Summary of Small-Scale Meeting (Online)

1. Outline of the meeting

(1) Date: August 4, 2021 (Wed) (1) 10:00 AM to 11:00 AM (2) 1:30 PM to 2:30 PM
August 5, 2021 (Thu) (3) 10:00 AM to 11:00 AM (4) 1:00 PM to 2:00PM (Total 4 times)

(2) Attendees: Yasuo Nakatani, Representative Executive Officer, President and Chief Executive Officer
Takashi Jinguji, Representative Executive Officer, Executive Vice President and Executive Officer
Seiki Sato, Senior Vice President and Executive Officer
Nobukazu Hayashi, Senior Vice President and Executive Officer
Kiyoshi Nagao, Vice President and Executive Officer

(3) Subject: Q&A

2. Main Q&A (Summary)

(1) About the financial results for the first quarter ended June 30, 2021

Q1. I understand that operating income in 1Q increased due to strong performance of the freight forwarding business. Can we expect further increase in 2Q and onward?

A1. Both air and ocean transport posted strong performance affected by a rise in freight costs due to space shortage. We don't expect this situation will last long but it may continue until around 3Q. In Japan, cargo movements of distribution-related and home appliances are relatively steady, but we need to keep close watch on the situation as demand may have already settled down compared to last year when there was strong stay-at-home demand.

Q2. How are COVID-19 impacts compared to last year?

A2. The impact of COVID-19 is getting smaller than expected. It is difficult to distinguish from changes in volume excluding COVID-19 impacts as volume is recovering from last year's level which was affected by lockdowns, etc.

Q3. Why did EBIT and net income decrease?

A3. Last year, we recorded net gain on sales of fixed assets of approximately ¥2.7 billion, but there was no such big gain this year. In addition, share of profits of investments accounted for using equity method decreased approximately ¥1.3 billion due to a transfer of shares of SAGAWA EXPRESS CO., LTD. in September 2020. On the other hand, approximately ¥1.3 billion of fixed costs associated with suspended operation due to lockdowns, etc. was recorded in non-operating expenses last year, but an absence of such costs has had a positive effect this year. Financial expenses include approximately ¥1 billion of exchange loss in subsidiaries in Indonesia and Turkey.

Q4. It appears domestic 3PL showed sluggish growth compared with last 1Q. Why do you think that is?

A4. In last 1Q, while there was a large cargo movement related to daily commodities due to stay-at-home demand, a significant decline in shipping volume of some products such as apparel due to COVID-19 caused ballooning inventory and storage fees. In this 1Q, although some apparel and cosmetic-related customers are struggling, overall cargo movements are steadily recovering and inventory is decreasing, and as a result, the performance of domestic logistics remained almost unchanged year on year.

(2) About the progress of the Mid-term Management Plan

Q5. Please tell us factors or measures that will contribute to profit growth after FY2021, if any.

A5. In the next Mid-term Management Plan which we are currently developing, we plan to make further investment in DX to improve profitability and productivity in the existing businesses, pursue automation and labor-saving, and continue improvement measures such as Value Change & Creation 2021 (VC21) activities. In terms of our efforts to grow topline, in Japan, we will deploy sales activities targeting specific industries including distributions and manufacturing. And overseas, we will make investments in the truck business in North America, 3PL in India, and the intermodal business in Europe. In particular, investments in North America have been producing results in operation of new warehouses and milkrun, etc. mainly in the automobile-related business, and we intend to further strengthen these initiatives.

Q6. Do you plan to grow topline by expanding new areas?

A6. We organized sales teams by industry and propose to customers solutions to share DX strategy and decarbonization mainly consisting of SCDOS, Smart Warehouse, and SSCV. It's not really a new area, but our proposals include undertaking of ancillary work as Value Added Services (VAS) strategy in addition to the current logistics domain. We are also promoting creation and expansion of an ecosystem with domestic truck operators while making investments in SSCV, etc. to enhance the transport business.

Additional Q. How do you plan to balance the growth of topline and profitability?

Additional A. We use the phase-gate methodology to control profitability of each project. However, if a project has a high potential for future business growth, we may consider accepting it even if it generates very small profit at first and monitor its profitability subsequently. We will grow topline while maintaining margin.

Q7. What are advantages of collaborative innovation with PE funds?

A7. For example, we plan to construct a logistics center in India, and we may consider the use of private placement funds or asset liquidation by using insight of PE funds. We also think the partnership with PE funds will become important in executing large-scale M&As. In addition, we expect to obtain various information from companies in which PE funds have a stake and PE funds themselves.

Q8. Are there any projects in M&A strategies that are likely to be realized soon?

A8. Overseas, we are considering multiple projects in North America, India, and Europe including Turkey. Especially in North America and India, we are examining truck business. In Japan, we are considering support for business succession of small and medium-sized truck operators to strengthen transport capability. In considering M&As, we expect to obtain various information from companies in which PE funds have a stake and PE funds themselves.

Q9. Have you decided what you are going to do with the remaining treasury stock? Do you have another plan to cancel treasury stock?

