Aiming to Further Enhance Corporate Value

NAOYOSHI KASUGA

Director and Group CFO

GROUP CFO MESSAGE

Review of FY6/24 Business Results

In FY6/24, the first year of the "BE GLOBAL 2028" Medium-Term Management Plan (hereinafter "MTP"), both sales and profits increased from the previous year, and all KPIs got off to a good start, exceeding the plan. In particular, net sales of the Digital Transformation (DX) Promotion Business grew significantly by 21.7% y-y, and within Consolidated Financial Disclosure Business, the Outsourcing business also continued to perform well, with sales up more than 20% y-y, and both businesses improved their profitability, resulting in a significant increase in profit. Meanwhile, the Management Solutions Business, which is taking on the challenge of creating new markets, finally began to get back on track in the fourth quarter, after a difficult start due to sales activities hampered by the impact of the Group's business reorganization. As a result, although consolidated net sales grew at the same level as the previous year, the growth rate of consolidated net profit was 36% y-y, far exceeding the 25% CAGR targeted in the MTP, due to increased profits in each business segment and a decrease in one-time expenses incurred in the prior year in connection with the Group reorganization.

However, there are still four years left in the MTP period, and we cannot rest easy at this point. The average annual growth rate of consolidated net profit over the five-year period of the previous medium-term management plan was 14.5%, which is quite high. We believe that it is impossible for each company to achieve this goal simply by proceeding along the same path as before.

Analysis and Evaluation to Enhance Corporate Value

The Group has incorporated stock price analysis into the regular agenda of the Board of Directors, and at the beginning of each monthly meeting, the Board of Directors evaluates the movement of the Group's stock price relative to a group of similar companies currently selected for comparison and the group of companies to which it is aiming, and reports and discusses the factors behind this movement. In addition, by adopting P/B as a measure of corporate value improvement and expanding it into four components that lead to improvement of P/E and ROE, we clarify the strategies that must be addressed by the Group as a whole, while monitoring the implementation of each strategy through changes in each indicator.

Specifically, although the Group has set a target of 8x P/B, the current P/B ratio is 5.37x*, which is still a considerable discrepancy. As mentioned earlier, P/B is broken down into P/E and ROE, and while the respective targets are P/E of 40x and ROE of 20%, ROE was 24.3% in FY6/25 2Q, but P/E is still at 20x, so it needs to be nearly doubled going forward.

*FY6/25 2Q average

Utilize the Tree to Improve P/B

Improvement of P/E

P/E is theoretically calculated as 1/(cost of shareholders' equity - expected long-term growth rate). Therefore, P/E is expected to increase if we transform our business model through the promotion of our Software Driven Strategy, which will reduce the cost of shareholders' equity and increase the expected growth rate of profit.

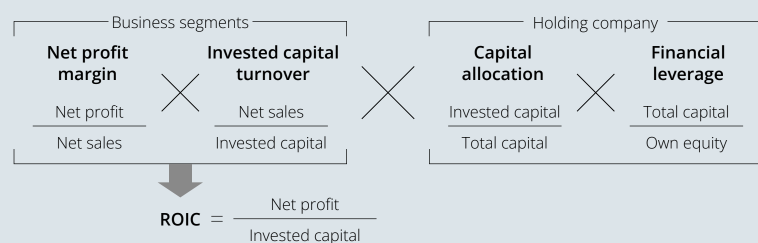
The only variable among the components of cost of shareholders' equity costs expressed in the Capital Asset Pricing Model that can be controlled by the company to some extent is beta, and we believe that lowering it can be done by, for example, making the cash flows to be earned in the future more certain. However, we recognize that the Group's current business model is still flow-based and centered, and as a result, cash flows are highly variable, thus not resulting in a lower beta and no decrease in the cost of capital. In order to stabilize cash flow, it is necessary to implement a Software Driven Strategy and shift the entire Group to a recurring-type business model represented by SaaS companies.

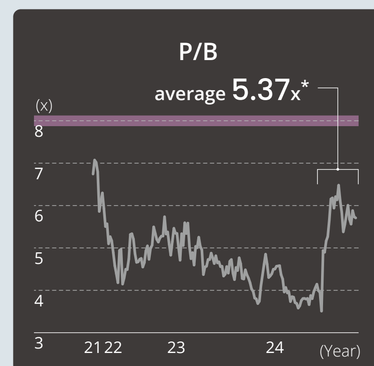
The concept is also the same for improving the expected growth rate of net profit. For products that take time to implement, rapid expansion in scale is unlikely, and profitability will decline because a larger percentage of deals will be service sales, but for SaaS companies, once they are able to develop a marketable product or solution, sales may grow exponentially through its sale, and as a result, we believe that the expected growth rate of profits that will be earned later in the year will increase, which is likely to lead to a higher P/E.

Improvement of ROE

In the DuPont decomposition, ROE is usually expressed as net profit margin x asset turnover x financial leverage, but it can also be expanded as follows.

