

Currently, we are in the process of drafting the details of the next medium-term plan (FY 2025 to 2027) taking the current medium-term plan into consideration. As for numerical targets, we are thinking of achieving 60.0 billion yen in net sales and 8% in ROE. We are also planning to maintain dividend payout ratio at 60% or higher and allocate the remaining 40% to internal reserves. In this case, we anticipate net assets to reach about 35.5 billion yen at the end of FY 2027 from the 33.1 billion yen at the end of FY 2023. Here we would require net income

attributable to owners of parent to be 2.84 billion yen to achieve ROE of 8%, so our target for operating income is 4.0 billion yen (operating margin of 6.7%). This is the minimum level we should be achieving for the 10% operating margin stated in our long-term vision for 2030. We have positioned the next medium-term plan as the period for recovering the upfront investments we made in the current medium-term plan, and we are focusing on profitability and cash flow creation.
In the next medium-term plan, improvement in profitability in China and Thailand in the AP-related business, expansion of the maintenance service business, and increase in unit price of the contract-based manufacturing business are expected to contribute to profit expansion. Net sales in the Chinese market in FY 2023 halved compared to FY 2022, but the demand is steadily recovering for recycling and environment-related equipment, and we are estimating net sales to increase by 2 to 3 billion yen. We plan to make the Thai business profitable in FY 2025 and secure stable profits. Net sales in the maintenance service business are currently 13.0 billion yen. Our plan is to grow it into 15.0 billion yen three years from now. In the new field of mobile plant business also, we are anticipating an increase in maintenance service sales from expanded share in the domestic market in addition to the Ukrainian project

◆ Cash allocation for the FY 2022–2024 medium-term plan



of FY 2023. We plan to improve profitability of the maintenance service business by raising maintenance service charges and prices of parts. We are constructing a new factory as the production capacity of the two companies we acquired in the contract-based manufacturing business is insufficient.
In order to achieve the FY 2030 long-term vision, we are expecting a 5% increase every year in personnel expenses in the next medium-term plan also from the human capital aspect. We plan to continue to increase hiring of new graduates and mid-career personnel to compensate for the shortage of staff in the maintenance service business. The plan is to hire about 30 new graduates annually and about 10 mid-career workers for a net increase of 45 employees in the three-year period. R&D has been somewhat sluggish till now, but we expect to see an increase in basic research related to carbon neutrality in the future.

Q What are the key points in the current medium-term plan for cash allocation?

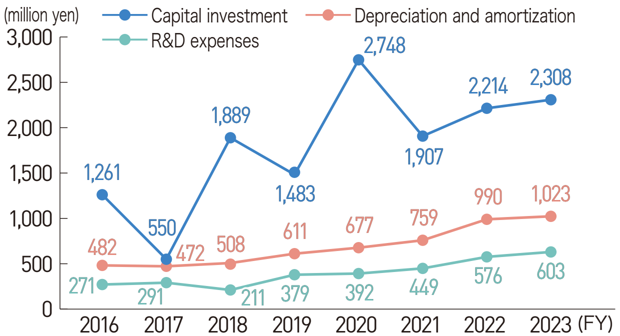
For the ongoing medium-term plan (FY 2022 to 2024), we are expecting a cash inflow of about 6.0 billion yen in operating cash flow, about 0.7 billion in sale of strategically held shares, and close to 6.0 billion yen increase in loans for a total of about 12.5 billion yen. Also, operating cash flow was a little more than 8.8 billion yen in the previous medium-term plan, so it is expected to decline this time. This is also because of the increases in cash payment of accounts payable and inventory, and the need to make payment within 60 days in accordance with the Subcontract Act based on the partnership declaration. Further, order backlog is at record high, and we will be requiring loans as working capital, and inventories increase in response to that. The pace of increase of contract liabilities (down payments) is also slowing down. The Company's CCC grew to more than 134 days in FY 2023. However, since we have been unable to collect down payments from about 30% of our AP-related customers, we are continuing with negotiations. Strategically held shares stood at about 5.2 billion yen at the end of FY 2023, and the sales amount is on a declining trend. Nevertheless, we believe it is necessary to continue taking measures to reduce strategically held shares in order to improve capital efficiency.
Regarding cash-out, we are planning on about 7.0 billion yen in capital investment, about 2.0 billion yen for M&As, and about 3.5 billion yen in shareholder returns. We will implement capital investment of about 4.5 billion yen in FY 2022–2023, and we expect it to ultimately exceed the medium-term plan target of 6.0 billion yen. In M&A, we acquired Ube Kohki and Matsuda Kiko in FY 2022 and FY 2023, and recently we acquired another small company. As for shareholder returns, with dividend payout ratio of 60% as a standard, we have continued with a dividend payment of 30 yen per share.
The key point in cash allocation in the current medium-term plan is that we are allotting about 70% of capital investment and M&A and other such growth investments on a cash-out basis. We expect this to bear fruit and give returns in the next medium-term plan. On the other hand, we expect the amount of shareholder returns to decline, though we will continue to maintain dividend payout ratio at a high level.

