Financial strategy

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Chief Financial Officer

Message from the CFO

Our PBR (price book-value rate) was 0.66 at the end of FY2023, and I take the fact that our PBR was below 1, very seriously. I recognize that the biggest cause is our ROE (return on equity) being as low as 4%. We used to have an ROE of over 8%. While our decline from over 8%, which we were previously capable of maintaining, was partially due to deteriorated capital efficiency caused by increased capital, the main and root cause was the significant drop of our business profitability. I acknowledge that our first step to improving this situation is to recover our profitability in our core businesses as soon as possible.
Our current initiatives to tackle are: (1) promotion of portfolio transformation, (2) curation of investments, and (3) the “Best Practice Project”, a company-wide cost reduction project. The main goals of these initiatives are for the improvement of Denka Group’s profitability, but they also lead for the pursuit of a robust constitution of the company. These three initiatives are therefore designed to improve our capital efficiency at the same time. I firmly believe that they will help us improve our ROE, in terms of both profitability and efficiency. None of these initiatives are easy to implement and involve various challenges and difficulties. However, I acknowledge that we are currently at a difficult stage, which is inevitable for the Group's future growth, and we will continue to work to deal with this situation.

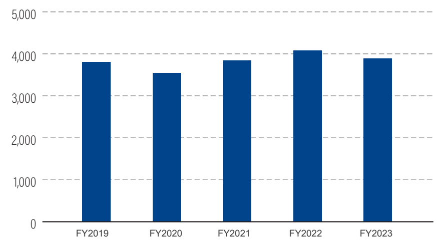
1. Status of the initial year of management plan “Mission 2030”

In FY2023, the initial year of our management plan “Mission 2030”, the net sales were 389.3 billion yen (-18.3 billion yen year on year) and the operating income was 13.4 billion yen(-18.9 billion yen year on year), resulting in decreases in income and profit year on year.
In addition to changes in the economic environment, including the prolongation of the decline in demand for semiconductors, downturn of China's economic growth, and global inflation, various factors such as the decline in demand for chloroprene rubber, we were not successful to achieve an increase in sales to balance the cost for the forward-looking investments and other expenses planned in the previous management plan “Denka Value-Up”. Despite some extraordinary income from the sale of strategic shareholdings, we are facing unsatisfactory results, with the overlapping of the aftermath of the Noto Earthquake and impairment loss due to the termination of norovirus vaccine development. While our operating income, ROE, ROIC (return on invested capital) significantly declined in FY2023 along with the downturn, the facilities we had invested up front for will start operations in the upcoming fiscal years. While capturing these potential demands, we will have no change in our long-term strategy of driving our growth strategy stated in our management plan “Mission 2030”.
Our management plan “Mission 2030” sets ROE and ROIC as the primary KPIs to promote management with the capital cost in mind and enhance corporate value.

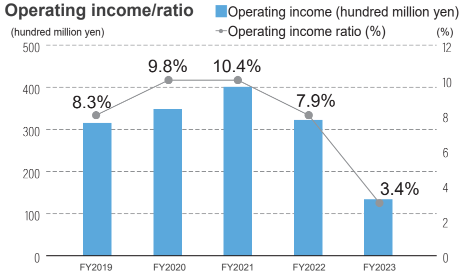
We aim to increase our ROE to over 15%, and ROIC to over 10% by the year 2030. By applying ROIC to the business assessment, we will advance our portfolio transformation, as well as enhancing our profitability and capital efficiency.
Also, under the financial disciplines with ratings in mind, we will pursue the optimal capital structure using financial leverages for improving ROE. While our ROE and ROIC in FY2023 experienced significant declines as stated above, we will implement initiatives to improve them in terms of both profitability and capital efficiency.

	FY2023	FY2030 KPI
Operating income	¥13.4 billion	100 billion yen or more
ROE	4%	15% or higher
ROIC	2.5%	10% or higher

Net sales (hundred million yen)



Operating income/ratio



2. Three Measures for the Recurrence to Growth Track

1 Business portfolio shift

Top priority: Fundamental measures for the chloroprene rubber business

Fundamental measures for nonprofitable businesses take the top priority. It is important to turn nonprofitable businesses into highly profitable businesses, and we are discussing this matter with the Portfolio Transformation Committee. ▶P25 This is not a mere measure for improving profits but an issue of optimal allocation of assets and capital. Denka has many assets accumulated in its long history, and we strive for regenerative reformation by reallocating capital from the businesses with low profitability to the growing businesses. We sold our strategic shareholdings, primarily aimed at enhanced governance, many of which were assets for older businesses or common assets that do not directly lead business profitability. By converting them into money, which will be allocated for investment capital in the growing fields, we will achieve our portfolio reformation.

