QA session at the briefing for earnings results for the fiscal year ended March 2023 and the new medium-term management plan “VISION2025”

Q: The new medium-term management plan, “VISION 2025,” was very promising, with a clear message of "aiming to achieve a P/B ratio of more than 1.0x as soon as possible." One aspect that was a little confusing was the section on redefining and optimizing the business portfolio on page 8 of the mid-term plan materials. In the matrix, the OEM Business (dealer-installed products for the domestic market) and the Aftermarket Business in the Mobility & Telematics Services Sector (M&T Sector) are both positioned as revenue base businesses and treated as highly capital efficient. My understanding, however, is that the primary reason why the company's capital efficiency and the P/B ratio remain low is because of low capital efficiency in the M&T Sector, which accounts for the majority of revenue. I have doubts about the fact that the M&T Sector is positioned as a business that is highly capital efficient and in which you will grow sales in the mid-term plan, so I would like to hear your thoughts on this point.

A: As we are looking to maximize corporate value, the business portfolio is segmented by revenue CAGR on the vertical axis and our hurdle rate on the horizontal axis. Segmentation is based on internal capital efficiency, not the current ROIC. Under our approach, revenue base refers to a contribution to business profit, while also generating a certain level of marginal profit and contributing through revenue, so this is what our threshold for segmentation shows. Specifically, the Aftermarket Business itself is positioned as a revenue base business because it has a very high operating profit margin within the M&T Sector, while the Entertainment Business is also positioned as a revenue base business because it has been highly profitable to date. The reason why the OEM Business (dealer-installed products for the domestic market) is also positioned as a revenue base business is because of its current position and our intention to improve this business into a revenue base business as part of our medium-term vision.

A: Supplementary explanation. We are now thinking about how to generate marginal profit with a light asset base. Although the market has been declining in the Aftermarket Business, we hope to improve the capital efficiency of this business as a revenue base business through business expansion with the aim of increasing market share and improving efficiency. The OEM Business has struggled considerably over the past two years owing to issues such as semiconductor shortages and price hikes caused by rapid increases in component prices. On the other hand, in the previous medium-term management plan, we have worked to improve production efficiency, including utilizing design and technology assets accumulated in the past and now this downsizing of our production base in Shanghai, China. We will also ensure that profits are secured by shipping products that have already been ordered for domestic automakers, as well as products that will be ordered in the future, in a manner suited to an efficient production environment. As a result, we believe that capital efficiency will continue to be optimized going forward, and we have therefore positioned the OEM Business (dealer-installed products for the domestic market) as a revenue base business in this new mid-term plan.

Q: I now understand why you are positioning the M&T Sector as a revenue base business. With that in mind, in terms of the future direction of the M&T Sector, according to the materials, you plan to increase revenue and business profit, but what is the future outlook for the M&T Sector in terms of invested capital? The term "increased efficiency" has come up several times, but can we think of this as being able to grow business profit even while limiting invested capital?

A: We will continue measures such as necessary development for our growth-driver businesses and the expansion of our factories to increase production, but we intend to focus on capital efficiency as we develop our businesses, constantly taking into consideration the balance between revenue and invested capital.

Q: I think the market environment in the M&T Sector contains many volatile elements. If revenue were to fall, would that change your approach to business profit? I understand the company’s desire to increase revenue based on various business opportunities, but perhaps this is not a market where revenue will increase as we head into 2030.

A: As part of the new medium-term management plan, we will change the revenue breakdown between the OEM Business and the Aftermarket Business. In addition, sales of products such as in-vehicle speakers, amplifiers, antennas, cables, and lenses are currently growing rapidly in the Chinese and European OEM markets, meaning that the proportion of revenue from car navigation systems and display-audio products, which were previously the mainstay of our OEM Business, is gradually decreasing. In the future, in China and other markets that are growing as they shift to EVs, we plan to expand our range of in-vehicle speakers, amplifiers, antennas, cables, lenses, and other products that differ from our mainstay categories to date.

A: We would like to aggressively increase revenue, but as you pointed out, the market itself (for car navigation systems and display-audio products) is not growing to such an extent, so we have now decided to end our business activities at our factory in Shanghai. During the period of “VISION 2025,” we intend to promote management that balances market expansion/contraction and investment, while also basing our operations on the premise of increasing production efficiency at factories.

Q: About the Safety & Security Sector (S&S). The business profit margin is not expected to change much through fiscal 2025, but in your plan, are you assuming that fixed costs will increase for the next few years, as they did this fiscal year? Also, on page 18 of the mid-term plan materials, it states that the company is "in the process of converting to a portfolio based on maintenance services as a source of revenue." What sort of rate will the business profit margin increase at over the next few years, and what sorts of things can contribute to the improvement of the business profit margin?

