FY2016 Earnings Conference: Major Q&A

Date/time: May 11, 2017 (Thurs.) 1:00pm – 2:30pm			
Place: Daiwa Securities Conference Hall			
Attendees:	President	CEO	Hiroshi Shimizu
	Director and managing Executive Officer	CTO	Hirokazu Maeda
	Director and Managing Executive Officer	CSO	Mikio Sakai
	Director and Managing Executive Officer	CFO	Tomoki Matsumoto
	Director and Executive Officer	COO	Tatsuji Omori
	Director and Executive Officer	CMO	Takehiko Sumiya

Major points of this fiscal year

Q. You are positioning this year as a year of adjustment ahead of progress expected next year and beyond. As such, what points should we focus this year?

A. First, a vital point will be whether or not we are able to maintain status in favorable areas, particularly favorable sales in the USA and Brazil.
Next is whether or not our roadmap for enhancing capacity to address a lack of capacity is progressing according to schedule.
Even at the same level of capacity, we will secure profits by shifting from commodities to high added-value products.
For soybeans business, in addition to the restructuring of existing business another key point will be what level of profits we are able to generate from the new USS business.

About confectionary and bakery business

Q. In the past, favorable sales growth for confectionary and bakery ingredients has been a growth driver but what caused the lull during 4Q of this year?
You have stated that Japan was at full production capacity for the favorable chocolate segment but did that have an impact?

A. The lull in chocolate sales growth in Japan during 4Q was due to a cooldown of favorable performance at CVS (convenience store) and on the gift market due to a slowdown of inbound demand. Sales of chocolate ingredients for ice cream were favorable. We will continue to pay attention to trends during the upcoming 1Q.
In Japan, chocolate demand has increased to a point where even after the construction of a new plant last year, we are still seeing insufficient capacity on certain lines.
As such, we are proceeding with the elimination of unprofitable products to reduce switchover losses.
We still have production capacity for functional chocolates so we will seek to increase profitability by producing value-added products in the health chocolate segment.

Q. How long will this situation of stagnant profit growth in Japan continue due to increased investments and rising costs?

A. Investment increases are mainly scheduled for 2018 and 2019 but we expect cost increases to continue through 2020.
As part of our global integration, we are consolidating accounting periods, backbone systems, and corporate brand strategy. And to enable these efforts, we are enhancing our hiring of global personnel.
The consolidation of our backbone systems will create a standardized workflow system that will lead to significant cost reductions both in Japan and overseas, and we believe these investments will produce a high return.
It will be too late if we engage in overseas markets only after we are no longer generating profits in Japan.
We are looking ahead and preparing to create a structure that will enable us to pursue profits overseas. I said that this reform would require 10 years but we will first build a platform and over the last 3 years transition into a structure that enables us to generate strong profits both in Japan and overseas.

Q. What will enable the confectionary and bakery ingredients in Asia to expand sales and secure profits this fiscal year?

A. During fiscal 2016, in Thailand we engaged in proposal-based sales and achieved success on the bread market by utilizing FUJISUNNY PLAZA, one of the strengths of our Group. This fiscal year, we will take advantage of the Asia R&D Center we established in Singapore to adapt the Thailand business model to the various countries in Asia.
- WOODLANDS SUNNY FOODS in Singapore built a warehouse on the company grounds.
The start of warehouse operations will improve production efficiency for cream and margarine sold externally.
- Malaysia's GCB SPECIALTY CHOCOLATES SDN. BHD., of which we acquired a 70% share last year, will begin selling chocolate to nearby countries.
-Will launch sales at the new Thailand chocolate plant.
-Sales of margarine and filling are strong in China and we expect the production line increase to contribute to increased profits.
Furthermore, we are projecting fiscal 2018 as when we will see profit contributions from the launch of operations at the No. 2 plant currently under construction.

About the soy protein division

Q. What is the impact of business structural reforms?

A. The soy protein division possesses numerous tangible fixed assets but revenue is transitioning at about 30 to 40 billion yen.

In the past, the division was generating profits when it maintained a high marginal profit ratio but the impact of competition from Chinese companies led to a decline in profits, which caused fixed costs and assets to become a burden. As a result, the division is unprofitable in certain aspects.

Also, the increasing distribution of fixed costs, including common business expenses, has created a situation where the division must reduce assets and reorganize sales.

To fulfill our responsibilities to customers in terms of product supply, we will prioritize the selection of products and buyers and then move onto the consolidation and elimination of sites.

Regarding the soy protein food and ingredients business, we are reviewing and validating our sites in Japan and China.