2 Revision of investment plans

Curation of investment projects: Aiming at 100 billion yen reduction in the investment cash flow in eight years

We aim to deduct approximately 100 billion yen of investment expense from the initial plan in management plan “Mission 2030”. The aim is to maintain our financial principles in a situation where the current performance is significantly lower than the initial plan, but it is not a simple suppression of investment. By reviewing the megatrend demands through examination, we will not hesitate to make investments required for our business growth. In addition to investments for growth based on the increase of demand in the future, a large amount of investment expenses is inevitable to maintain and update the current facilities as well as for safety and quality. We have made quantitative judgment on investments for growth in terms of investment efficiency (profitability). For investment for maintenance and update, we will introduce ROIC (return on invested capital) as a quantitative criterion from the last fiscal year to make stricter judgment on investments. For investment for growth, needless to say, we should make more accurate evaluations of their underlying demand forecasts.

3 Best Practice Project

Cost deduction: More than ¥10 billion/year in FY2026　Operational efficiency: Growth of each employee

Besides the eternal factor of declined demand for electronic materials and decreases in other demand, our low profitability in the core businesses is largely due to the increased fixed costs. We believe that we will regain demand for semiconductors and other electronic materials for smartphones, PC, and xEV, and we are in process of establishing our production systems. We also think that, on the other hand, the current fixed costs will prevent us from achieving the level of our highest profit in the past, even if we regain the net sales. Cost reduction is an inevitable initiative for us to get back on track with our business growth. We have made efforts to reduce costs as a part of daily operations. Unlike the conventional initiatives, however, this project is our first attempt to analyze the cost with external experts and to incorporate best practices.

3. Cash Allocation

● Optimal capital structure

We will finance businesses by examining the optimal capital structure in terms of capital efficiency and financial health and by leveraging interest-bearing liabilities while controlling it with a D/E ratio of 0.6 - 0.8.

● Proactive shareholder returns

With anticipation of the improvement effects from the fundamental measures for the chloroprene rubber business and marketing cash flow improvement from FY2025, we will make proactive shareholder returns with the same or increased dividends with a return ratio around 50% over eight years total in the management plan “Mission 2030”.

● Curated strategic investments

Trends in capital investments by four business divisions ▶P42

We will ensure to continue to invest in important projects for our growth strategy. For strategic investments, we will clarify the priorities of investment projects, further curation of investment plans, and reviewing schedules for less urgent projects to control investment cash out, deducting 100 billion yen from 570 billion yen of investment cash flow in eight years planned in Mission 2030 management plan, resulting in 470 billion yen. Even after this reduction, the annual average investment will still exceed 1.5 times the amount invested during the five years stated in the previous management plan “Denka Value-Up”.

Curated investment projects

	FY2024	FY2025	FY2026 and later
ICT&Energy	Enhancement in spherical silica business (In action in the 1st half)	Enhancement in silicon nitride business (In action in the 1st half)	Acetylene black New manufacturing site in Thailand (in operation in the 2nd half of 2026) Investment value: 4 hundred million dollars
ICT&Energy	Heat dissipation sheet site relocation/ new plants (In action in the 1st half) Investment value: ¥1.7 billion	LCP film equipment in operation	Methane to Acetylene Introduction to Omuta Plant (in action in the 2026 1st half) Investment value: ¥6.7 billion yen
ICT&Energy	SNECTON manufacturing/ marketing (Starts in the 2nd half)	TBM equipment in operation	Scheduled investment for SNECTON
ICT&Energy	Enhancement in emitter business (In action in the 2nd half) Investment value: ¥1 billion		
Healthcare	Enhancement in clinical reagent/ diagnosis kit business (In action in the 2nd half) Investment value: ¥11 billion	Enhancement in G47Δ production Investment value: ¥12 billion	
Sustainable Living		Polyethylene drainpipe Toyo Drain site relocation/new plants (in operation in the 1st half) Investment value: ¥2.3 billion	Methane to Acetylene Roll out to Omi Plant
Sustainable Living			Carbonated admixtures/ concretes LEAF Scheduled for investment

[Denka's mindset for capital investment]

Prioritizing and curating investment projects are important for a company to grow. To clearly understand the capital cost when making decisions for equipment investments, we make decisions with the weighted average cost of capital (WACC) in mind. We also adopt the internal rate of return (IRR) as an investment criterion for our strategic and growth investment to curate the investment projects.

▶Strategic investment
Investments that contribute to the growth in the core areas, investments that lead to process transformation (production, research, and operation), and investments targeting energy saving and carbon neutrality, etc.

▶Growth investment
Investments to increase profit, excluding strategic investments

	Strategic investment	Growth investment
IRR15%≦	Investable	Investable
	Determined strategically	In principle, difficult to invest
	In principle, not feasible to invest	In principle, not feasible to invest

4. Raising funds through sustainable finance

Denka is also looking to raise funds through ESG and SDGs initiatives. In the last three years (FY2021 to FY2023), approximately 50% of our long-term funds were procured through sustainable finance, which we will continue to actively utilize in the future.