To Achieve 2030 Vision and Sustainable Growth

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The Nikko Group relies on the objective perspective, as well as pieces of advice based on diverse experience, offered by its outside directors in order to ensure that its Board of Directors has meaningful discussions and to improve the transparency of management decision-making. The three outside directors discussed progress in the Medium-Term Management Plan 2024, which Nikko defines as the investment phase toward 2030 Vision, and expectations and challenges to meet to achieve sustainable growth after the Plan.
(Discussion held in August 2024)

Monitoring Progress in Medium-Term Management Plan 2024

Sadakari: There are four items on the checklist I use when I review progress in the Medium-Term Management Plan 2024. The first item is whether the profitability of AP, Nikko Group's core business, has improved; second, whether a pillar of a third business apart from AP and BP has been established; third, how much progress the Group's international operations have made; and finally, investments in new business areas including M&A and outcomes thereof. I particularly pay attention to how the businesses that have become part of the Group through M&A are contributing to synergy between their businesses and the Group's main businesses. I also carefully watch post-integration risk management.

Saeki: I expect the financial targets set in the current Medium-Term Plan that ends this fiscal year to be met if the Thai subsidiary successfully cuts its deficit. Key financial data are presented to the Board of Directors, and I believe that the Group can further strengthen its supervisory function by allowing its outside directors to review the post-M&A integration process and data on the status of key projects.

Ishii: The current Medium-Term Plan is defined as the process for establishing the foundation of 2030 Vision, and I believe that the goal of ASEAN markets' penetration has been achieved. Nikko's technologies, especially solutions the Group offers to the issue of climate change, will be in demand across Asia. I hope that discussions for the next Medium-Term Plan will lead to establish a foothold in the Vietnamese, Indonesian, and Indian markets, like it did in the Thai market. To this end, Nikko needs to meet the challenge of hiring and training suitable human resources.

Sadakari: The targets set in the current Medium-Term Plan include net sales of 50 billion yen, and it is coming into view. In regard to operating income, the AP business's earnings rate has been picking up, which will likely be a positive factor. The Group has overcome negative factors, including the load of up-front investments in Thailand and China's economic slowdown, to reach the point where the target profit is in view. I am impressed with this outcome. In the next Medium-Term Plan, I will continue to focus on improvement in the profitability of the AP business. This is because to continue investing in growing Asian markets will be difficult unless the core business, which boasts an overwhelming market share, steadily generates cash.

Saeki: Given rising personnel expenses, improving domestic business profit margins is crucial. We should think in a more strategic manner that entails having specific logic behind price revisions to increase margins to a certain level. This is different from improving the earnings rate as a direct consequence of lower cost rates. Since it is difficult to revise prices without convincing customers, we should work to clarify the reasons for revisions and improve transparency.

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Ishii: As a company plays a part in strengthening national resilience, I think Nikko should raise its national profile. For this reason, we should consider focusing more on public relations. Having a higher profile will help in recruitment and lead to the Group's greater ability to negotiate prices, producing a far-reaching investment effect.

Now that more women are in managerial positions, I hope that the advancement of diversity and inclusion will pick up speed.

Business management geared to profitability and growth

Sadakari: When considering M&A, Nikko does a good job of setting a hurdle rate to discuss return on investment. However, I believe that the Board of Directors could use more discussions about processes and logic needed to reach target return on equity (ROE). I think it is necessary to strengthen ROE management in order to achieve the goals set for 2030 Vision.

Saeki: The overall capital efficiency of the businesses and the profitability of projects are reported as outcomes to the Board of Directors. That said, I believe that there should be more discussions about processes. I think that detailed explanations about processes to achieve target ROE, coupled with how the processes can be rolled out to business divisions, will generate more in-depth discussions about capital investment to revisit, among other topics.

Ishii: I believe that the Board of Directors should have more in-depth discussions about process management. For example, the Board could deconstruct return on investment capital (ROIC) to discuss how to examine each factor. That said, I think the Board of Directors has done great jobs when it comes to making decisions on and carrying out M&A. Synergy between the main businesses and acquired businesses has begun to emerge, contributing to revenues.

Saeki: When we assess a business to acquire, I intend to weigh whether the acquisition is in line with Nikko's long-term strategies. I believe that outside directors will be able to offer more input if each acquisition is presented to the Board of Directors a little earlier.

