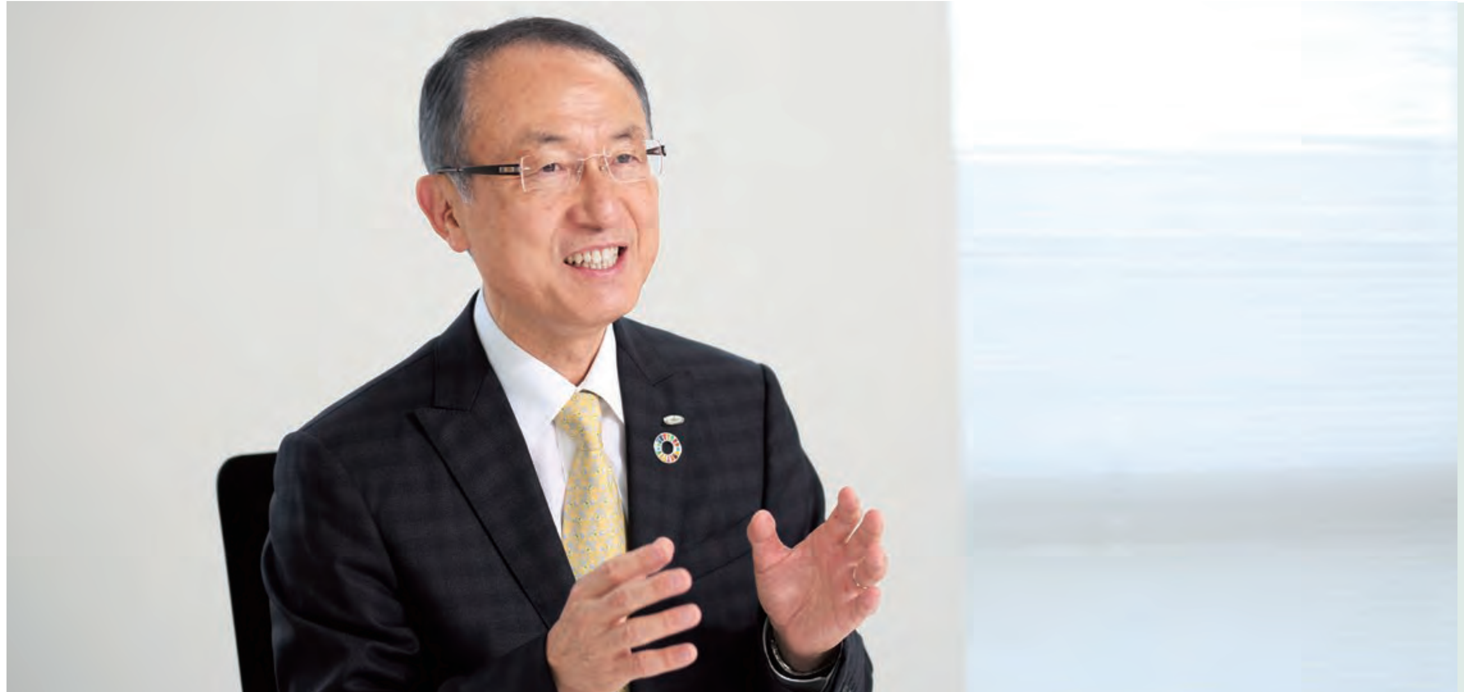
Aiming for sustainable growth by improving capital efficiency while maintaining financial soundness



Capital Policy

Emphasis on efficient business management to realize medium- to long-term growth
In addition to maximization of revenue, we will work on ROIC management (optimal fixed asset management and reduction of working capital)

Business units
- Automotive batteries (Japan)
- Automotive batteries (Overseas)
- Industrial batteries and power supplies
- Automotive lithium-ion batteries

Profits before amortization
Maximize

Invested capital
Reduction of fixed assets and working capital

Operating cash flow
Secure operating cash flow necessary for growth

Optimal mix of funds required for growth and returns

Utilization of external funds
Utilize a variety of different fund procurement methods

Investment and lending
- Capital investment for boosting production capacity in the automotive lithium-ion battery business and updating related facilities
- Major investment and lending for growth (M&A, etc.)

Shareholder return
Total payout ratio* (FY2022) **30**% or more

*Total payout ratio before amortization of goodwill

Toshiyuki Nakagawa, Chief Financial Officer/Senior Managing Director and Representative Director, GS Yuasa Corporation

Looking at reality calmly to achieve a dream

In my role as chief financial officer (CFO), there is something I think about constantly. If the company were an automobile, the chief executive officer (CEO) would be the accelerator and I, as CFO, would be the brake. The CEO's mission is to set out an expansive dream, and to lead the company's employees while taking a certain amount of risk in working to achieve that dream. Meanwhile, in order to make the dream a reality, the CFO is required to look at reality calmly, identify risks, and take accurate steps to minimize them. In corporate management, I think it is important to move forward while maintaining a balance between these two functions.