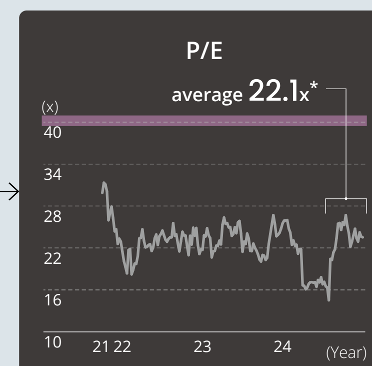
Augmented DUPONT Formula





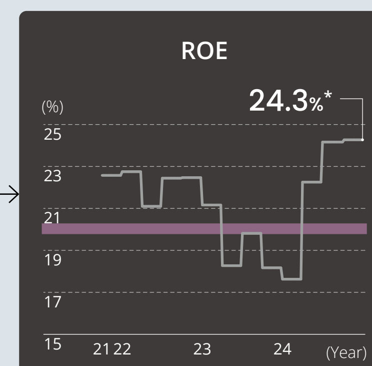
*FY6/25 2Q average

Target: 8x



* FY6/25 2Q average
Calculated from P/B and ROE

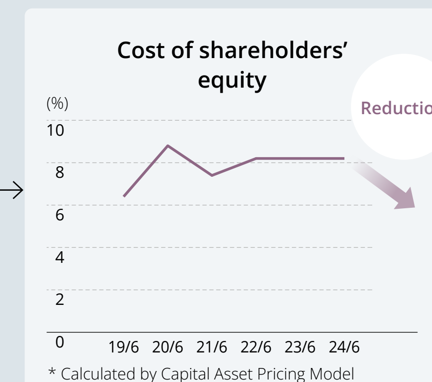
Target: 40x

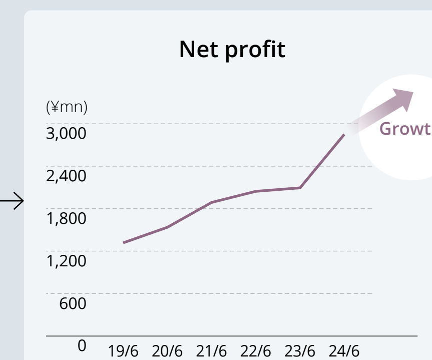


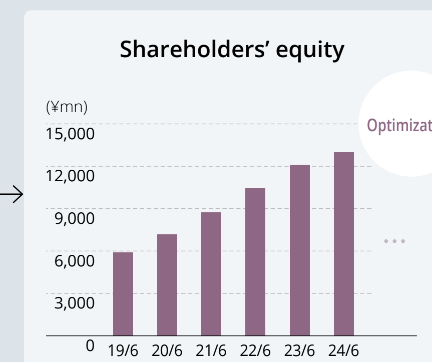
*FY6/25 2Q

Target: 20%

Measures to improve P/E and ROE







Approach to financial strategy

Business model transformation through growth investments

Capital allocation optimization

Creative dialogue with investors

The first two elements constitute ROIC, and we can see that to maximize it, each business must maximize profitability by making the best use of capital invested. However, since none of our Group's businesses are capital-intensive, we are currently not so conscious of asset turnover. On the other hand, in order to become a "world-class software company" as stated in the Group's vision, we identify and benchmark global SaaS companies and use the Rule 40*, which is used by many managers and investors in the SaaS industry, as one measure to compare and analyze their performance with our own. Since the previous MTP, we have been working to implement Rule 40 in all business segments, and each business is striving to maximize the two components of ROIC while taking into consideration the balance between sales growth and profitability (operating profit margin). To encourage these activities, performance bonuses for each of the operating company directors for each fiscal year are to be paid in accordance with the Rule 40 approach.

* Rule 40 is a management indicator based on the sum of a company's growth rate and profitability (usually using net sales and operating profit, EBITDA, free cash flow, etc. in the numerator) being at least 40%. It is particularly used by software and SaaS companies for a simplified assessment of the balance between growth and profitability. In general, meeting the criteria suggests sound management, but the weighting of growth rate and profit margin can be changed as necessary to take into account the economic environment, and new criteria such as Rule 50 have recently emerged.

Capital Allocation Optimization

On the other hand, the remaining two elements in the extended DuPont formula described earlier indicate the role that we, as the holding company, play as the main entity, i.e., to optimize capital allocation to maximize the ROIC and ROE of the group and to maintain an appropriate level of equity capital.

