

## CFO Message



## Greater Sophistication of Financial Management and Capital Allocation for Growth to Further Expand Corporate Value

Managing Executive Officer, CFO and  
Senior General Manager, Global Strategy HQ

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I was appointed CFO and Senior General Manager of the Global Strategy HQ in April 2023. In my career with OMRON to date, I have had various opportunities to gain experience, including management of the healthcare business in China, the U.S., and Latin America, execution of M&A, and formulation and promotion of the medium to long-term strategy of the OMRON Group.

Going forward, leveraging my experience and the valuable assets built up by the previous management team, I will work to unleash OMRON's full potential in terms of both the Group's growth strategy and its financial strategy, taking on new challenges toward the management goal of "maximization of corporate value" set forth in long-term vision SF2030 launched in fiscal 2022.

Your cooperation will be greatly appreciated.

### Progress of the Medium-term Management Plan

In fiscal 2022, the first year of the medium-term management plan "SF 1st Stage," we promoted transformation of business and growth and expansion by seizing emerging business opportunities. We operated in a highly volatile environment throughout fiscal 2022, including tight supply of parts and materials associated with a sharp increase in demand in the post-COVID-19 era, factory shutdowns due to Shanghai lockdowns, and the rise in inflation worldwide. However, we achieved higher sales in all segments. Consolidated net sales were ¥876.1 billion,

an increase of 14.8% year on year, and operating income was ¥100.7 billion, an increase of 12.7% year on year, setting new records. We demonstrated our ability to effectively respond to change and to generate profit, which we have been strengthening. In addition, I believe business transformation is gradually bearing fruit.

In particular, in the Industrial Automation Business, which is driving the growth of the OMRON Group, the number of customers adopting the innovative-Automation concept has more than quadrupled from approximately 900 in fiscal 2016 to approximately 3700, and the ratio of the solutions business has expanded to 35%. This is the result of development of innovative applications essential for resolving customer issues, and continuous investment in systems engineers (SEs) who propose the value of the application to customers and implement it, and front-end human resources centering on solution sales. I feel that the format of the solution business is taking shape.

In the course of achieving these results, certain issues became clear. Firstly, self-propelled growth. I think we need an objective assessment of our record performance in fiscal 2022. This is because in fiscal 2022, in addition to medium to long-term demand arising from changes in social and industrial structures, associated with digital and environment-related investments, such as for EVs, there was a temporary rebound in demand associated with supply chain disruption due to the emergence of geopolitical risks and the abating of the COVID-19 pandemic. As a result, demand significantly exceeded the actual end-market demand, particularly in the Industrial

Automation Business. This led to a high order backlog, supporting net sales in fiscal 2022. From that perspective, I do not think OMRON's growth potential has reached the level we target. Our aim is to achieve growth that outperforms market growth. For this purpose, it is essential to enhance the ability to identify customers' issues, propose solutions, and fully implement them. Secondly, supply chain management. In the face of continued tight supply of parts and materials worldwide, we implemented measures, including the use of EMS and parallel production, and managed to rapidly increase our product supply capacity. However, working capital levels rose as inventories built up in the value chain. As a result, we were unable to increase operating cash flow although profit levels were at an all-time high. We view this as a matter of great regret. In the current fiscal year, we will further enhance the linkage between the timing of revenue recognition and production plans, as well as strengthen supply chain management using new IT systems. Lastly, business transformation is still ongoing. Each

of our businesses is promoting initiatives for the shift from "products" to the "combination of products and services" and for value creation utilizing data. Going forward, we will appropriately implement capital allocation in accordance with the execution stage of each business to further enhance our execution capabilities and accelerate transformation.

#### Tender Offer for Shares of JMDC Inc.

OMRON commenced a tender offer for shares of JMDC Inc. (JMDC) on September 11, 2023. The aim is to accelerate the Group's transformation and increase its overall growth potential, not only in the healthcare domain but also in the industrial automation and social solutions. We had a scenario for medium-term growth of the Group through co-creation with JMDC in mind when we took a 33% equity stake in JMDC in fiscal 2021. Although we were greatly attracted by JMDC's growth potential from the beginning, it was difficult to judge the feasibility of creating synergy as well as the differences between the two companies in terms of their business models and corporate cultures based

on desktop analysis alone. Thus, we started with a capital/business tie-up to secure an opportunity to test our hypothesis. In the 18 months since then, we have been able to achieve a lot, as we disclosed in September 2023. I am pleased that we have progressed from initial hypothesis testing to the tender offer.

