9 Jan, 2025

IR Department, SATO Holdings Corporation (6287)

FAQs following the Announcement of Financial Results for Q2 FY2024

FAQ Contents

Q2 (Jul-Sep) Results

1. What is the breakdown of the difference between planned and actual results?
    - Sales: Achieved the plan on a consolidated basis. Overseas (Primary Labels business) and Japan achieved the plan while overseas (Base business) almost achieved.
    - Operating income: Achieved the plan on a consolidated basis. Overseas (Base business and Primary Labels business) achieved the plan while Japan almost achieved.

FY2024 Estimate

2. What is the breakdown of the full-year operating income plan by region, and what is the background behind the revision from the initial plan?
    - Overseas Base business: Upward revision. In H1, performance was driven by Asia and Oceania and exceeded the plan. In H2, Asia and Oceania will likely continue to lead the way, but the forecast was revised downward in anticipation of economic recession in Europe and lower demand from some customers in the Americas. Overseas Primary Labels Business: Upwardly revised. H1 results exceeded the plan as the competitive environment in Russia did not deteriorate as much as expected. H2 plans were revised downward slightly in anticipation of deterioration in the competitive environment. Japan: Unchanged. H1: Fell short of plan due to lower-than-expected sales of high-margin printers and in the high-margin manufacturing and healthcare markets. H2: Revised upward. We are anticipating large-lot orders mainly in the retail market and the effects of our initiatives. Is there any seasonality impact on the H2 performance?

- Overseas: In Europe and the U.S., sales tend to increase in Q3 compared to other quarters due to the large number of customers in the retail market. On the other hand, Q4 tends to see a decrease in sales due to the Russian Orthodox Christmas and Chinese New Year, which will reduce the number of factory operating days at our and our customers' plants.
- Japan: Sales tend to increase in Q4 due to budget execution by customers whose fiscal year ends in March.

<u>Overseas Base business</u>

3. What are the factors behind the difference between Q2 results and the plan for the Americas, and what is the outlook for the full year?
    - Q2 Results: Net sales fell short of plan due to lower demand from some existing customers, despite a large order from a new customer in e-commerce. Operating income fell short of plan due to shortfalls in sales.
    - Full-year plan: Net sales will likely be affected by a decline in demand from some existing customers, but the plan remains unchanged due to expected large-lot deals. Operating income: We maintain the plan, as the relatively low profit margin at the start of large-lot transactions leading to adverse customer mix is expected to offset the surplus in H1.

4. Will the large deals won in e-commerce mentioned above continue going forward?
    - They are expected to continue. First, printers will be sold, followed by consumables, maintenance service, and others. We also aim to capture other demands for the same customers.

5. What are the factors behind the difference between Q2 results and the plan for Europe, and what is the outlook for the full year?
    - Q2 Results: Net sales fell short of the plan due to the economic slowdown, despite a recovery in sales to distributors following the completion of printer inventory adjustments. Operating income did not reach the plan due to shortfalls in sales.
    - Full-year plan: Both net sales and operating income were revised downward due to the anticipated impact of the economic slowdown.

6. What are the reasons for the difference between the Q2 results and the plan for Asia and Oceania, and what is the outlook for the full year?
    - Q2 Results: Net sales achieved the plan thanks to contributions from Australia, where large-lot RFID projects are continuing, and Argox, where sales to distributors recovered as printer inventory adjustments have run their course. Operating income achieved the plan due to robust sales and improved profitability of factories resulting from increased production volume.

- Full-year plan: Sales are expected to continue to be strong in Australia in H2, leading to an upward revision of the full-year plan. Operating income is expected to increase due to higher sales in Australia but decrease due to changes in inter-group transaction prices between the Malaysia and Vietnam plants and Japan, resulting in a downward revision of the overall operating income forecast.

7. Will Australia's RFID big-ticket deals continue?
    - Based on customer demand, we estimate that current sales will continue for at least the next three years.
    - Our Australian customer sells their equipment to entertainment facilities in various countries.