Naturally, acting as the brake does not mean overriding everything. It is clear that slowing down more than necessary is a negative in terms of corporate growth. I often tell our departments that, "I'll give you money to live, but not money to die." I would like to see the Group share in the major objective of sustainable growth, while advancing a balanced approach to investment and financial strategy.

What counts as "money to live"? And when to hit the brakes? What matters in making those decisions is a rigorous examination of the merits and demerits of each case, and their risks and opportunities. We need to judge when and how much to apply the brakes after first visualizing everything that could possibly occur. Even then, things will happen that we did not anticipate, but I believe it is still crucial that we take that approach to assessing the validity of each deal. This does not, of course, mean pushing through my own individual decisions; the process involves numerous discussions with the relevant departments based on information collection and analysis. At GS Yuasa, we also hold monthly meetings of our Facility Investment Committee, where capital investments of 30 million yen or more undergo rigorous debate by executive-class committee members based on their respective areas of expertise, ensuring the appropriateness of each proposal.

Internalizing ROIC management to boost earning power

Improving capital efficiency to prepare for medium- to long-term growth is one financial policy set out under the Fifth Mid-Term Management Plan we have advanced since fiscal 2019. Our goal is to increase earning power by introducing return on invested capital (ROIC) as a key performance indicator (KPI), and by strengthening management of revenue and efficiency at the individual business level.

Our rough guide for ROIC is a number around double our operating income ratio. We calculated our target for operating income ratio under the Fifth Mid-term Management Plan at about 6%. Therefore in fiscal 2022, the final year of the plan, that guide calls for ROIC of about 12%. I think that is a reasonable standard considering the current state of our weighted average cost of capital (WACC). The Fifth Mid-term Management Plan also lays out a goal for return on equity (ROE) of 8% in the final year of the Plan, and with an ROIC of 12%, we expect that goal can, for the most part, be cleared.

We have made considerable progress in raising awareness of ROIC management at the management level. Even during business plan reviews, we are seeing more vigorous discussion taking capital efficiency into consideration. Going forward, we intend to work at further internalizing the concept through in-house training and education. We then hope to establish ROIC management throughout the organization by, for example, incorporating the approach in making day-to-day improvements and through other practical steps.

As CFO, I also emphasize the need to ensure the soundness of our financial base. That said, my approach is not simply to raise shareholders' equity ratio to achieve debt-free management. The business environment in which the Company operates includes growth areas in which we wish to invest, so we believe a shareholders' equity ratio in the range of 40% to 50% is fine. As of the end of fiscal 2019, that ratio stood at 45.8%. If we can maintain that level, our corporate rating will stabilize, making it easier to raise funds and make bold investments in areas of growth. Another indicator of the soundness of our financial base is the ratio of interest-bearing debt to cash flow. Our target under the Fifth Mid-Term Management Plan calls for keeping the total amount of interest-bearing debt, including lease obligations, at no more than three times each fiscal year's operating cash flow, a target we have cleared with interest-bearing debt in the near term at 2.2 times operating cash flow. Personally, if possible I would like to see this happen within two years.

Continuing large-scale investments for the future, funded basically by operating cash flow

Announcement of our fiscal 2020 results forecast has been significantly delayed by the impact of the novel coronavirus pandemic. That said, we wish to present investors and analysts with at least some material on which to base their decisions, and during the announcement of our financial results on May 12, offered guidance indicating that we expect a year-on-year decline in net sales of about 10%, and a drop in operating income of about one-third. Upon subsequent examination, we announced our official forecast on August 4.

There are three major facility investment projects scheduled for fiscal 2020, and including these, capital investments are expected to total about 22 billion yen. The first is to boost production capacity in the strategic field of lithium-ion batteries for HEVs; the second is the final round of investment in the automotive lead-acid battery plant we have constructed in the Tianjin area of China; and the third is for a facilities upgrade at our head office in Kyoto. There are many aging facilities on the grounds of the head office, and over the next ten years or so we plan to renovate and relocate them. Funds for these facility investments will basically come from operating cash flow.

Note that in terms of short-term funding, we currently have a credit facility totaling nearly 100 billion yen, including the committed credit line of 30 billion yen we have maintained for contingencies. As of July, 2020, this credit facility remains largely untouched, and we believe it will be sufficient to address the novel coronavirus pandemic. A more urgent issue, in fact, is ensuring long-term funding for growth investments. From that perspective, in May of this year we worked with our two main banks to secure long-term loans totaling 5 billion yen for a term of four years.