For example, in terms of capital allocation, when the current MTP was first formulated, the plan was to actively pursue small investments, considering about ¥3.5 bn of the ¥5 bn for the first growth investment over the three-year period from FY6/24 to FY6/26 as seed money for capturing future growth opportunities outside the group. However, as the number of investment targets, including recruitment of future management candidates and research and development, has increased within the Group, we have decided to reduce the amount of investment allocated to the search for growth opportunities outside the group to ¥1.5-2.5 bn, and to shift the surplus to investment in internal group businesses that are expected to yield more reliable results in a relatively short period of time, thus the Company has decided to increase the amount allocated to internal investments. Although expenditures for human resources and research and development are recognized as expenses for accounting purposes, they are also considered investments, and we intend to execute them more aggressively than before during the current MTP period. On the other hand, small investments will be made with the minimum discipline that ROIC exceed the cost of capital, with the objective of acquiring from outside the company a variety of SaaS solution groups that will help increase corporate value, which will be provided through our proprietary platform, TRINITYBOARD. For example, in business areas where future growth is expected but there is still much uncertainty, as a potential alternative to in-house R&D, where approrpriate we will pursue initiatives such as ties with domestic SaaS start-up including the possibility of longer term comprehensive business alliances, or acquiring exclusive sales rights in the Japanese market for products and solutions developed by an overseas startup company that are not developed by our Group.

We are also revising our plan at the time of the announcement of the current MTP for a ¥15 bn second growth investment phase, including large-scale M&A, which was planned for FY6/27 and beyond. Based on the negative financial impact factors of corporate M&A, such as large temporary cash outflows and several years of lower profits and ROE due to goodwill amortization, as well as the organizational and human resource burden of PMI, we currently do not believe that M&A is the only way to go at all costs. Rather, in my opinion, as in the first three years, we expect to continue to make new and additional investments in businesses, products and solutions that contribute to the formation of our SaaS Suite that will help enable us to increase our corporate value, regardless of whether the target is inside or outside the Group. As of 2023, the adoption of International Financial Reporting Standards (IFRS) was also on the agenda for consideration, based on the benefit of non-amortization of goodwill, but after discussion by our Board of Directors, we decided to forego this option, judging that improving accounting figures is not essential.

Shareholder Returns

With respect to shareholder value, we emphasize maximizing total shareholder return (TSR) over the medium to long term. TSR is broken down into capital gains and income gains, and capital gains will be enhanced by improving P/E through sustained growth in net profit and reduction in the cost of shareholders' equity, as mentioned earlier, and by improving EPS through an increase in net profit itself. Income gains will continue to be targeted at DOE of 8%.

As part of its shareholder return policy, the Company has also been acquiring its own shares since the fourth quarter of FY6/24. Frankly speaking, I personally considered our acquisition of own share to be an undesirable use of cash and cash equivalents, as it could be seen as a statement of the lack of good investment opportunities within the Group. However, through dialogue with the Group CEO and discussions at the Board of Directors' meeting, we reaffirmed that the conversion of cash and cash equivalents into treasury shares opens up the possibility of using it for incentive compensation for employees and officers and for future M&A, and that, at least in the short term, it is expected to contribute to improving ROE, thereby increasing the share price. Although we must give due consideration to liquidity, I believe that this will continue to be an option to make effective use of cash and cash equivalents and will be implemented appropriately. Incidentally, for employees, a lump-sum purchase of five years' worth of restricted company stock was made through a trust bank to provide each employee who had been with the company for one year with an annual grant of ¥50,000 worth of restricted company stock. Our intention was to raise awareness of the need to increase corporate value by having employees hold shares in the company, and we are seeing a gradual increase in employees' interest in the share price.

Creative Dialogue with the Market

In FY6/24, we conducted 99 individual meetings with institutional investors. More than 40% of these investors are foreign investors, and we place particular emphasis on dialogue with growth-style investors among them. In addition to helping to eliminate information asymmetries and reduce the cost of shareholders' equity, dialogue with investors also helps us to improve our strategies. For example, the review of the balance between the amount of internal investment and the amount of investment to procure growth assets that I mentioned earlier referenced the exchange of opinions when we met with foreign institutional investors who have been long-term owners of our shares. On the other hand, before the business

reorganization, the most common question was about the Consolidated Financial Disclosure Business, the Group's ancestral business. However, now there is more interest in the market trends and product status of the Management Solutions Business, and we feel that the growth strategy since the current MTP is gradually gaining understanding.

CFO Succession Planning

Finally, I will share progress on the Group CFO succession, which I mentioned as an issue in last year's Integrated Report. Although CFOs are expected to play a variety of roles these days, I personally believe that, at a minimum, CFOs need to have a good balance of knowledge in both finance, which is a forward-looking perspective, and accounting, which is an accurate understanding of past performance and analysis of its causes and effects. But, of course, knowledge alone is not sufficient. Regardless of whether the candidate is appointed from inside or outside the Group, we believe that the candidate having experience as CFO of an operating company is a shortcut to the next Group CFO appointment. This is because, compared to the holding company, at an operating company the CFO is more likely to be able to visualize the results of individual activities, and by building a track record and a relationship of trust there, it is more likely to be recognized as "natural progression" within the Group.