Q What are the key points regarding the contents of capital investment and M&A, and what is the future policy? Also, what are your thoughts on shareholder returns?

Regarding capital investment, we are constructing a development test center at the head office in FY 2024, which is scheduled to be completed in the next term. A new factory is also being constructed, our fifth one (Factory E), which will be completed within the current fiscal year. Currently, we have four factories for building plants and two for belt conveyors within the head office site. We will construct another block. In the future, we will relocate the two belt conveyor production facilities and use the head office factory exclusively for AP and BP. We expect improvement

in production efficiency with this. The development test center will have a demo facility where customers can visit and observe tests and will also be used for business negotiations. This facility targets the AP-, BP-, and recycling-related plant fields. The current Techno Center is dedicated to design and development, but we plan to enhance demonstration function at the development center. Taking the above into account, it is likely that the investment will fall to around 4.0 billion yen in the next medium term.
Regarding M&A, we have so far acquired two contract-based manufacturing companies. While capital investment will most probably come down in the next medium-term plan, we will put more efforts into M&A up to a maximum of 5.0 billion yen, primarily with focus on suppliers. This is expected to expand the business domain. We have set the scope of investment for M&A between 1.0 and 5.0 billion yen and EBIT (profit before tax) between 0.3 and 0.5 billion yen. There are already several M&A candidates, and these are companies that can add technological edge to our products. Also, we are not thinking of acquiring any foreign companies at this point of time. Depending on the M&A, we may also consider taking out more loans, if necessary.
For shareholder returns, we aim to maintain dividend payout ratio of 60% or higher also in the next medium-term plan. We would also like to consider share buyback with an eye on capital productivity.

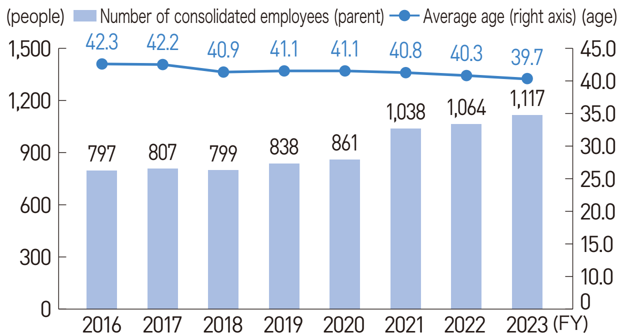
◆ Trends in capital investment, depreciation and amortization, R&D expenses



Q Nikko has also been strengthening human capital in the past few years for achieving the long-term vision. What are the objectives behind that and its impact on profits? Also, what is the outlook?

We hired 32 new graduates and 33 mid-career employees for a total of 65 people in FY 2023. This is a further increase from the number of people we hired in the year before that (32 new graduates and 21 mid-career hires for a total of 53). Taking those who retired into account, we had net increases of 40 people in FY 2024 and 35 in FY 2023. We have already decided on accepting 44 new graduates in FY 2024, and personnel expenses have increased significantly as upfront investment for achieving the long-term vision.
Personnel expenses for the first quarter of FY 2024 was 1.6 billion yen due to the impact of wage increases and new hires, which is an increase of 0.15 billion yen year on year. In particular, we are increasing human resources in maintenance and engineering-related divisions. There is overwhelming shortage of hands in the maintenance division. If we can secure sufficient human resources, we will be able to acquire new projects, but the current situation is that we have been unable to do so in some cases. As it takes about seven years to become a full-fledged service personnel, we are aiming to increase staff by 10% every year and expect to produce results in five years in terms of revenue. We are also considering raising fees and price of parts in the maintenance service business. Our

◆ Trends in number of consolidated employees and average age



service fees are lower compared to other companies, so we are thinking of raising the unit fees also to attract more contractors. We aim to increase the number of contractors taking these into account so as to secure work volume and avoid missing out on opportunities. We have not yet decided on the specific timing for unit fee revision but plan to implement it as soon as possible.

In the next medium-term plan, while the policy is to rather keep in check the overall number of hires, securing human resources in specific fields remains a high priority. Currently, we are proceeding with the development of a contamination removal device called “AI'll be sorter,” AI-based aggregate diagnosis for BP, and asphalt mixture remote shipping system for addressing the AP plant operator shortage, but we are facing a shortage of outstanding technicians to promote these projects. As it is difficult to hire such staff from within Japan, we are considering hiring graduates from the Indian Institutes of Technology (IIT). There are 23 IITs in India, with the one in Hyderabad having especially good facilities. We are planning to hire engineers from this institute in the future, and we already have hired a female employee in the personnel division who is proceeding with the hiring activities.