Working to minimize the diverse risks brought on by the novel coronavirus

While we have taken all possible steps to address the novel coronavirus pandemic in terms of funding, we need to continue monitoring the global spread of infections. The impact of this pandemic on the worldwide economy is being compared to that of the recession brought on by the collapse of Lehman Brothers in 2008. More than that, I think we need to be prepared for a corresponding economic recovery to take at least around three years. As CFO, my mission is to minimize risk, and to ensure our countermeasures do not fall behind, I am more determined than ever to make swift decisions and take quick action.

Our mainstay storage battery products are important in supporting social infrastructure, and the risk of a market contraction is low. Still, that is all the more reason we must watch out for market incursions by powerful rivals. Also, while we have experienced no major problems on the production side, going forward we do need to reevaluate our production front lines, where close contact is unavoidable. We should consider investing in automation, labor-saving measures and remote work. In the supply chain, we have taken steps to address earthquakes, floods, and other natural disasters, but because infections are fundamentally different from these kinds of temporary, geographically limited disasters, I also feel the need to look at new business continuity planning (BCP) measures.

While discussions of the novel coronavirus tend to emphasize the more negative elements, major changes in our times will undoubtably also generate new opportunities. We will move forward with a positive attitude, turning risk into chance.

Targeting a total payout ratio of 30% or more based on shareholder dividends

Shareholder returns are one of the most important issues for management. Our policy is to target a total payout ratio of 30% or more combining shareholder dividends and treasury stock acquisitions. In consideration of shareholder interests, this total payout ratio is based on net profit before amortization of goodwill.

In fiscal 2019, we instituted a dividend totaling 50 yen per share (15 yen interim, 35 yen at year-end). In addition, since May, 2020, we have begun acquiring treasury stock equivalent to about 1.5 billion yen, the addition of which brings our total payout ratio to 34.9%.

A year-end shareholder dividend of 35 yen per share is planned for fiscal 2020, for a full-year dividend of 35 yen. Based on comprehensive consideration of consolidated results, internal reserves, and our financial status—in accordance with our existing rules—we believe that the additional impact of the novel coronavirus pandemic will force us to reduce the dividend for fiscal 2020.

Shifting CSR activities from a defensive to an offensive phase

CSR is positioned at the very root of the GS Yuasa Group's corporate management. Since fiscal 2016, we have been working in stages to strengthen the CSR promotion framework I set up as the executive in charge. Looking back at those efforts, I feel we have made some progress.

One of my initial thoughts is that CSR involves both defensive and offensive aspects. Our efforts to strengthen our CSR framework were triggered when we received some harsh feedback from a customer in Europe. In that sense, we began from a defensive position, but since then we have established a dedicated CSR department and formulated a CSR Policy and Code of Conduct, which in turn led to steady implementation of other steps, including clarification of materiality (key CSR issues) and our signing on to the United Nations Global Compact. Appropriate disclosure of information regarding those efforts has enabled us to gain a certain level of regard from our customers and assessment organizations.

Based on those results, I regard the Group's CSR efforts as having moved into the offensive phase. Under the Fifth Mid-Term Management Plan we set forth a goal of "establishing business processes that incorporate CSR issues into our business strategy." Our aim is for sustainable growth through business development that places particular emphasis on contributing to Sustainable Development Goals (SDGs).

Aiming to further improve corporate value from an ESG perspective

Environmental, social and governance (ESG) perspectives are also important to sustainable corporate growth. This involves not only the Group, but partner companies and others responsible for our supply chains. We are working to explore the issues, including human rights, safety, the environment, and risk management, from a multi-dimensional perspective as we advance these efforts. In fiscal 2019, we expressed our support for the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD). Prior to that, we also conducted a survey targeting some of our sites in and outside Japan regarding climate change risks, reaffirming the need to reduce CO_2 emissions. Going forward, we will conduct further internal discussions and ensure our goals are aligned before presenting our objectives as a Group.

Institutional investors taking a long-term stance have also often pointed out that, compared to our environmental and social initiatives, they find it difficult to see what we are doing in the area of governance. Based on this feedback, in fiscal 2019 we established the Nomination and Compensation Committee. In fiscal 2020, our first female outside director was appointed, and we also changed our accounting auditors. In addition, we have prepared governance training for all executives.

As of the June, 2020 general meeting of shareholders, I have left my position in charge of CSR at GS Yuasa International. Still, CSR activities are, in a sense, corporate management itself. As CFO, I will continue to engage in management from a perspective that integrates both the financial and the non-financial, conveying to our stakeholders in a timely, honest manner information about the Group's activities and issues. At the same time, I will work to further enhance corporate value through dialogue with all of you.

August 2020

T. Nakagawa

Chief Financial Officer/Senior Managing Director
and Representative Director
GS Yuasa Corporation