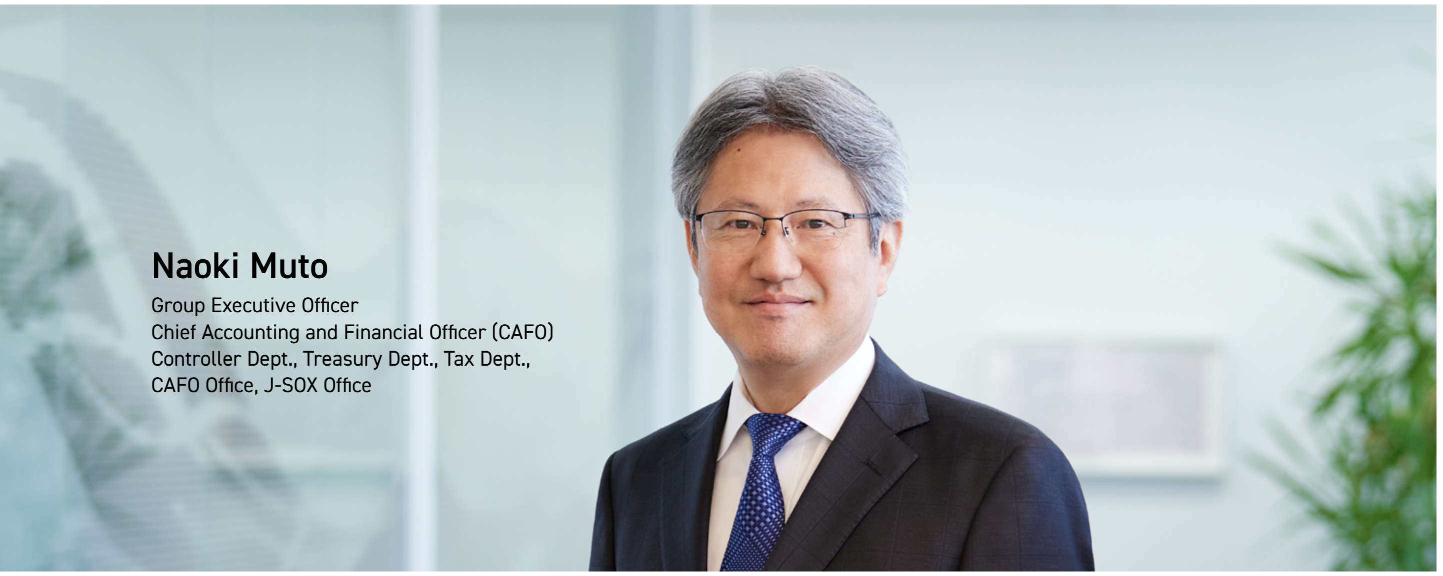
CAFO Message



Naoki Muto
Group Executive Officer
Chief Accounting and Financial Officer (CAFO)
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Maximizing profits and optimizing cash allocation toward sustainably raising corporate value

Looking Back on Fiscal 2022

Fiscal 2022 marked the first year of our GS26 growth strategy, which we announced in fiscal 2021, the year of our 100th founding anniversary. That strategy set three financial goals as KPIs:

Growth	Revenue growth............ High-single-digits (5-year CAGR)	
Profitability	Operating margin (Before adjustment)............ 20% or higher (in 5 years)	
Capital efficiency	ROIC............ 10% or higher (in 5 years)	*ROE of 10% or higher

In the first year of fiscal 2022, sales revenue was 820.2 billion yen and operating profit was 117.3 billion yen; each was our highest-ever result, and we also secured an increase in profit for the year. Revenue was driven by strong global demand in the cardiovascular field, particularly in the largest market, the United States, resulting in 5% growth when excluding FX.

In profit, we achieved an increase, although multiple factors—the rising costs of purchased materials due to the supply chain disruption that began during COVID-19, increased electricity, gas, and other energy costs, and inflation such as labor cost in the United States, along with a temporary earnings downturn at the end of the fiscal year—combined to result in an operating margin decrease to 14.3%. The profit amount also unfortunately fell below our February 2023 guidance. The temporary earnings downturn was caused by an increase in fixed costs due to delays in standing up our new Plasma Innovation business, and increased costs of transferring production of the Blood and Cell Technologies and Cardiac and Vascular companies to Costa Rica.

The impact of these negative factors brought our ROIC to 6.8% and ROE to 8.4%. We will strengthen our management controls toward better guidance accuracy as we strive to restore the trust of the market.

Efforts Toward Maximizing Profitability

Promotion of profitability improvement measures

To achieve our GS26 goal of 20% or higher operating margin, we are working to improve profitability through the Group-wide VC2 (Value Creation through Collaboration) project. In previous acquisitions, our management mentality was to prioritize the development capability and speed of business expansion, and we refrained from absorbing the organizations and operations of the acquired companies. With VC2, we are partially revising that policy to optimize and raise efficiency across the Group through control of operations like production, procurement, and logistics under the guidance of corporate. One aspect of this is that we created the internal organization Global Business Services (GBS) in November 2022 and integrated the order and payment functions of Europe and the United States into the GBS. We will continue to expand the GBS functions and scope going forward, taking the lead in improving profitability by standardizing and raising the efficiency of shared Group operations. We also continue to implement SAP, to integrate the core Group functions that support operations standardization and efficiency, and centralize information management.

