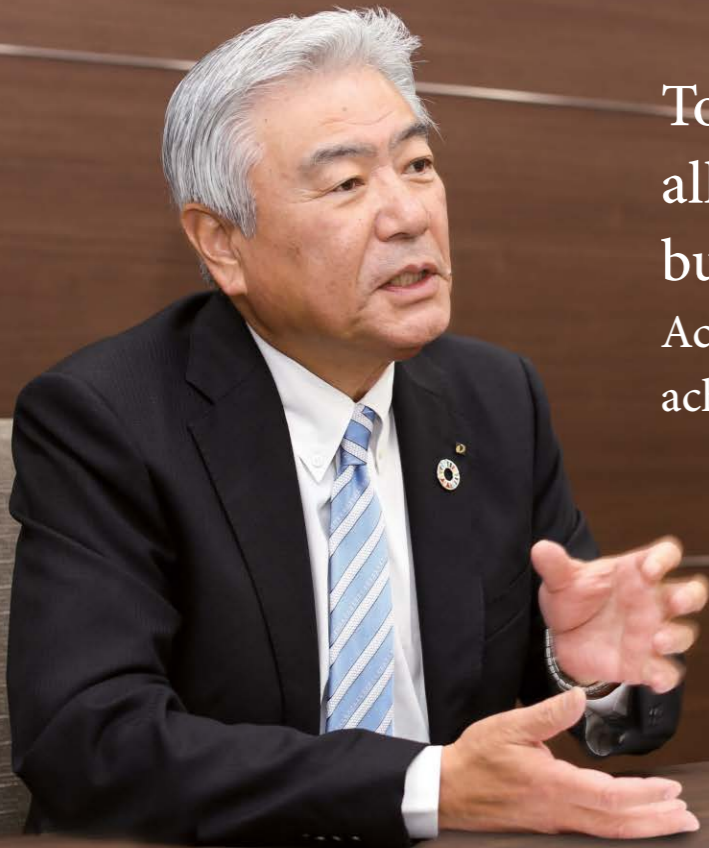


Interview with Top Management

Toward becoming an all-embracing company for building materials Acceleration of the growth strategy to achieve the long-term vision GP25



Representative director,
President

Masahori Okuda

At the completion of the previous medium-term management plan

Q Could you summarize the achievements and requirements of the previous medium-term management plan GP25 1st Stage?

The previous medium-term management plan GP25 1st Stage was designed for the first three years when we set out to realize the long-term vision GP25 for ten years into the future, on the 70th anniversary of the Company. While some quantitative targets remain unachieved, we achieved a profitable structure by improving the average return on investment (ROE) to 10% level and an operating profit ratio of 4% level over the three years of the plan. As a result, we achieved the highest ever operating profit, ordinary profit, and net profit in the first year. Over the course of the last year, we attained the managerial targets for sales and net profit, which we consider impressive achievements. I believe that *“taking the first step to become an all-embracing company for building materials”* as our corporate image and long-term vision has been established. This has been achieved through M&A that raised the presence of MDF as the core of our industrial materials business, aggressive investments that led to the development of new applications, enhanced product lines for public and commercial buildings, the opening of an R&D center, and other initiatives.

On the other hand, our greatest problem over the past year was

our short comings in material procurement, order placement and receiving systems, which caused considerable problems for customers. We failed to achieve some of the managerial targets of operating profit of 7 billion yen, ordinary profit of 7 billion yen, and ROE of 8% primarily due to the issues above. We must sincerely face these issues and take the initiative to convert these problems into strengths. Therefore, we strengthened the organizational structure by establishing the IT and Logistics Division across all departments in February 2019. In addition to implementing short-term corrective and improvement actions as basic measures, we will fundamentally review our systems from the medium-term and long-term viewpoints, thereby optimizing our supply systems ranging from order placement and receiving systems to logistics.

Initiatives in the three priority markets

Q How do you feel achievements in the three priority markets for reform into business management that will be less dependent on new housing construction starts in Japan?

Public and commercial buildings

We focused on public and commercial buildings as a priority market because the new home market in Japan as our conventional mainstay is expected to shrink. We failed to achieve the final targets, but our sales steadily increased over the past three years.

