

## CFO's Message

# Achieve sustainable growth and improve enterprise value by realizing both a sound financial position and growth investments through strengthening business portfolio management

## SATO Hirofumi

Senior Managing Executive Officer, CFO



In FY2022, the final year of the previous mid-term management plan, we had set a target of 140 bn yen in segment profits (operating profit + equity method profit), but with a tailwind from the global surge in raw material prices, we achieved 417 bn yen, nearly triple our target. Although this result exceeded our expectations, our analysis posits it as a result of our raw material procurement portfolio and the risk control ability we have built up to date, which have enabled us to appropriately respond to significant market fluctuations.

In FY2023, we are assuming raw material prices on a normal basis, so a significant decrease in profits is inevitable compared to FY2022, and we are forecasting segment profits of 154.8 bn yen.

## In the execution of the new mid-term management plan, respond flexibly to the drastically changing business environment and explain the process in detail

The new mid-term management plan, Compass Transformation 23–25, is a more concrete implementation of Compass Action, an action plan through 2030, with a three-year period from FY2023–FY2025. We have positioned these three years as a period for us to accelerate a transformation, and it will be very important for determining the certainty of the path to 2030 as depicted in Compass Action.

The profit forecast for the new mid-term management plan appears almost flat, but there are some changes in the content. As announced in October 2022, we are currently in the process of selling our upstream assets in Australia, and we expect to lose the operating profit from the Australian upstream business during the new mid-term management plan period. This is a challenging indicator, as we are aiming to reach 150 bn yen in FY2025, after compensating for this loss with other factors. In addition to profit growth in the electric power business, we would like to achieve this by selecting projects that can

Introduction

Introduction  
Contents

CEO's Message

CEO's Message

How We Create Value

How We Create Value  
The Value Creation Process  
Promoting Sustainability and Material issues

Business Strategy

Business Strategy  
Compass2030 & Compass Action  
Compass Transformation 23-25  
Strategy 1: Achieve both stable energy supply & decarbonization  
Strategy 2: Fully roll out Solutions business  
Strategy 3: Realize a flexible corporate culture resilient to change  
Introduction of Internal Companies  
CFO's Message

Corporate Strategy

Corporate Strategy  
Sustainability  
Corporate Governance

Financial Data

Financial Data

### Web Site

Investor Relations Website  
Investors' Guide  
(Financial Data and Industry Data)  
Financial Results Presentation Materials  
Financial Results Bulletin  
Corporate Governance Report  
Sustainability Factbook

contribute to profits at an early stage in each business and making investments.

On the other hand, with regard to the outlook for income and expenditure, we believe that it is difficult to predict three years from now amid such drastic changes in the business environment. During the previous mid-term management plan, there were significant changes in the business environment, such as a decline in demand due to the impact of COVID-19 and a fall in crude oil prices, that disrupted the assumptions in the plan. In the actual situation, the effects of this change were carefully examined and reworked for the plan for that year. Based on this experience, we believe it is important in the new mid-term management plan to respond flexibly and appropriately to changes in the environment, including changes in planned values. When reviewing the mid-term management plan, we will provide detailed explanations, including the background.

With regard to asset efficiency, although it is inevitable that volatility will cause performance fluctuations in a single fiscal year, we believe it is necessary to clear an ROA of 4% on average as a financial discipline. As shown in the new mid-term management plan, it is time to accelerate growth investments, including those related to decarbonization. To prevent a decline in asset efficiency, we will implement full-scale business portfolio management and promote the reduction and replacement of assets that are not expected to lead growth while confirming the ROA and ROIC against the required returns on a business-by-business basis. Similarly, with regard to ROE, we will first aim for 8% and proceed with business operations with a strong awareness of capital efficiency.

**Increase flexibility in cash management to maintain necessary growth investments in the face of increasing volatility**

We have revised the total return ratio from 50% to 40%. Since the rate has just been lowered from 60% to 50%, we expected to receive severe comments from shareholders and investors.

We in fact achieved a record profit level of over 400 bn yen in FY2022, but the impact of market price volatility is so great that, depending on the situation, our Group's earnings may decline significantly due to external factors. Under these circumstances, we are planning to invest 1 tn yen during the new mid-term management plan, which is necessary for decarbonization and sustainable growth. Investment decisions are made with sufficient discipline, but important investments need to be made steadily regardless of the status of operating cash flow, and depending on the timing and scale of the project, there is a risk that financial soundness could deteriorate significantly. In order to achieve stable business operations and increase business value over the medium to long term, we have decided to shift the focus of cash management somewhat to the safe side and to review the level of the total return ratio and flexibility in the management.

We want to give back to our shareholders not only through short-term returns, but also through long-term improvement of enterprise value, such as the sustainable growth of our Group and contribution toward a decarbonized society.

**We aim to improve the Price Book-value Ratio (PBR) by enhancing efficiency and profitability through business portfolio management and increasing confidence in our future growth potential.**

In the spring of 2023, we received a request from the Tokyo Stock Exchange to take action toward realizing management that is conscious of the cost of capital and stock prices for listed companies with a PBR of less than one. At our company, we consider the factors contributing to the low PBR to be that our business stability and growth potential has been perceived as declined due to the liberalization of the gas and electric power businesses and the expansion of the business domains, and that the levels of ROE and ROA have declined on lower profit as well as asset expansion.

PBR can be understood as  $ROE \times PER$  (Price Earnings Ratio), and in order to improve it, we believe that it is important to raise ROE by applying appropriate leverage while increasing ROA, as mentioned earlier. At the same time, in order to improve PER, we will work to lower the cost of capital by stabilizing the profit structure through the initiatives of the new mid-term management plan, and strive to raise expectations for future growth potential by enhancing dialogues with shareholders and investors as well as disclosure.

**Basic policy for improving PBR**

PBR

=

ROE

×

PER

Improve PBR by working to improve efficiency and profitability through business portfolio management (ROE improvement) and aiming to increase stock prices by improving market evaluation of future growth potential (PER improvement)

ROE improvement	<p><b>Efforts to improve ROA and appropriate leverage</b></p> <ul style="list-style-type: none"><li>Developing a portfolio management system (improving asset efficiency through ROA vs WACC by department and business)</li></ul>
PER improvement	<p><b>Reducing cost of capital through stabilizing the profit structure</b></p> <ul style="list-style-type: none"><li>Reducing earnings volatility by strengthening market risk management</li></ul> <p><b>Eliminating undervaluation factors and raising growth expectations through Investors Relations</b></p> <ul style="list-style-type: none"><li>Improving capital market confidence in the growth story by explaining the progress and results of investments</li><li>Enhancing disclosure of initiatives that contribute to long-term improvement of enterprise value, such as investments in human capital and technological development, through information media such as integrated reports</li></ul>