<u>Overseas Primary Labels Business</u>

8. What are the reasons for the difference between Q2 results and the plan, and what are the prospects for the full year?
    - Q2 Results: Net sales achieved the plan because the competitive environment in Russia did not deteriorate as much as expected and sales of high value-added products were strong. Operating income achieved the plan due to strong sales.
    - Full-year plan: In H2, both sales and operating profit are expected to decline due to the deteriorating competitive environment in Russia. Due to strong H1 results, both sales and operating income for the full year have been revised upward from the initial plan.

9. Do you intend to continue operating the Russian subsidiaries?
    - We are considering various options in close communication with the local colleagues and estimating the financial impact of each.
    - As a result of these considerations, we have come to the conclusion that we continue our business for now. We will review the decision as necessary in response to changes in circumstances.

10. What is the normalized operating margin of the Russian subsidiaries?
    - The current profit margin is well above the norm. Considering historical averages and the profit margins of major competitors, the mid teen range seems to be the normalized level in the medium term.

Japan Business

11. What are the reasons for the difference between Q2 results and the plan, and what are the prospects for the full year?
    - Q2 Results: Net sales achieved the plan as mechatronics sales and consumable price revisions progressed as planned. Operating income achieved the plan due to an increase in gross profit from exports to overseas subsidiaries, despite a decrease in gross profit due to a worsening product and market mix.
    - Full-year plan: unchanged. In H1, sales and operating income were lower than planned due to lower than expected sales of printers and in the manufacturing and healthcare markets, which all have relatively high profit margins. In H2, we expect to see large-lot orders and the effects of our initiatives mainly in the retail market, leading to upward revisions to both net sales and operating income.

12. What is behind the strong retail market?
    - Customers are increasing capital investments against a backdrop of favorable business performance.
    - In addition, there is a strong need for increased efficiency due to labor shortages and work standardization due to the diversification of workers.

13. What is the status of rising raw material costs and price revisions?
    - Price revision impact in both mechatronics and consumables exceeded the plan.
    - Consumables: Rising raw material costs were in line with expectations, and price revisions progressed according to plan.
    - Mechatronics: Although raw material cost increase in dollar terms was less than expected, the cost in yen terms was in line with the plan due to depreciation of the currency. Price revisions progressed according to plan. We expect to see an improvement in the raw material cost situation, as price revisions for purchases from factories in Vietnam and Malaysia to Japan starting in H2 will likely have a larger impact than the negative effect from yen depreciation.
    - About 50% of customers agreed to the price revision of intangible services such as mechatronics freight in Q2. Effects are expected to appear in H2.

14. Why are profit margins in the Japan business lower than before?
    - Profit margins are lower due to a decline in sales of industrial printers, which have high gross margins, compared to the peak, as well as the inability to reflect rising raw material costs in selling prices, and the increased cost burden of IT system, new printer development and head office leasing (see next section for measures to address these issues).

Medium-term Management Plan

15. What are the key points of this MTMP?
    - To contribute to solving more complex and wide-ranging customer pain points through advanced tagging = unique ID assignment, full automation of processes, and tagging across the supply chain = Perfect and Unique Tagging (PUT).
    - To invest in PUT by restoring profitability.
    - To intensively restore profitability in Japan during the first two years of MTMP. To achieve this, we will strive to reform the internal value chain, shift sales personnel to higher profit and growth fields, change the evaluation system for sales personnel from a focus on sales to profit, and launch new printer models.

16. Isn't the operating income plan conservative?
    - FY2024: Japan business plans to increase profit through focused recovery initiatives. On the other hand, the Overseas business is planned to see lower operating income overall due to a drop in profits at the Russian subsidiaries due to the normalization of the competitive environment in the Primary Labels business and a drop in profits in the Base business due to one-off factors from the previous year in Europe, and an increase in development costs for new printers in the Americas. It is understandable to regard the overall plan to be conservative, but we see it as realistic.
    - FY2025 and beyond: Japan business is expected to remain flat as the increase thanks to MTMP initiatives would be offset by an increase in expenses related to growth investments and upfront costs for large orders. Growth is expected from FY27 onward due to growth investment effects. Overseas, we aim to maintain profit margins while growing sales by efficiently creating and scaling solutions.
    - We endeavor to steadily achieve the plan and regain the confidence of the capital market.