Sadakari: Nikko's investment in the business in Thailand adds up to 5 billion yen, including liabilities, which is an enormous amount. To keep expanding the scale of the company, Nikko has no choice but to advance into growing Asian markets. I highly value Nikko's commitment to making critical management decisions to actively invest in ASEAN markets and generating revenues.

Business management geared to sustainability

Sadakari: To achieve carbon neutrality, Nikko has been working on the development of new products, including burners that use hydrogen, ammonia, and other alternative fuels. Demand for these decarbonization products depends on regulatory moves, such as carbon pricing. Yet Nikko as a responsible leading company cannot get away

with not preparing for those moves. In connection with human capital, Nikko has been making steady progress in updating the personnel system and enhancing training programs. I think that the challenge the Group must meet in the coming years is hiring and training human resources capable of managing international businesses. Whether they are Japanese or not does not matter.
Saeki: I am impressed with Nikko's initiative to visualize employees' well-being. Now that more women are in managerial positions, I hope that the advancement of diversity and inclusion will pick up speed. The practice of working long hours has been improving. That aside, I believe providing working environments that are congenial to anyone regardless of gender will lead to higher well-being scores.
Ishii: Asphalt for paving uses a mixture of recycled paving materials. Crushers and crushing plants offered by Nikko play a key role in the recycling process. These crushers are also used to clear away debris in disaster-stricken areas. Given that the need for resource recycling is no doubt expected to grow across Asia, I hope that Nikko will work to increase its corporate value while creating social value.
Saeki: Advancing into international markets has expanded value chains. So, in regard to actions to address human rights issues that also involve suppliers, I think Nikko should assess risks based on not only Japan's standards but also international standards.
Sadakari: Full-time Audit & Supervisory Board members share risk information with us in a timely manner. Employees' overtime hours and work-related accidents, along with information provided by whistleblowers, are also promptly reported. I also find the regular meetings for information exchange between auditors and outside directors meaningful.
Saeki: Since the start of regular meetings with executive officers, we have been able to gain a clear picture of risks involved in achieving targets and what actions have been taken to address issues at just the right time. I also think that the Board of Directors will be able to have more in-depth discussions about situations surrounding overseas subsidiaries if we understand risk information early on, in addition to hearing reports on outcomes at board meetings.
Ishii: I am not concerned much about the status of internal control at overseas subsidiaries. I admire their management's ability to manage risks, and their internal audit departments and auditors properly perform onsite audits.

Role and function of the Nomination and Remuneration Committee

Sadakari: The outside directors as members of the Committee participated in the process of selecting executive officers this time. Assessments by external professionals were also conducted. I believe that Nikko took a significant step by incorporating outsiders' perspective into the process for selecting human resources who will become part of its management. The Group is moving ahead in choosing human resources who will manage its business, and so it should present specifically how it plans to train the talent and give them duties. I personally believe that these human resources should be trained as deputy managers of business divisions so that their management skills will develop.
Saeki: I would like candidates for the management team for the next fiscal year to gain management experience at overseas subsidiaries. Problem-solving skills in an organization with diversity operating in a different culture will become an essential qualification for the management team of Nikko that will be rapidly globalizing. I also intend to ensure diversity by appointing women and foreign nationals as next-generation management team members. What is vital to this end is that women become aware of their ability to work among decision-makers. Nikko should provide more refined environments that allow women to choose flexible ways of working.
Ishii: I hope that working overseas will be established as a career path. Nikko's international businesses are an extension of the AP business and have a lot in common with domestic businesses. Younger employees as well as middle-ranking employees should also take up the challenge of working in overseas locations.
Sadakari: To establish a well-developed remuneration system, the Committee openly discusses issues regarding the ratios of performance-linked compensation, validity of evaluation indicators including those for individual performance. I personally hope to create a remuneration system that sets more ambitious goals and incorporates incentives more according to achievements.
Saeki: As for performance evaluation indicators, I think that incentives designed to balance short- and long-term indicators are essential. Given the need for greater productivity, incorporating those indicators will probably work. Currently, as I see it, Nikko's key themes are operational efficiency and the advancement of digital transformation. Nikko should focus particularly on digital transformation because the outcome of the effort will have a direct impact on business model innovation and employees' ways of working.

I highly value Nikko's commitment to making critical management decisions to actively invest in ASEAN markets and generating revenues.