

Kaga Electronics Co., Ltd.  
Top Management Meeting Hosted by SBI Securities  
Main Questions and Answers

Date and time: 4:00-5:00 pm, Tuesday, December 7, 2021

(Online Briefing)

<Points to note>

The “Main Questions and Answers” has been posted as a reference for the convenience of those who were unable to attend the financial results briefing. Please be aware that it is not a transcription of all matters discussed at the financial results briefing, but rather a brief summary of those points that Kaga Electronics deems to be key.

Please also note that the statements contained in this document that relate to the future, such as results forecasts, are based on information currently available to Kaga Electronics and certain assumptions that have been judged to be reasonable. Actual performance, etc. may differ substantially due to a range of factors.

**Q&A about Next Medium-term Management Plan**

**Q: You have said that net sales in the electronic components business will increase by about 80 billion yen from current levels. What products and genres do you expect to see growth in?**

A: This applies to both electronic components and EMS, but although it takes about two to three years to promote sales of automotive-related products, these transactions continue for the next five years or so. This suggests that we could see growth in about four to five years.

In addition, communications-related products do not only include general components—we also have the addition of transactions for unit manufacturing for small wireless LAN modules, which is a business transferred from TAIYO YUDEN Co., Ltd. to KAGA FEI. This is another factor behind gains.

**Q: Does an increase in net sales mean that the number of business partners will also increase?**

A: Our business partners will increase, but the number of components that we handle—particularly automotive products—is increasing. Naturally, we expect electronic components for EV to rise, and as more vehicles go electric, the number of parts used will also increase.

**Q: Is the 380 billion yen sales target for the electronic components business just a midway goal?**

A: We expect the annual average growth rate to show about 7% annual growth. Although the shortage of electronic components is still an issue, market forecasts point to roughly 10% growth even for semiconductors going forward. Moreover, we expect growth of more than 20% for EV, so this is not an impossible target to achieve.

**Q: If net sales (in the electronic components business) do reach 380 billion yen, do you think that the current profit margin would be a fitting level at that point as well?**

A: Even in the electronic components business, we hope to achieve a gross profit margin of 10% or more. Although our SG&A expense ratio is high compared to our competitors, I think we can generate solid profits.

**Q: If the Company is not able to carry out new M&A, would it be difficult to achieve the 750 billion yen target?**

A: Our current sales are about 470 billion yen, so it would be somewhat difficult to reach 750 billion yen without carrying out M&A.

## **Q&A about EMS Business**

**Q: Please provide some background for the plan to achieve 150 billion yen in the EMS business in the fiscal year ending in March 2025, compared to the forecast of 110 billion yen for this fiscal year.**

A: We have many projects in the automotive-related and other markets in which mass production starts three years after orders are brought in, so we can see the potential for reaching 150 billion yen. Regarding other factors, now that KAGA FEI is a Group company, we can engage with customers from upstream in the process (semiconductor design, design of the plate layout, etc.) and we are seeing a sharp increase in cases in which this has led to orders.

**Q: What industries will your customers come from in three years' time?**

A: Our main markets are automotive, medical equipment, and industrial equipment. We aim for long-term transactions in these three markets, so we expect these industries to account for most of our customers.

**Q: What is the status of medical-related transactions?**

A: We have many inquiries from Japan's medical equipment manufacturers, and we expect this to increase going forward. In the medical equipment market, we have to look at the process from development to mass production over a longer span than in the automotive market, but we also have many requests for prototypes, and are now reaching the stage at which we'll shift to mass production.

**Q: To what extent does the EMS business depend on major customers?**

A: Ten major companies account for about 60% of our EMS business.

By industry type, the automotive market accounts for 25%–30%. Our business from the medical-related, office equipment-related, and air-conditioning equipment-related markets is growing every year. I think we can contact a broad range of these industries with a good balance, including these customers.

**Q: What are the factors behind the Company's ability to maintain its profit margin?**

A: I think that it can be attributed to the Company's origins as a general trading business selling parts, which means that we are accustomed to cutting costs in our relationship with suppliers. Cost-cutting starts from the time we receive an order, and we gradually build up profits. While, of course, returning these to customers, we also continue with transactions while maintaining profit margins.

**Q: Will the Company aim to improve the profit margin in the EMS Business going forward as well? Do you give high priority to increasing the scale of this business?**

A: We aim to boost the scale while maintaining our current profit margin, and keeping a good balance as we move forward. On the profit side, capital expenditures have a major impact on depreciation and amortization, so we will keep production capacity within the company and reduce capital investment to lower costs. In terms of increasing scale, we are taking up the challenge of seeing how much we can increase the number of large business partners with net sales over 10 billion yen.

**Q: The Company has manufacturing bases all over the world, and aims to continue expanding bases until the 150 billion yen target has been achieved. What is the thinking behind this?**

A: Our thinking on expanding bases has changed over the past four to five years, and we now put more of an emphasis on the proximity of our manufacturing bases to the point of sale (customers), given political risks and BCP considerations. In particular, in cases in which we make products in China and export them to the US, previously the US and China had tariff disputes, but now the political risks pose a more serious problem than tariffs. As a result, business inquiries from Mexican factories for the US market are increasing. Our basic policy going forward will be to produce products close to

the customer.