Meanwhile, the internal review team and the Board of Directors had various discussions until we made the decision. In the course of a year and a half, the business concept in the healthcare solutions domain became more tangible, and we confirmed JMDC's data management capability and its capability to convert data into value, as well as the potential for deploying such capabilities in the OMRON Group. On the other hand, there was a need for thorough deliberation on governance after making JMDC a consolidated subsidiary and concerning recoupment of our investment totaling approximately ¥210.0 billion. Regarding the evaluation of investments, some people may have misunderstood OMRON's approach. Although we have been implementing management based on return on invested capital (ROIC), ROIC is not the only indicator we use for evaluating individual investments. Conventionally, in evaluating investment, with an eye to the market's growth potential and opportunities for synergy, we conduct risk verification based on multiple performance simulations, and calculate corporate value by adopting a multifaceted approach, using discounted cash flow (DCF), comparable multiples valuation, and so on, and incorporating third-party evaluation as well. Since the data solutions business field is in the market formation stage and it is difficult to forecast long-term operating cash flows, we have also conducted verification using the internal rate of return (IRR) based on a market approach. Specifically, we set the cost of capital in the industry as a hurdle rate,

#### <Consolidated Financial Results>

	FY2021 Results	FY2022 Results	Y/Y
Net Sales	¥762.9 billion	¥876.1 billion	+ 14.8%
Gross Profit Margin	45.5%	45.0%	- 0.5pt
Operating Income	¥89.3 billion	¥100.7 billion	+ 12.7%
Net Income	¥61.4 billion	¥73.9 billion	+ 20.3%
ROIC	9.6%	10.4%	+ 0.8pt
ROE	9.7%	10.6%	+ 0.9pt

evaluated the synergy to be created by considering the exit value, and discussed appropriateness of the investment in view of the impact on ROIC as well as on P/L and /B/S after the investment. At present, our target is net sales of ¥100.0 billion in 2027 as the effect of making JMDC a consolidated subsidiary, but I feel that we may be able to do even better by exploiting the potential for expansion through co-creation.

Expanding the data solutions business is a medium to long-term initiative. I believe that it is vital to execute sufficient upfront investment at the optimum time to maximize this growth potential. This is because although the potential market size in this field is very large, the field is still in its infancy, and it is important to gain a strong market position. We will continue to accelerate collaboration and share the progress and achievements with you.

\* As of this writing (September 15, 2023), the tender offer to make JMDC a consolidated subsidiary has not closed. The share acquisition is scheduled to be executed on October 16, 2023.

### Evolution of Management Systems to Expand Corporate Value

As I have discussed so far, OMRON is promoting a number of initiatives to increase corporate value. I believe that the most important issue is “to expand profit through sales expansion.” In other words, we need to shift the driver of the expansion of corporate value from “improvement of profitability” to “profit growth through sales growth.” Of course, we will continue our initiatives to improve profitability through ROIC management, which has so far supported the expansion of OMRON’s corporate value. This is because reinforcement of the earnings base is essential for achieving new growth.

However, OMRON’s goal under SF2030 is to create significant social value and economic value by seizing business opportunities arising from changes in social

and industrial structures. This means that we aim to generate significant profit through sales growth that exceeds the previous cruising speed. To accomplish this goal, we intend to establish a management system that will use earnings per share (EPS) and return on equity (ROE) in addition to ROIC as key performance indicators for operation of the Group. While we will continue to use ROIC to improve investment capital efficiency and profitability, we will use EPS and ROE for evaluation of the Group’s growth strategy and implement appropriate measures. I think EPS is a suitable indicator for managing the expansion of corporate value not only because of its inherent nature as a direct profit indicator attributable to shareholders but also from the perspective of more accurately measuring the Group’s actual performance after deducting minority interests in JMDC. The reason for our focus on ROE is that we intend to grow through the use of leverage with a certain degree of discipline. Leveraging may lower ROIC levels in the short term, but it is an important option indispensable for expanding future operating cash flows, and I believe ROE is suitable for evaluating medium to long-term value creation initiatives.

Moreover, regarding operation of the Group, we will emphasize the following three perspectives. Firstly, strengthening of investment discipline. The three social issues defined by the OMRON Group are linked to markets with medium to long-term growth potential, and we expect many growth opportunities to emerge in the future. In order to be sure to seize these growth opportunities, we must make necessary investments in a timely manner, with a view to utilizing debt. However, in order to realize the expansion of corporate value, probability of achieving returns on those investments must be high. OMRON has conducted individual evaluations for each case of M&A and each business investment. However, I think we

must evolve the format of investment evaluation in order to maximize the return on limited management resources. Specifically, the indicators of decision-making used in investment evaluation will be unified as NPV and IRR, and hurdle rates will be set in a manner that considers the characteristics of the business field and market stage. While each executive department is responsible for formulating the business plan, the corporate organization is responsible for setting the hurdle rate, thereby clarifying the level of return required for the business and enhancing the objectivity of investment evaluation.