Taking into account shifts in the sales force were delayed because of relatively steady sales of the new home market, I believe that real achievements were made. In the metropolitan district, we opened a technical space targeted at customers who were professional users, which established a flow on effect to the home renovation market. We also proactively marketed new products, such as doors for the elderly, kindergartens, and nurseries; floor materials using local materials; and well-designed wall materials using the proprietary non-combustible material Dai-Lite as flagship products. These new products completed our portfolio of functional building materials that could be used in multiple situation for use in various facilities. This achievement will lead to future expansion.

Global market

If we only look at the figures, we have certainly made progress in global market as was planned in the 1st Stage. However, our progress is steady in some aspects but has problems in others. The steady aspects include the industrial materials business where we focused on MDF for which we newly acquired a new plant in New Zealand. The new structure now consists of four plants—two in Malaysia and two in New Zealand, which will increase production by 30% and expand sales channels overseas. Sales to Japan also increased, and our market share in Japan including HOKUSHIN Co., Ltd. establishing Daiken as the dominant MDF supplier in Japan.

Conversely expansion was delayed in Indonesia and China. While profitability has yet to be realized in Indonesia, manufacturing systems have been established in plants, and we have steadily advanced toward production increases. In the coming years, we will establish a structure to achieve increased sales and profitability through collaboration with local companies. In China, continued improvement would be implemented according to how the Chinese market develops. We will continue to provide products to Japanese companies and promote increased sales through agents. We will use ITOCHU Corporation network with which we established a capital and business alliance in September 2018 to address the above problems and expand into global markets.

Home renovation market

The home renovation market has been considered to replace the shortfall in new home sales, but these two markets are actually correlated as the data suggests. From this viewpoint, we implemented measures in a slightly different aspect for the renovation market.

One of the measures was to shift focus from building new to decorating styles and renovation of living in showrooms that we jointly operate at eight sites in Japan with TOTO Ltd. and YKK AP Inc. This shift from things to styles has taken root as a new form of proposal making. It cannot be denied that growth has been slow if we only look at the sales of products because the number of direct customers is decreasing from the lack of successors to construc-

tion companies and other reasons. Therefore, we also started the condominium refurbishment business in the metropolitan district in October 2016 as an initiative to expand construction projects in addition to the sale of products. With the expansion of the engineering business, we are also promoting the development of products with a short construction period and small construction projects linked to the functionalities provided by manufacturers.

These initiatives are gradually taking effect. We have also made steady achievements in other areas including the opening of R&D center for strengthening and accelerating R&D activities, which is essential for the medium-term and long-term growth strategies, reducing CO₂ emissions by proactively utilizing wood biomass boilers from the ESG viewpoint, and promoting diversity measures that include workstyle reforms and enhanced opportunities for female employees.

Regarding finance, we succeeded in increasing our financial soundness by generating additional cash from profits for new investment over and above our M&A requirement and purchase of new equipment. I think it is worth stating that we are currently enjoying the strongest financial structure experienced over the past 10 years or so.

Positioning of the new medium-term management plan

Q What do you want to achieve over the three years of the new medium-term management plan GP25 2nd Stage?

Please share how you position the plan and its key points.

In the first year of the GP25 2nd Stage, the consumption tax will be raised in October 2019, which will undoubtedly lead to a significant reduction in new housing starts. To change this high risk into an opportunity, we wish to position the 2nd Stage as a three-year period of acceleration of growth strategies and will pursue targeted sales of 225 billion yen and operating profit of 12 billion yen. The targeted profit and sales are the highest since foundation. Our final target of 250 billion yen in the long-term vision, we will substantially upgrade our stage.

To this end, we will make aggressive investments to expand the business scale and strengthen profitability by leveraging cash generated 1st Stage.

In the meantime, we have undertaken business activities that emphasize CSR and ESG. We will further pursue the *resolution of social issues through business* in the 2nd Stage through enhanced corporate values.

In this sense, we will clarify the relationship between our businesses and SDGs as *global standards for social issues*, with each employee undertaking activities emphasizing that relationship.