17. Are the new fields that you are aiming to commercialize in the MTMP already contributing to earnings?
    - They are expected to contribute to earnings from FY27 onward.
    - To develop new fields, the company invested in MobileLogic to independently develop a next-generation cloud platform that enables no-code, low-code application creation and SaaS and database integration. The company also invested in a fund established by Abies Ventures, a deep-tech company, to strengthen the conception and development of new solutions for future growth and the creation of added value for our products.

18. What is the background of the delay in the development of new printers and what are the measures to deal with it?
    - The top management at the time had too strong a passion and the frontlines were unable to realize it.
    - The organization was reformed from a functional axis to a mechatronics/consumable product axis, and the decision makers were clarified from the perspective of total optimization.
    - SATO is making more sophisticated and prompt management decisions by strengthening the Executive Officers Meeting and the Business Review Committee.

Financial Strategy

19. What are your financial strategies and areas for improvement?
    - To promote ROIC management and set KPIs for each component in related divisions, aiming for improvement. In particular, we would like to promote improvement in profit margins, emphasize cash flow, and improve capital efficiency. This is also in line with TSE requests.

20. What is your capital allocation policy?
    - The capital allocation policy is to first restore operating cash flow through the medium-term management plan, and then invest in advanced tagging technology. We plan to acquire technologies through internal R&D, M&A, and alliances.
    - In addition to cash on hand, funding will come from direct and indirect borrowings if necessary. SATO assumes a scenario in which WACC falls as a result of increased debt ratio.
    - As for shareholder returns, the company will endeavor to maintain stable and progressive dividend payouts. Share buybacks will be implemented flexibly depending on the availability of cash reserves.

Other Business-related Topics

21. What is the composition of RFID sales? What are the differences in the degree of adoption by market? What will be the impact on profit margins when adoption increases in the future?
    - Global RFID-related sales in Q2 FY24 were about 5% of consolidated sales.
    - In Japan, the penetration ratio in the apparel industry is high. It is also being introduced in the manufacturing and healthcare markets.
    - RFID adoption overseas has been faster than in Japan. Our RFID solutions have been fully implemented for various customers, including major US/European companies in logistics, PC manufacturing and healthcare, and Asian semiconductor manufacturing in addition to apparel customers. These companies use RFID on a global scale, resulting in large deals.
    - Currently, the gross profit margin for RFID solutions is about the same as the consolidated gross profit margin. In Japan, RFID margins are typically lower than those overseas. We anticipate that margins will improve as customers implement tags at full scale. Increasing tag production volume and sales of high margin products, such as printers, software, and maintenance services, will improve margins going forward.

Institutional investors' View on SATO

(Long-only investors in Japan)

- FY26 operating income target of 11.5 billion yen is likely to be achieved this fiscal year, but the regional composition differs from the plan, which is not preferable (higher ratio of Russia with higher volatility). I would like the Company to raise the profit ratio of Japan, which should be a stable revenue base, and to increase and focus on improving capital efficiency.
- I am interested to see how well Japan's profit margins can recover going forward.

(Hedge funds in Japan and overseas)

- Domestic profitability in Q1 was stagnant but was able to recover in Q2. The shares currently appear to be undervalued, but this could be resolved down the road. SATO has a niche business that will not disappear. We feel the current share price is undervalued. Fluctuations in the Russian situation may have a short-term impact on the share price, but the downside in terms of business is likely to be small.
- The high operating income composition and volatility of the Primary Labels Business (mainly Russia) makes it difficult to invest in the company. Stock valuations could change if the U.S. presidential transition calms the situation in Ukraine.

*This section describes institutional investors' evaluation of SATO and why they requested a meeting. These do not reflect all investor comments.

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Explanation about the appropriate use of forecasts and other notes

Forward-looking statements, including the forecasts stated in this material, are based on information currently available to the Company and certain assumptions deemed reasonable. Any statements herein do not assure particular results by the Company. Results may differ from the consolidated forecasts due to various factors. Please refer to Financial Result (Kessan Report) for assumptions behind the consolidated forecasts and other information.