Secondly, strengthening of financial discipline. Looking back, OMRON had a long period of debt-free management. We have been maintaining a high level of financial soundness, with a shareholders’ equity ratio of 73% at the end of fiscal 2022. On the other hand, this partly reflects insufficient reinvestment for the purpose of business growth, and we recognize this as a management issue. Going forward, we will vigorously execute investment, focusing on growth fields, with an eye to debt utilization when good investment opportunities arise. However, this requires mechanisms to maintain a healthy balance sheet. As a result of the tender offer for JMDC shares, interest-bearing debt will amount to approximately ¥85.0 billion. Even though we still have spare capacity for investment, failure to exercise proper financial discipline would risk causing significant harm to operations of the existing businesses. In order to seize investment opportunities in a rapidly changing business environment in a timely manner without overlooking them, we will practice management that is both “aggressive” and “defensive” by constantly maintaining a financial base that enables flexible and smooth financing.

Thirdly, reduction of the cost of capital. Reducing the cost of capital is another important factor in expanding corporate value. OMRON’s weighted average cost of

capital (WACC) at the end of fiscal 2022 was around 8%. In light of the increasing level of beta as well as the impact of the recent increase in interest rates, it is necessary to promote initiatives for improvement from now on. Our basic approach is to reduce the cyclicity of the stock price by promoting business transformation and increasing the sustainability of profit growth. But that is not enough. Even if we are affected by short-term market fluctuations, I think it is essential to ensure that as many investors as possible understand OMRON's medium to long-term growth potential and intrinsic value and support OMRON's value creation initiatives. I would like to vigorously disseminate OMRON's equity story to the market through transparent disclosure.

**Capital Allocation to Increase Growth Potential**

From SF 1st Stage, OMRON set operating cash flow as a management indicator. This is because we view operating cash flow as a source of growth investment and a key indicator that has a significant impact on increasing corporate value. Operating cash flow for

fiscal 2022 was ¥53.5 billion, having declined from ¥67.4 billion for fiscal 2021, owing to a decrease in the efficiency of working capital. In the current fiscal year we will continue to strengthen our ability to generate profit and steadily implement measures to optimize inventory levels to enhance our cash generation capabilities.

In the current fiscal year, we plan to execute the tender offer for JMDC shares through borrowings, but there is no change in our policy on the use of funds, which accords the highest priority to business investment and the two fields we have designated as growth fields, industrial automation and healthcare solutions. As the uncertain business environment is expected to continue, we will be selective in implementing growth investments. In addition to business investments, we will steadily make necessary investments in human resources, the environment, and other areas associated with sustainability that are strongly demanded by society. With regard to shareholder returns, our policy is to maintain continuous and stable dividend payment with dividends on equity (DOE) of around 3%, similar

to fiscal 2022, so as to achieve medium to long-term enhancement of corporate value.

**To Our Shareholders**

As social and industrial structures undergo significant changes, OMRON views these changes as business opportunities as it seeks to transform itself and take on the challenge of creating new value. Maximizing corporate value is our target for 2030, and management targets for 2024 are set as milestones along the path that we are taking. OMRON's goal is to become an enterprise that resolves social issues and achieves sustainable growth. To this end, all employees are working as one under the medium-term management plan. I believe that it is essential to engage in a series of dialogues with shareholders, receive their valuable opinions, and make the most of them as we vigorously pursue our initiatives. We will continue to make transparent disclosures, listen sincerely to the voice of the market, and co-create the future of OMRON with our shareholders. I look forward to the continued support of our shareholders.

<Cash Allocation Policy during SF 1st Stage>

- 1) Aiming to maximize corporate value through the realization of the long-term vision, OMRON prioritizes the necessary investment to create new value from a medium to long-term perspective. During SF 1st Stage, priority will be accorded to investments in human resources and R&D with a view to resolving social issues and pursuing innovation driven by social needs; capital investments in production capacity increases and digital transformation (DX); investment in growth initiatives such as M&A&A (mergers acquisitions, and alliances); and investment in sustainability initiatives such as decarbonization, reduction of environmental impacts, and respect for human rights in the value chain. On this basis, OMRON will return profits to shareholders in a stable and sustainable manner.
- 2) Such investment for value creation and shareholder returns will be, in principle, sourced from internal reserves and operating cash flows that are generated continually, with appropriate financing facilities used as necessary. We will maintain a degree of financial soundness that allows us to seek financing regardless of the current financial situation.

<Shareholder Return Policy during SF 1st Stage>

- 1) With priority accorded to the investment necessary for value creation over the medium to long term, annual dividends will be based on "dividends on equity (DOE) of around 3%." Taking past dividend payments also into account, we intend to ensure stable and sustainable shareholder returns.
- 2) After making the above investments and distributing profit to shareholders, OMRON will distribute retained earnings accumulated over the long term to its shareholders through strategic share buybacks and other measures.