A: In relation to business profit through fiscal 2025, marginal profit will naturally increase in line with revenue, but in this and the next fiscal year, we will make necessary investments in human resources as we look toward the expansion of our business in the North American public safety market. At the same time, orders for the private market are also extremely strong, so we intend to invest in production facilities to boost production. In addition, although not mentioned in the materials, we are considering investing in development in this and the next fiscal year, in order to expand our product lineup for 2025 or 2030. As a result, we expect that business profit will remain around the same level as the previous fiscal year.

Regarding the maintenance services described on page 18 of the mid-term plan materials. System orders for the public safety market typically require two or three years after an order is received to generate revenue from the order backlog, and maintenance services are accompanied by contracts for around eight years. That means the more system orders increase, the more revenue from maintenance services also increases. Currently, maintenance service revenue accounts for 10% or less of the total, but we want to increase that to around 20%.

In terms of the breakdown of revenue from the North American public safety market, we expect professional radios to make up at least half of revenue by 2025. We expect systems and services to make up approximately 41% of revenue by 2025, and we intend to ensure it makes up the majority by fiscal 2030 as a result of our investments in this fiscal year and the next. This will also create synergies in the form of increased revenue from professional radios.

Q: What is your target for the S&S Sector business profit margin in 2030?

A: At present, the overall profit margin in the S&S Sector is approximately 15%. As revenue grows, so does marginal profit. Accordingly, we hope to increase the profit margin to around 20% by 2030.

Q: About the M&T Sector. In relation to ASK industries, S.p.A. (ASK) in the overseas OEM Business and display-audio sales in Southeast Asia, is it safe to assume that business plans have been determined for the next few years and unforeseen negative factors, including costs, are unlikely to occur?

A: ASK has already secured many orders for its China and European businesses, and expects to continue to grow orders. Development for display-audio products in Southeast Asia and major new North American orders is also progressing in line with plans. Accordingly, as long as there are no notable abnormal conditions, business progress will be smooth.

Q: Page 14 of the mid-term plan materials provides a breakdown of growth investments and strategic investments with cash outflows totaling 100 billion yen. In this breakdown, to what extent do you anticipate investments related to environmental considerations when building new factories, etc.? Do you have any kind of outlook regarding any areas where initial costs will be higher than in the past?

A: First, we are considering investing around 15 to 20 billion yen in new businesses, but these investments have not been confirmed, so we will be making decisions as appropriate. One thing that has already been confirmed is the creation of the “Value Creation Square” that we described earlier. This is an environmentally friendly building, and although no specific amount has been set, we are making progress on efforts to build this new environmentally friendly building, even at a cost. We are also thinking of reorganizing our bases, etc., as a form of office allocation, and we would like to focus on reducing our impact on the environment, including such measures.

Q: There may be differences between businesses, but what do you see as the company's strengths, including aspects such as human capital and intellectual property, as well as strategy and business expertise beyond patents? How do you plan to utilize these strengths in your new medium-term management plan?
A: Page 24 of the mid-term plan materials. As part of our technology development strategy, we have established the Future Creation Research Laboratory, and we are particularly focusing on creation related to patents. We hope to connect technologies such as optical communications, AI technology, which is now mainstream, and digital twinning, a simulation technology, with our current strengths in "sound," "communications," "video," and "design," and use these connections to create our next business opportunities. We are not yet ready to open it up, but we're also targeting major patents related to "inferential AI," and we hope to enhance our strengths in such areas as well.

Q: Page 8 of the mid-term plan materials. It is stated that the growth potential of the company's businesses are expectations over the next three years, but can we assume that capital efficiency is based on current actual performance?
A: This expresses our intention to develop businesses into revenue bases by enhancing capital efficiency over the next three years. For example, we are shifting production in our OEM Business (dealer-installed products for the domestic market) to Japan, based on supply chain issues and geopolitical risks. In addition, we will seek to build revenue bases in conjunction with "Monozukuri (Manufacturing) Reform," such as design reforms and factory reforms based on automation.

Q: What is the level of the capital efficiency line that separates the left and right in the four-quadrant matrix on page 8 of the mid-term plan materials? Is it the company's target ROIC for 2025 of 9%?
A: We use our weighted average cost of capital (WACC) as a hurdle rate for basic classification on the horizontal axis. At present, the rate is 5-6%. We created this four-quadrant matrix with the intention of moving up further in the positive direction from there.
A: A supplementary explanation concerning redefining and optimizing the business portfolio. Our capital efficiency is the previous year's hurdle rate, which divides the matrix into left and right based on a weighted average cost of capital of 5-6%. There are four categories, which are incorporated into our mid-term plan measures, including businesses that we will raise to the relevant quadrant during the mid-term plan period, and businesses that we will improve from their current structure to make revenue base businesses.
On the other hand, as we have seen in the last two years, a lot of things can happen, including market changes and the emergence of competition. Accordingly, we consider this portfolio to be a dynamic component of the mid-term PDCA cycle. For this reason, we must periodically review our portfolio in accordance with the business environment, different earnings cycles, and changes in the environment, and we intend to constantly update our portfolio to the optimal form. We will also promote business and structural reforms as needed. Our approach during the mid-term plan period can be seen here.

