LIVING PLATFORM

28th June, 2022

Dear Stakeholders,

In late May of this year, the World Economic Forum, commonly known as the Davos Meeting, was held in Davos, Switzerland. Last year it was cancelled due to COVID-19, and this year it was postponed to May from the original schedule of January.

We recognized that one of the biggest issues seems to be inflation. It is said that Inflation is called "Merry devil," which has a more positive image than deflation, but still it must be the devil, and each country is focusing on inflation fights.
The current inflationary trends are particularly strong in the U.S., which should have been predictable to some extent when U.S. President Joe Biden made his massive fiscal spending decisions shortly after taking office last year. However, the Federal Reserve Board didn't raise interest rate.

Unlike other countries, FRB has a dual mandate, which are maximizing employment, as well as stable prices, but unemployment rate was historically low at the moment, so there should be no excuse.

This is one of the reasons why Chairman Powell has been criticized recently, but there was Russia's invasion to Ukraine, along with the stagnation of production activities and logistics due to the spread of COVID-19, and now inflation concerns have become a reality. Countries are scrambling to tighten monetary policy such as raising interest rates in order to stabilize inflation, even at the expense of the economy.
However, despite the efforts of governments and central banks, this inflationary pressure will be prolonged on a global level and will also hit Japan for sure, which has long been accustomed to deflation.

This could be attributed by the fact that the principle of comparative advantage advocated by British economist David Ricardo will no longer work, as the invasion to Ukraine increased geopolitical risks, and allow countries to focus only on industries which have an advantage in their own counties from the viewpoint of economic security
In addition, from the viewpoint of military security, we will have no choice but to emphasize self-sustaining, and we believe that there is high possibility that fiscal expenditures on military area will squeeze spending on industrial development.
Due to the above factors, we are now at the threshold of an era of long-term structural slowdown in global economy growth, and I would like to share with you in this "Letter to Stakeholders" what strategies companies should pursue and what management policies we should adopt.

First of all, in the fiscal year ended March 31, 2022, we were able to compensate for the slowdown of new development due to the impact of COVID-19 pandemic by restarting M&A that we stated in the "Letter to Stakeholders" of last fiscal year, and show an increase of 27.3% year-on-year. We were also able to grow to a level that greatly exceeded the promised annual sales of 10 billion yen.

On the other hand, although profits at each stage grew significantly due to specific factors, we are not yet at the stage of showing our strength, and therefore, as we newly disclosed last fiscal year, we presented 4 KPIs, and we have indicated mid-term targets for operating margin and net income before income taxes out of 4 KPIs from the viewpoint of profitability. In addition, as a supplement to the financial results material, we have clearly shown the target year as the fiscal year ending March 31, 2025. In the fiscal year 2023, we intend to focus particularly on increasing sales and operating income.

We will disclose our guideline for the current fiscal year and our three-year mid-term business plan as soon as possible and explain how we will achieve our KPIs for the fiscal year 2025. One of the reasons we have not yet announced our guideline for fiscal year 2023 is the difficulty in estimating the progress of inflation.

At present, we recognize that the three costs of utilities, foodstuffs, and construction are the areas that will be affected by inflation, but the first point is that although we usually have some buffer in our earnings forecasts, we already have seen a considerable rise of the electricity cost in winter in the first half of 2022, and in past years we have tried to curb electricity bills with the cooperation of electricity retailers, but according to the "New Electric Power Company" bankruptcy trend survey announced by Teikoku Databank on March 30, 2022, 14 electric power retailers went bankrupt in FY2022, and a cumulative total of 31 companies withdrew from the business in the past year, so measures to control electricity costs have been very limited.

In our company, about 3-4% of sales are utility bills, and while it is said that the increase in electricity charges is 30% in the past year at TEPCO, the policy of energy policy, including the direction of nuclear power policy, which has a particularly large impact on electricity rates, will be presented after the House of Councillors election in July

The impact of surge in electricity prices are significant for our business as it accounts 3-4% of the sales, and while the increase in electricity charges is approximately 30% in the past year according to TEPCO announcement, we need to find out if the energy policy, including the future of the nuclear power plant which has a significant impact on electricity prices, will be updated after the House of Councillors election in July.