Q. Why have you chosen this timing to conduct restructuring?
Is it safe to assume that your company has no other businesses requiring restructuring?

A. All businesses could be subject to changes in business structure.

We will change our business model as appropriate to respond to changes in this age of disruption.

Our target for business structural reforms are soy protein isolate, which is the core of the soy protein business, and the soy protein food division, which produces products such as *ganmodoki. These two are completely separate businesses.

In the past, the soy protein was able to distinguish itself through quality and safety but as Chinese products increased quality while engaging in pricing warfare, the profitability of plants operating in China declined.

Soy protein foods are mainly frozen food products but this is not enough to establish the division as a frozen foods business. Despite handling processed foods, the structure is one that produces weak profits.

In order to contribute to our Group mission of “delicious and healthy food”, we believe we must not abandon the soybean business. And while there is no change in our commitment, this business is changing towards a direction where USS, etc. are profitable.

*ganmodoki : deep-fried tofu mixed with thinly sliced vegetables

About capital expenditures

Q. You are planning to invest in facility enhancements over the next two years to address insufficient capacity but isn't insufficient capacity due to increasing demand something you could have predicted? Is there a problem with your investment decision-making process?

A. A few years ago, we did not predict this level of favorable chocolate sales. Rather than increase plants for raw material chocolate, we decided it would be better to first build a plant focused on high value-added products.

While I won't say we couldn't have read things differently, current conditions are not such that capacity is so insufficient that we don't have enough inventory or causing an inconvenience to customers.

In our decision-making process, we focus on supply and demand projections, profitability, and capital costs when making a decision.

For China filling, the investment decision was delayed by a year to a year and a half because we dissolved a merger partnership last fiscal year. We believe this delay resulted in lost opportunities. However, decision-making in other areas is proceeding relatively smoothly and this year has not seen any lost opportunities due to insufficient capacity.

About this age of disruption

Q. As it relates to domestic sales, what do you view as disruption and what does your vision for the future look like?

A. Our domestic business separates into two areas and approaches differ between business targeting large-scale manufacturers and the retail market.

With large-scale manufacturers, we believe the traditional model of collaborating with each manufacturer is sufficient for securing profits.

The retail market further separates into local confectioneries and bakeries, and CVS.

CVS business continues to focus on capturing profits by driving team merchandising and we believe this model will continue.

The issue is with local confectioneries and bakeries.

We are in an age when consumers purchase products directly via EC and value itself is changing. As such, the existing business model does not suit the times.

The most important thing for our Group is ascertaining what types of cakes and bread consumers truly desire and accurately incorporating the true needs of consumers. We are searching for a new sales format in this new age.

About Group synergy

Q. In fiscal 2017, you are planning for overseas sales to account for nearly 40% of operating income.
Your medium-term business plan strongly focuses on generating Group synergy but what do you view as synergy?
Particularly for Brazil, do you have any specific strategies?

A. Our policies for generating intergroup synergy will begin with SCM (supply chain management).
For the oils and fats, milk, cacao, etc., used commonly by Group companies, we will increase our sensitivity to market prices and proceed with the creation of a purchasing structure that comprehensively assesses the global market.
In particular, we are aiming to generate synergy between oils and fats for chocolate and chocolate.
We are working to generate synergy between the North American oils and fats division, which currently imports raw materials for oils and fats from Asia, with the South American chocolate division.

We also want to generate synergy between the Ghana oils and fats division and the European oils and fats division, which uses Ghana's products as raw materials.
For Brazil, our profit plan is one year behind schedule relative to when we first acquired the company so we are expecting further growth.
Stagnancy on the Brazilian market was unexpected and so now is not the time to plan for major increases in capacity. Instead, we will eliminate unprofitable products and transaction partners. Costs are declining and together with our new brand enhancement strategy, we will increase our status and profitability in Brazil.

Brazil also has a unique market in which housewives purchase confectionery raw materials at wholesale super markets and then make confections to sell to the general public. Harald has strong brand recognition in that arena. In the past, I explained that our Group wants to apply our knowhow related to raw materials such as cream and margarine to advance sales in this market. We are just now finally beginning with test sales.

About approach to human resources

Q. Tell us about your approach to human resources. Why did you choose this timing to change directors?

A. The appointment of personnel to lead new reforms in this age of disruption is deliberated by the Nomination and Compensation Committee and each year this is determined by the Board of Directors. To achieve reform, we switched to a holdings company format, divided the execution of management functions, and created a team charged with outlining growth strategy.
   Positioning the Board of Directors as being responsible for creating management strategy and ensuring governance as the representatives of our shareholders, we have implemented significant personnel changes.

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