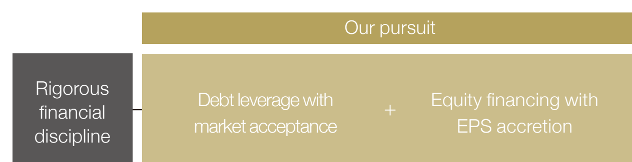
Our Finance Strategy Presented by Co-President Wakatsuki

How Shareholder Value Is Maximized »» See pages 3-4.

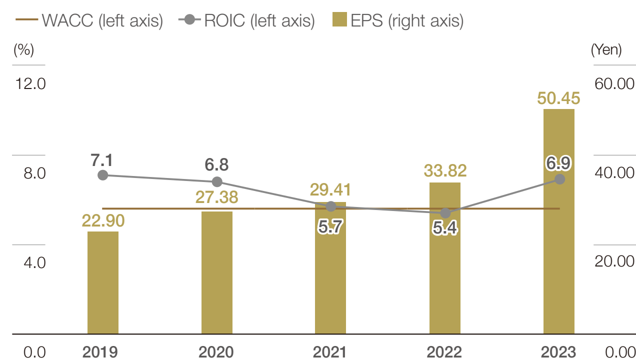


Our consolidated ROIC performance

In 2023, our consolidated Return on Invested Capital (ROIC) reached 6.9%, reflecting a 1.5 pp increase compared to 2022. This improvement is primarily attributed to: (1) limited increment in goodwill absent large-scale M&A activities in 2023, (2) accelerated compounding of EPS within our existing businesses, and (3) improved Cash Conversion Cycle (CCC), particularly in our China business. We estimate our Weighted Average Cost of Capital (WACC) to be around 6%.

Over the past five years, while EPS has steadily increased, ROIC has remained static in the range of 5-7%. This stability is largely due to the posting of goodwill associated with our M&A activities.We consider this to be inevitable for a company that places M&A as a pillar of its growth strategy.

WACC/Consolidated ROIC/EPS



* ROIC (IFRS): After-tax operating profit / (net debt + total equity)

Our approach to ROIC

We have noticed increased interest from our investors concerning our approach to ROIC. To address this, I would like to clarify our basis by answering the following questions.

Q1 Are we acquiring companies with high capital efficiency?

Our strength as Asset Assembler lies in our ability to consistently make safe acquisitions. While our goal is to maximize long-term and sustainable EPS through these acquisitions, we believe that a strategy overly focused on improving ROIC does not optimally utilize our platform nor align with our overall strategy. I would like to emphasize that the companies we acquire (1) operate their businesses with high capital efficiency relative to the invested capital, such as working capital and capital expenditure, and (2) generally present low business risks and high safety due to their stable business models, strong brand power, and quality management teams.

Please refer to the chart labeled "ROIC of major acquired assets" on the following page. Since we are allocating capital entrusted to us by investors for acquisitions, our standard procedure is to examine the respective ROIC of each acquisition. Our goal is to achieve an ROIC that surpasses the WACC within a few years post-acquisition. Indeed, the

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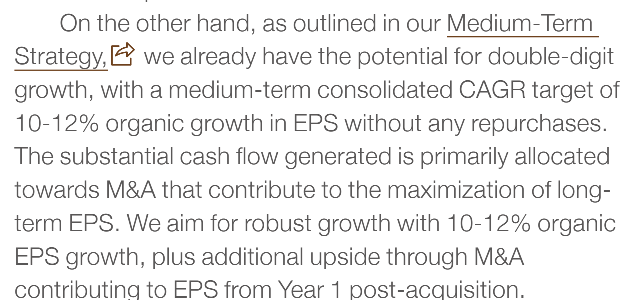
major five companies we acquired since 2019 have either already seen their ROIC exceed the WACC or are on a steady path towards this goal, with all demonstrating year-on-year improvements in their ROIC. For your reference, observing the evolution of individual companies' ROIC excluding goodwill shows that these companies already had relatively high ROIC immediately after their acquisition, specifically in Year 1 or Year 2 post-acquisition.

There is a common perception that companies actively engaged in M&A carry significant risk. However, a unique characteristic of our business is its high efficiency: we generate cash and profits locally, and our capex requirements are relatively low. As we consistently acquire such safe companies our Group, even with the inclusion of goodwill in our consolidated accounts, can be confidently described as a collection of very low-risk assets.

Q2 How should we interpret your strategy for returning value to shareholders? Are there any plans to enhance shareholder payouts?

During our dialogues with investors, some have expressed a desire for double-digit expected growth rates. We note that our business domain generates substantial cash flow that can be deployed towards share repurchases, rather than undertaking M&A, which will consistently improve ROIC. Indeed high-ROIC paint manufacturers can demonstrate a scenario of achieving double-digit growth through a combination of single-digit organic EPS growth and share repurchases.