Accelerating growth strategies

Q What growth strategies do you have for the global market and for the domestic market?

Global market

The core of growth strategies in the global market will be expansion of the industrial materials business in global market, in particular North America. We recently invested in the LVL and veneer businesses in North America. ITOCHU Corporation originally launched these businesses, established their local positions, and produced solid achievements. I believe that when our company joins these businesses, enhanced efficiency can be gained as a manufacturer, and opportunities can be found to expand through innovative ideas, such as the development of new products. The U.S. housing market is the largest in the world and supplies approximately 1.2 million homes annually according to recent data. Taking into account the floor area per home and substantial market growth, this provides scaling of two to three times current market share. In addition, the population is expected to increase by approximately two million per year, which is rare among developed countries. Demand for LVL is mostly linked to the number of housing construction starts in the United States which in turn is influenced by long-term interest rates and housing starts. While uncertainties remain in the short-term, stable demand can be expected over the medium and long-term. It is also a characteristic that most houses are constructed of wood and therefore have a high correlation to the industrial materials and building materials businesses that we operate in Japan. Our business model incorporates technology and added value industrial materials. Daiken will expand in the North America market by deploying this business model.

We will focus on industrial materials and expect to expand into the building materials business. We continue to pursue opportunities for expansion in the MDF market in North America. By promoting these initiatives, we plan to increase the share of global market sales from 11% to about 23%.

Domestic market

Even though the new house market is shrinking, we will increase revenue in the domestic market by increasing sales of competitive products including floor materials where we have a dominant share. This expansion will be into public and commercial buildings and the home renovation market. Among other domestic markets, public and commercial buildings will be a priority. Based on the product portfolio developed in the 1st Stage, we will categorize facilities into four groups: elderly and healthcare facilities, where steady demand is expected due to the aging population; public, educational, and kindergarten/nursery facilities that need to be renovated at certain intervals; accommodations and commercial facilities that will be in high demand by inbound tourists; and buildings and offices that are continuously developed in urban areas. We will pursue expansion by proposing functional building materials for floors, walls, ceilings, and doors for each group and category.

In addition, through the full-scale expansion of the joint venture with TO Holdings Corporation, we will broaden the range of proposals by including solid floor materials that have not traditionally been part of our market range. This will enhance business opportunities, due to the on-going requirement because of the persistent need for solid floor materials, particularly by educational facilities. In these initiatives for expansion, we will proactively utilize external resources, including M&A and collaboration with other companies, without relying on internal resources alone.

Enhancement of the management foundation

Q The policy states the enhancement of the management foundation from the three perspectives of business infrastructure, financial, and ESG.

Please share your ideas from each perspective.

Restructure business infrastructure

This is included in our policy as a requirement due to the issues we encountered in material procurement, order placement and sales recovering over the past fiscal year. Through these problems, we recognized the importance of IT supply systems and logistics that operate every day. Through this experience, we will review *our foundation to be continuously chosen* in the 2nd Stage.

The specific initiative is to establish systems that enhance service to customers. We have aimed at systems that are easy to use by customers, but they need to be upgraded to achieve enhanced convenience. Such upgraded systems will become powerful tools in strengthening the relationship with customers. We will identify all requirements and establish optimal systems that range from IT and logistics functions to manufacturing in pursuit of increased competitiveness in the medium and long-term. In the meantime, we will reduce the workforce for routine internal operations by proactively using AI, IoT, and other advanced technologies so that we can place human resources in new positions that become necessary through the development of new businesses and markets.

Optimize our financial foundation

In the 1st Stage, we invested in large-scale M&A and new products, as well as in the opening of an R&D center and other initiatives that will lead to growth. While maintaining the dividend payout ratio of at least 30% as a return to stockholders, we improved the capital adequacy ratio and D/E ratio, thereby strengthening our financial structure.