A9. We are now considering the scheme for each M&A project individually. If we decide to execute M&As without using treasury stock, we may cancel unnecessary treasury stock. We also consider canceling treasury stock as needed to mitigate concerns over dilutive effects from using treasury stock.

Q10. Please explain how SSCV and EC platform center ("ECPF") will contribute to financial results.

A10. For SSCV, we have installed it within the Company so far, but now that our external sales structure with partners including Hitachi, Ltd. ("Hitachi"), etc. is ready. And we will develop services to external parties going forward. The business scale of SSCV will be determined depending on the number of solutions provided as pay-per-use services and the number of installation to vehicles.

In terms of ECPF, we think adding EC related functions to the existing centers is effective and are examining such development in each site by making use of what we learned in ECPF in Kasukabe, Saitama Prefecture.

Q11. I understand that external sales of SSCV-Safety have already started. How is customer response?

A11. We started external sales using sales channels of Hitachi and Mitsubishi HC Capital Inc. Going forward, we will consider coordinating SSCV with database used to manage mobilities or electric vehicles of automobile manufacturers. We are going to show you an image of SSCV's business scale.

Q12. The medium-to-long-term environmental targets include a 50% reduction of CO_2 emissions in FY2030 compared to FY2013. Please tell us about the initiatives and investments necessary to achieve that.

A12. There are five ways to reduce CO_2 emissions including energy-saving, electrification, energy generation, emission trading, and renewable energy, and we have launched projects to promote them. To achieve this target, we will proactively work to replace our commercial vehicles to electric vehicles and shift to green energy. Further, we will expand an environment to visualize decarbonization to the entire company and develop it into a business model.

Q13. For automated and labor-saving equipment in East Japan II Medical DC, what effects can be expanded horizontally?

A13. It introduces the resource control system (RCS) that manages multiple material handling equipment simultaneously, which enables process planning and management. While it requires coordination with customers, when the 24-hour operation becomes available, it will start to increase earnings. It improves flexibility of spaces by shifting from the conventional conveyor-type fixed system to using automated guided vehicles (AGV). One of the important points of smart warehouse is that it can be shared by any industry.

Q14. Please tell us about collaborative innovation initiatives with Maersk.

A14. Maersk made a proposal to us about 3PL business development, and the collaborative innovation with our 3PL (transportation/delivery and warehouse operation) has started. Currently, we are exchanging human resources with Maersk, and plan to consider/promote a collaboration between Maersk's "TRADELENS" and our "SCDOS".

(3) Other

Q15. What has changed in terms of business methods or customer needs after the spread of COVID-19?

A15. Due to the spread of COVID-19, collaborative innovation with customers and partners has increased although the situations vary depending on customers. The EC ratio in customers' business has increased in the apparel and distribution sectors. Demand for non-contact operation has increased, and we think the trend of automation and labor-saving will continue. As the EC market is expected to expand beyond national borders throughout Asia, which we think will bring about unprecedented business opportunities such as collaboration with EC sites.

Q16. What are advantages of domestic 3PL business in the future?

A16. Our advantages include our financial power to make investment in large-scale 3PL projects and ability to build a system such as our own warehouse management system (WMS). One of the points of differentiation is our advantage as a pioneer in response to digitalization including SCDOS, Smart Warehouse, and SSCV.

Q17. Please explain the situation of cost increase and collection of appropriate fees, and concerns about future.

A17. Increase in costs such as vehicle allocation expenses are moderate compared to previous years, and we are collecting appropriate fees as expected. As cost increase is a risk, we control it through labor-saving and flexible shift of human resources. Our concern is that some customers struggling with poor performance stopped outsourcing certain operations to save cost, and we are closely monitoring such cases.

Q18. What sort of measures have you taken to address the Year 2024 Problem (application of overtime work regulations to vehicle drivers)?

A18. We are working to increase female drivers to address driver shortage, and we also think our SSCV solution will be a powerful tool to improve working environment. In addition, we will promote the nationwide centralized vehicle assignment system and share it with our partner companies in a bid to improve transport efficiency and address driver shortage. In addition, as an effort in the loading dock management to address the “White Logistics Movement,” we will reduce drivers’ waiting time by building a system to link material handling equipment in a warehouse with the loading dock management.

Q19. Please explain your efforts to improve capital efficiency.

A19. As we introduced ROIC for the budget control, capital efficiency has been improving. In Japan, we plan to effectively use assets in more than 300 sites, and we launched an initiative to achieve an environment close to 24-hour operation by conducting preliminary work at night and combining customers in different industries. ROIC is gradually rising, and we will continue to work on the improvement of capital efficiency.

Q20. What is your view on the shareholder return policy with dividend payout ratio of over 20% including its balance with investment?

A20. Currently, we set payout ratio of 20% as a minimum aim. For the future growth, we need to make business investments as well as strategic investments such as environmental investments. We also recognize that we need to increase payout ratio, and therefore we will consider dividend increase in the future.

End