On the other hand, as outlined in our Medium-Term Strategy, we already have the potential for double-digit growth, with a medium-term consolidated CAGR target of 10-12% organic growth in EPS without any repurchases. The substantial cash flow generated is primarily allocated towards M&A that contribute to the maximization of long-term EPS. We aim for robust growth with 10-12% organic EPS growth, plus additional upside through M&A contributing to EPS from Year 1 post-acquisition.

Based on this strategy, our approach to returns is twofold: (1) to expand the basis of EPS growth through M&A rather than focusing on short-term shareholder returns, and (2) to reserve cash flows as dry powder (standby funds) for future M&A, even if this reduces leverage in the short term. While we have consistently acknowledged the potential for equity financing in acquisitions, we prioritize debt financing given the lower cost. In this context, short-term returns such as share repurchases could also create an opportunity loss by limiting our financing optionality for larger-scale acquisitions.

Within our Asset Assembler model, we do not set limitations on the business areas, regions, or scale of our M&A targets as long as they are low-risk and offer good returns. Given the abundance of safe targets that contribute to EPS, we believe our policy and strategy are justifiable. As we naturally consider ROIC as one of the key indicators, we are dedicated to achieving organic profit growth and shortening CCC. However, we believe it is not appropriate to rely solely on consolidated ROIC to evaluate the potential of our Company.

ROIC of major acquired assets*

	2019	2020	2021	2022	2023
DuluxGroup (Pacific)	-	3.6%	4.2%	5.6%	5.8%
Betek Boya	-	9.4%	11.8%	8.1%	12.6%
PT Nipsea	-	-	3.7%	5.3%	6.5%
Cromology	-	-	-	2.6%	3.1%
JUB	-	-	-	-	5.9%

* ROIC (IFRS): after-tax operating profit (after PPA amortization of intangible assets) / acquisition cost (including transfer consideration and subsequent capital increase, etc.), converted into Japanese yen using actual exchange rates
* The ROIC calculation for DuluxGroup (Pacific), Betek Boya, and JUB excludes Year 1 as these companies were acquired during the fiscal year.
* The ROIC for DuluxGroup (Pacific) is calculated by subtracting Cromology and JUB from DuluxGroup's consolidated figures. The 2022 figures exclude expenses related to the acquisition of Cromology and JUB, as well as expenses related to other small-scale acquisitions.
* The ROIC for Betek Boya is calculated using the statutory effective tax rate for 2022 and 2023, as the tax rates were at abnormal levels due to the application of hyperinflationary accounting and other factors.

For reference: ROIC of major acquired assets (excluding goodwill)*

	2019	2020	2021	2022	2023
DuluxGroup (Pacific)	-	9.7%	10.5%	12.6%	12.9%
Betek Boya	-	16.8%	21.1%	14.5%	22.5%
PT Nipsea	-	-	13.8%	19.5%	24.1%
Cromology	-	-	-	6.9%	7.8%
JUB	-	-	-	-	8.4%

* ROIC (IFRS): after-tax operating profit (after PPA amortization of intangible assets) / acquisition cost (excluding goodwill but including transfer consideration and subsequent capital increase, etc.), converted into Japanese yen using actual exchange rates
* The ROIC calculation for DuluxGroup (Pacific), Betek Boya, and JUB excludes Year 1 as these companies were acquired during the fiscal year.
* None of these companies incurred any acquisition-related costs in Year 1.
* The ROIC for DuluxGroup (Pacific) is calculated by subtracting Cromology and JUB from DuluxGroup's consolidated figures. The 2022 figures exclude expenses related to the acquisition of Cromology and JUB, as well as expenses related to other small-scale acquisitions.
* For the ROIC calculation of Betek Boya, the goodwill excluded from the denominator does not reflect the effects of hyperinflationary accounting. The statutory effective tax rate is used for the 2022 and 2023 calculations, as the tax rates were at abnormal levels due to the application of hyperinflationary accounting and other factors.

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Our financial discipline

Our financial discipline focuses on prioritizing debt financing while preserving leverage capacity to maintain access to low-cost funding. Recognizing the crucial importance of fostering a clear understanding of our Company's risk profile among financial institutions and rating agencies, we are facilitating active dialogue with these entities and enhancing our disclosure materials.

Financial discipline

1. Prioritize debt financing
2. Maintain the leverage capacity and promote engagement with financial institutions
3. Equity financing remains an option assuming EPS accretive

Balance sheet management

KPI: CCC, CF, Net Debt/EBITDA, ROIC, etc.