Q: On page 14 of the mid-term plan materials, growth investments amount to approximately 65 billion yen, but how will you allocate this amount to each business? Also, how will you make progress in the future in the restructuring businesses, which are positioned at the lower left of the four-quadrant matrix mentioned earlier?
A: Growth investments will mainly be related to areas such as product development and molds, and will basically be allocated in proportion with revenue, with slightly more than half going to the M&T Sector, around 30% for the S&S Sector, and the remainder for the Entertainment Solutions (ES) Sector. Going forward, we will also examine specific measures for businesses for restructuring in our portfolio, which we described earlier.

Q: About exchange rates. The waterfall chart on page 29 of the financial results materials does not include anything about foreign exchange in the previous fiscal year. On page 19 of the financial results materials, there is a negative impact of 3.4 billion yen from currency hedges in the current fiscal year, giving the impression that a weaker yen will increase costs for the company. What sorts of things led to this increase of 3.4 billion yen? Also, how was the previous fiscal year, and the fiscal year before that?
A: We basically sell in Japan what we manufacture at our factories, through our head office in Japan, or

we export these products to sales companies, etc., overseas, but at present, we are importing more than we export in US dollar terms, meaning that if the exchange rate moves toward a weaker yen, our costs will rise. In the fiscal year ended March 2023, the yen depreciated sharply from around June and July, but the materials do not show any impact from the yen's depreciation because we had forward exchange contracts (hedges) covering fluctuations in foreign exchange rates for the next year or so, meaning that the impact of yen depreciation was limited even if the yen depreciated significantly during the fiscal year. For the fiscal year ending March 2024, we expect a negative impact of about 3.4 billion yen from foreign exchange hedging on the difference in the forward rate between the previous fiscal year and the current fiscal year, because we entered into forward contracts when the yen was weak.

Q: Does this mean that forward exchange contracts have already been completed for the current fiscal year and the company will be less susceptible to the impact of future fluctuations in foreign exchange rates?
A: We have forward contracts for one year, so even if foreign exchange rates fluctuate significantly during the current fiscal year, it will have little impact on earnings.

Q: On page 14 of the mid-term plan materials, it states, "approximately 10 billion yen, including asset sales." In the company's past financial results, although you have often recorded one-time gains, I understand that there have also been some cases of one-time losses on the likes of restructuring expenses. How should we think about this? It was indicated in the balance sheet that the company would again incur expenses associated with closing the factory in Shanghai, China.
A: First, we expect that these anticipated asset sales will consist of the sale of factories that have already been closed, etc. We are aiming for cash inflows of approximately 10 billion yen over three years, but basically we do not expect a significant impact on profit and loss. As for the closure of the Shanghai factory, we have already factored in expenses associated with retirement, etc., into our earnings forecasts.

Q: There have been some releases concerning matters such as the transfer of the new healthcare business, but are you saying that confirmed sales amount to 10 billion yen, not the accumulation of such business sales?
A: This 10 billion yen does not include the transfer of the new healthcare business. We expect to be able to generate the 10 billion yen from the sale of land, including a factory in Thailand that closed at the end of March 2022.

Q: What is your expected outlook for the competitive environment with companies such as A and B in the Communications Systems Business over the period of the mid-term plan?
A: We do not expect any significant change in the competitive environment with Company A. While Company A originally had a market share of around 70%, we have captured and grown our market share, resulting in an increase in sales. Company B has been shut out of North America market, so its impact on us is not very significant. Accordingly, although we will continue to compete with Company A in the market, we expect that Company A's product supply will improve starting from this summer. However, we also have backorders, and our monthly orders are very strong. We expect orders to remain strong, as we do not anticipate any change due to response to global crisis management or increased demand following the switch from analog to digital.

Q: On pages 20 and 21 of the mid-term plan materials, it mentions utilizing IP*. Does this mean you have a large amount of existing IP that is not utilized, so you will utilize it? Or does it mean taking risks and investing in new IP, where you were not successful in the past?
A: Now, for our new Entertainment Business, we intend to develop and grow our IP business, which will be different from the existing so-called sound source business, and we are also considering investment for this purpose. The IP itself will not belong to the company, but we will use other companies' copyrighted property, described as strong intellectual property (IP) and well-known around the world, for business development. We are also planning original IP and will provide related information when appropriate.