As you are all aware, if the House of Representatives is not dissolved after this coming election, there will be no elections for about 3 years, and the government will get stability and will be able to make decisions on policies that are unpopular with the public.

It is true that public sentiment is still negative to restart nuclear plant due to the impact of the East Japan Earthquake in 2011. However, according to the trade statistics flash report for the May 2022 released by the Ministry of Finance on June 16, 2022, the trade balance deficit is the second largest on record since 1979, and one of the factors is the soaring in energy prices. In order to avoid inflation, we don’t have any other options to restart nuclear plant. So it is already a time to discuss which we will accept inflation or nuclear plant.

The second point is the cost of foodstuffs. Now, the Japan food self-sufficiency rate on a calorie basis in 2019 announced by the Ministry of Agriculture, Forestry and Fisheries was 38%, but due to the invasion of Ukraine, production and exports of grains such as wheat have stagnated, and import inflation has progressed due to the recent depreciation of the yen. Therefore, the soaring food costs that we have managed the costs by negotiating with partner companies and changing items etc. until now has reached a level where we are forced to pass it on to users by raising monthly fees. Now we have no choice but to pay close attention to trends in food costs, which account for about 5% of sales.

And the third point is construction costs. Except for lumber, we have managed to keep construction costs under control until last year by considering alternative measures, but since the beginning of this year, unit

construction costs for heavy steel frame and reinforced concrete structures, which is our mainstay products, have soared by about 10% compared to the price in the beginning of the year.
The operating margin excluding headquarters expenses for each business is at a high level as shown in the published materials, and we recognize that the business structure will not be significantly changed with that. However, since rent accounts for approximately 20% of our sales, we must continuously consider the overall impact.

Now what strategies should companies adopt , as inflationary pressures mentioned above?

It is well known around the world that labor productivity in Japan is very low among developed countries, and there is little sign of improvement.
However I believe that the only way to counter inflation is to raise productivity.
We are trying to achieve 100 billion yen (approximately 735.3 million USD) in sales in 10 years, so that we can expand our business and further demonstrate economies of scale.
There is rule of 72, which is a useful rule that roughly show you what percentage growth is needed to double it.
If we can achieve the 20% sales growth rate presented in our target KPI, it will take less than 4 years to double. And if we achieve a one-year growth rate of 26%, the sales will be increased tenfold in 10 years.
In the first half of this fiscal year, we will further develop our training system, which was renewed in April, through DX and other measures. We will also promote the digitalization of receipts, invoices, contracts, and other documents to increase operational efficiency.

The funds generated through these productivity improvements will be used to improve the compensation of our employees. From an individual's point of view, inflation is not something to be feared, as long as wages increase at the same rate, and real wages remain the same. The question is whether companies can raise wages. Of course companies have budget constraints and must invest in other areas for growth.
However, if productivity is increased, it is possible to achieve both.
Our business domain of elderly care, disability support, and child care are partially financed by public funds, and these funds are likely to be reduced in the future. However, measures to increase productivity should be effective in dealing with this problem. To do so, it is necessary to reform the current system, in which the personnel requirement is uniformly determined regardless of the level of productivity.

Our stock price, after rising significantly last fall, has fallen sharply due to the trend in the growth markets. However, the elderly care market will continue to expand for another 20 years, and the domestic market alone has enormous demand. In addition, the childcare market, which has already peaked out in Japan, will continue to grow in Asian countries.
In such an environment, we believe that if we continue to grow steadily, we can become a company that will be the rival of IHH, which I mentioned in my previous "Letter to Stakeholders," and your continued support and encouragement is highly appreciated.

Yours Sincerely,

CEO
Hirofumi Kaneko