Balance sheet management

In terms of balance sheet management, we have established CCC as one of the key performance indicators. Each partner company is working to shorten CCC by reviewing transaction terms within each region and business. As a result, we saw a considerable improvement in our CCC in 2023, particularly within our Asian operations, notably in China. While our fixed assets (tangible and intangible assets, goodwill) have increased primarily due to our M&A activities, we have been proactively monitoring these assets with an emphasis on efficiency and profitability. Our marine business within Japan Group, for one, has undergone structural reforms. Regarding goodwill, we strive to minimize impairment risks by selecting cash-generating target businesses, ensuring smooth post-merger integration (PMI) through our autonomous and decentralized management approach, and consistently pursuing high-quality M&A at reasonable valuations.

Regarding our financial leverage, in 2023, we saw a significant rise in cash generation, driven by revenue growth and an improved CCC. As a result, our net debt/EBITDA ratio decreased to 2.2 times by the end of the year (see the chart below). Our debt financing is primarily denominated in yen, and as of the end of 2023, we have achieved a highly stable debt composition, with an average duration of 3.5 years and a pre-tax average interest rate of 0.4%. Moving forward, while retaining adequate debt capacity to seize new opportunities, we will strive for an optimal capital structure and work towards fostering trust and creditworthiness with financial institutions and rating agencies.

Capital allocation

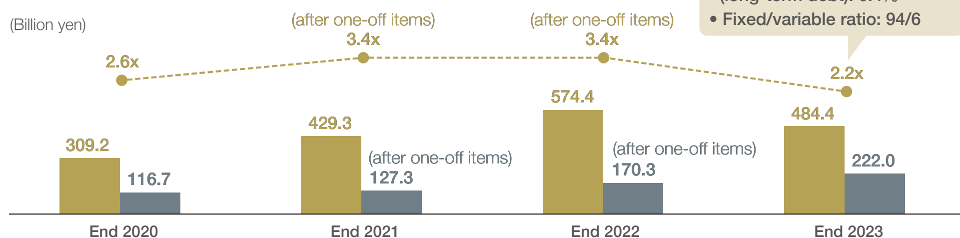
Our capital policy prioritizes growth-oriented investments while maintaining financial discipline, with the primary objective of sustainable and long-term maximization of EPS, ultimately leading to the maximization of PER (see the diagram below).

We deploy capital expenditures aimed at securing future sustainable growth noting the burden of capital investment is relatively small, accounting for only approximately 3% of revenue, mostly in maintenance capex. We maintain a disciplined approach to new investment initiatives aimed at enhancing production capacity, reinforcing digital transformation (DX), and advancing research and development across all regions and business segments. Consequently, M&A remains our most capital-intensive investment. In line with our Asset Assembler model, we will continue to focus on accumulating high-quality, low-risk M&A at reasonable valuations. Our current dividend policy aims to maintain steady payments with a target payout ratio of 30%, considering overall business performance and investment opportunities.

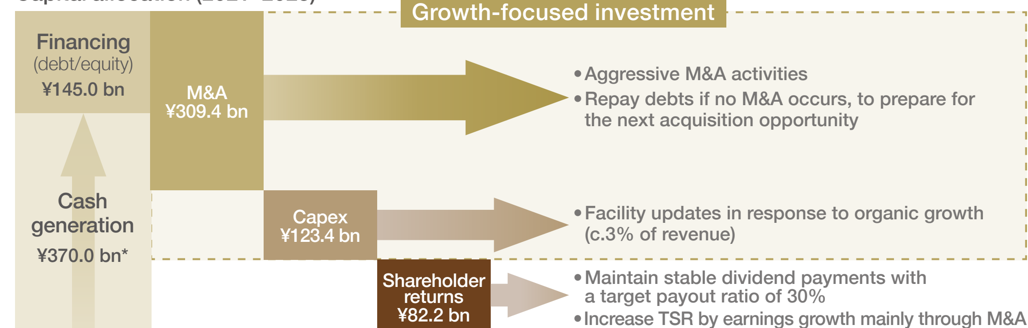
Reflecting on the three-year period from 2021 to 2023, we generated approximately JPY370 billion in operating cash flow, while allocating approximately JPY120 billion to capital investments, approximately JPY80 billion to dividends, and more than JPY300 billion to M&A activities. Although our net debt increased, we also experienced a rise in EBITDA. Given the nature of our businesses, we remain in a safe zone for debt leverage.

Regarding share buybacks, despite our dissatisfaction with the current stock price as of the end of July 2024, they are not under consideration at this point in time. We believe that utilizing our valuable capital for safe M&A activities will contribute more to the sustainable compounding of EPS in the future than allocating it to the purchase of our own shares. However, we remain flexible and will continue to assess market trends, keeping all options open for the future.

Net Debt/EBITDA



Capital allocation (2021–2023)



* Operating cash flow (on a continuing operations basis)