In the 2nd Stage, we plan to improve profitability for the next stage and further enhance our cash position. Based on cash generation through these initiatives, we will invest 5 billion yen per year on average for normal maintenance and renewal, and 40 billion yen in strategic initiatives for the North American industrial materials business. Through these investments of 55 billion yen in total, we will pursue further growth and infrastructural establishment. According to our plan and despite these investments, if we improve profitability and asset efficiency as targeted, we will maintain the dividend payout ratio of at least 30% large and achieve a D/E ratio of about 0.5 times with a capital adequacy ratio of approximately 40%. Large investments will exhaust our operating cash flow. We will need to draw down on corporate bonds and loans to cover the short fall.

Practice of ESG management

We have proactively promoted ESG. Particularly in the environmental space, I believe that business activities since our foundation, such as CO₂ emissions reduction, timber recycling, and the cascading use of wood products, have contributed to the environment. In this regard, we will continue to promote these initiatives rather than implementing any new measures, at this stage.

As a specific initiative, we intend to achieve the CO₂ reduction target announced by the Japanese government based on the Paris Agreement, a *reduction of 26% from fiscal 2014 by 2030*, but in fiscal 2022 the final year of the 2nd Stage, which is earlier than requested by the government, as our contribution to countermeasures for the most significant climate change risks. In addition to high public interest in water resources, chemical substances, waste, and compliance with environmental laws, we have also selected environmental contribution in fields that characterize our businesses, such as carbon fixation through the wood industrial materials business, and the increased share of use of domestic timbers in materials for flooring manufacturing.

In social aspects, we would like to focus on *product quality* and *human resources*, which are vital elements for a manufacturer. As the social responsibilities of a manufacturer, the guaranteeing of product quality is particularly important for customers. We will strengthen the structure by ensuring we continuously and promptly respond to public and customer quality and safety concerns. For human resources, we selected diversity, workstyle reforms, human resource development, and occupational safety and health as the four aspects we will promote. Particularly in human resource development, we will not only promote skill upgrading but also substantially enhance training programs in particular for executive managers who will be with the business over the medium to long

term. In addition, the highest priority will be placed on enhanced opportunities for female employees in everyday operations, as was the care in 1st Stage. In the 2nd Stage, targets will be set and balanced from a multitude of perspectives. This will include harmony with long-term care requirements and security of employment for veteran employees assessed on an impartial and bias free manner.

Regarding governance, the dissemination of the group corporate philosophy was selected, in addition to compliance and risk management. Our company faces a historic turning point where the domestic new home market as our conventional market will start shrinking. We must survive this severe market environment by realizing our long-term vision and growth strategies as presented by the medium-term management plan. To this end, it is essential that all employees in the group participate and exercise their skills. The mission of the group corporate philosophy is that *We will create a wonderful future with our technology, ideas, and passion*. *Create a wonderful future* here signifies the realization of a sustainable society and our contribution to SDGs as social issues. Dissemination of the group corporate philosophy to each employee will provide the basis for our contribution to the resolution of social issues and for the success of our business. Unfortunately, this philosophy was not fully disseminated throughout our group in the 1st Stage. We will seek further dissemination in the 2nd Stage until the philosophy takes root and employees understand not only the literal phrase but also that it is at the core of Daiken group corporate philosophy.

Toward the achievement of the new medium-term management plan

Q Please share your mind about the new medium-term management plan GP25 2nd Stage.

I regard the 2nd Stage as the most important stage for the realization of the long-term vision. First, we must definitely attain the targets in the 2nd Stage by pushing forward the achievements made in the 1st Stage. Our ultimate goal is the long-term vision GP25 be attained in fiscal 2026. Toward its realization, we must take an additional leap in the 3rd Stage, which will start in fiscal 2023. In this sense, we need not only attain the targets of the 2nd Stage but also steadily sow seeds for the next leap in the 3rd Stage.

One of the requirements to this end is to find the fourth pillar after industrial materials, building materials, and engineering. At present, our company mainly operates businesses in the new housing and renovation markets in Japan. In the global market we operate in the public and commercial buildings, industrial materials and building materials market. I believe that now opportunities exist in aligned business. We will define and enhance our direction over the next three years using our strength and experience achieved through 70 years trading. Through these measures, we plan to achieve our long-term vision of the highest level of sales and profit since foundation.