Capital efficiency (ROIC) improvement

Toward the GS26 goal of 10% or higher ROIC, we are working to improve both the numerator, which is profit expansion, and the denominator, which is efficiency of invested capital.

We will right-size invested capital through solid control of working capital. Specifically, we will normalize our inventory levels, which we had built up to avoid sales opportunity loss from COVID-19 and supply chain disruptions. Beyond inventory, we will also work to strengthen control of working capital in the form of accounts receivable and payable.

To raise our capability to create profit, we will not only make continual and timely investment in strengthening production capacity, but also consider M&A investments that promise greater future value and synergy with existing businesses. In judging investments, we will set a hurdle rate based on the weighted average cost of capital (WACC), with uncertainty risk added, confirming the business strategy and risk, to compare the hurdle rate with net present value (NPV) and internal rate of return (IRR), to strictly select and execute investments that have the highest probability of generating return.

To achieve GS26 financial goals, beginning with ROIC, we need to align the direction of the businesses and corporate, taking into account changes in business environments and performance status to carry out appropriate measures in a timely manner. Guiding the Group as a whole toward this is the role of the CAFO, and I consider this responsibility to be very large. To support this role, we established the Financial Planning & Analysis (FP&A) organization in 2022. It takes a high-level view of the entire Group's management status and closely monitors the progress of medium- to long-term profit improvement, along with the progress of short-term fiscal year planning, to speedily identify and analyze issues so that the CAFO and management team can make timely and accurate decisions.

Cash Flow

The source of investment capital for growth is ultimately cash flow from the businesses. In fiscal 2022, net cash provided by operating activities was 117.5 billion yen; net cash used in investment activities was 59.1 billion yen; and shareholder return was 78.0 billion yen.

In GS26, we aim by fiscal 2026 to create cumulative operating cash flow of 800 to 900 billion yen. We anticipate utilizing approximately half of that toward GS26 growth and infrastructure investments. In addition, when we need to procure capital from external sources, we will strive to balance capital efficiency and financial health to make the optimal and expeditious combination of borrowings from financial institutions and corporate bonds, etc., to ensure that we take advantage of growth opportunities.

Shareholder Return

In fiscal 2022, we enacted new measures toward raising corporate value going forward. One of these is to strengthen capital policy. In addition to improving capital efficiency and raising financial leverage, we announced that we will shift our shareholder return indicator from the previous dividend payout ratio to total payout ratio. Our target for dividend payout ratio has been 30%; going forward, we will utilize both stable increases in dividends as well as acquisition of our own shares as we aim for a 50% or higher level of total payout ratio. Regarding acquisition of our own shares, we executed a 50-billion-yen buyback and share retirement in fiscal 2022, and have earmarked 20 billion yen for acquisition in fiscal 2023. Through these measures, the fiscal 2022 total payout ratio was 90%, and we plan to achieve 52% in fiscal 2023.

Fiscal 2023 Plan

In fiscal 2023, we plan to grow the high-margin growth drivers of each company, while also strengthening and accelerating Group-wide measures to achieve solid profitability improvement. By company, we aim to return the Medical Care Solutions Company to double-digit profitability.

We anticipate that revenue will continue to grow globally, at the rate of 6%, to exceed the growth of the previous year when excluding FX. In operating profit, we look to improve both the profit amount and percentage by (1) expanding sales of high-margin products, (2) becoming more proactive regarding price policy, and (3) optimizing and raising efficiency in production globally. In price policy, to counteract regarding pharmaceutical products sold in Japan whose reimbursement price revisions have given them low margins, as well as inflation impacts that we could not absorb, we will gain the understanding of customers in passing these costs on to them, expanding both the number of businesses and regions where we do so. In optimizing and raising the efficiency of global production, we are reaping the benefits of the transfer to Costa Rica, while also promoting projects to bring yet another level of efficiency to Ashitaka Factory, which sustains the TIS business core.

In the first quarter, strong demand continued globally for the Cardiac and Vascular Company, resulting in the highest-ever quarter of revenue to start the year. Operating profit saw a slight decrease when excluding FX, but the good effects of the aforementioned Costa Rica production transfer are beginning to appear. Also, on a standalone quarterly basis, the positive profit improvement efforts outweighed negative inflation impacts for the first time; all this means that progress is as planned to achieve the annual guidance.

Fiscal 2023 Guidance (As of November 14, 2023)

Revenue	¥854.0 billion	+4.1% year-on-year
Operating Profit	¥132.5 billion	+12.9% year-on-year
Operating Margin (Before adjustment)	15.5%	+1.2% points year-on-year
Profit for the Year	¥101.0 billion	+13.1% year-on-year

In order to achieve our fiscal 2023 performance goals, we will strengthen our Group and make the investments necessary to steadily take advantage of growth opportunities. Through these efforts we will raise our sustained corporate value and contribute to our Terumo Purpose of advancing healthcare and enhancing patients' quality of life, fulfilling the expectations of shareholders and investors, and of course our customers and society at-large.