**Q: Does the Company view manufacturing bases in Japan such as KAGA EMS Towada in Aomori Prefecture and Kyokuto Electric in Tottori Prefecture as mother factories? Or is each of them just one of many manufacturing bases?**

A: Since we acquired Towada from Pioneer in about 2019, more customers have moved production from overseas back to Japan, and requests for production have increased. Since then, the consolidation of Kyokuto in the Group has reinforced our domestic production system with factories in eastern Japan (Towada) and western Japan (Kyokuto), and we have received many inquiries. Moreover, we decided that having a manufacturing center in Japan (previously it was in Shenzhen, China) as a horizontal structure that cuts through the factories spread throughout the world would be a good move, in part to monitor innovation in manufacturing technology. For that reason, we will move the manufacturing center to Towada in April 2022.

**Q: Are there are reforms underway at the EMS manufacturing sites?**

A: We are aiming to transform them into “smart factories.” Systems, as well as equipment, are important for smart factories, and reinforcing systems and building systems that can be visualized by parts vendors and customers alike at every stage is the most efficient approach in operating EMS factories, and also limits losses. Once this system is complete, it will be difficult for our customers to switch to other EMS companies, which will strengthen their ties to us.

In addition, we are bringing production capital (SMT mount assembly equipment and other ancillary equipment) back in-house. We launched a joint business with a local equipment manufacturer in China, and are gradually introducing production capital developed by ourselves that incorporates our expertise into factories in Suzhou, Shenzhen, Thailand, and Towada. In addition, if we are unable to make outside sales, this equipment is no more than our own capital, so we are engaged in outside sales activities targeting local EMS companies in China under the brand name “HATTEN,” which means “expansion.” I think that this HATTEN production capital will be an impressive source of added value for the Company.

**Q: Where is HATTEN equipment manufactured?**

A: We established Suzhou Kaga Intelligent Equipment Co., Ltd. as a joint company between an equipment manufacturer in Suzhou and KAGA ELECTRONICS, and produce a wide variety of equipment. We introduced this equipment to our factories in Suzhou, Shenzhen, and Thailand, and subsequently started outside sales within China. Plate mounting is our mainstay here, but we also manufacture modules, units, and finished goods.

**Q: Are there examples of ways in which the Group consolidation of KAGA FEI and EXCEL has had an effect on the EMS business?**

A: A major merit is that we are able to contact customers from the design stage for semiconductors. With EMS, customers design the product, and when the design is finished, they begin talking to EMS companies, and once they decide where to place the order, mass production begins. We get involved from the upstream stage, when customers are designing the semiconductor, so to that extent, we are able to obtain product information. This advantageous environment makes it easier for us to secure orders than other companies.

A: The customer finalizes their product specifications and standards, and in the case of EMS, the semiconductors manufactured in line with these specifications and standards are mounted on the plate. We have been in charge of the downstream processes until now, but we can now be involved in the upstream process as well because KAGA FEI worked on the upstream semiconductor design.

A: Another merit is that if we can be involved from the semiconductor design stage, we can obtain information on ancillary parts as well, and can replace these with products that are a strength for the Company.

**Q: What are the conditions like for parts procurement in the EMS Business and what countermeasures is the Company taking?**

A: We are taking countermeasures in regions in which we expect COVID-19 to spread, and are really struggling with parts procurement. We work with the customer to buy up parts from the market, and consult with the customer so that we can

change the items being manufactured without stopping the line. Conditions are really difficult on the front line, but we are working hard to avoid an impact on financial results.

### **Q&A about M&A**

**Q: I am sure that KAGA FEI and EXCEL have been producing results since the M&A, but can you tell us about any areas in which you would like to see even greater effects?**

A: This is not restricted just to the three companies of Kaga Electronics, FEI, and EXCEL, but it has been one to two years since the acquisition, and in that time, we have made steady progress in eliminating and consolidating bases. In terms of business partners, it is not efficient for all three companies to put all their efforts into pursuing the same customers, and there is still room for reforms, including adjustments to employee assignments. I think that continuing such reforms will drive reductions in SG&A expenses, but it will probably take another one to two years before we see any effects.

**Q: Are you considering M&A from the perspective of ROIC?**

A: We have not set standards from an ROIC perspective. We evaluate prospective M&A in terms of the extent to which we can generate profits in line with our business plan and the amount of loans that would be required, and if there are merits, we move forward with it. At present, we have over 40 billion yen in loans. Given the parts shortage, we are currently building up a safety inventory, and the net D/E ratio is slightly positive, but if inventory declines in the future, we think this ratio will turn negative. All of our financing consists of bank loans, but we keep it within an amount that we can return every year, and strive to ensure that these loans never become a financial burden. We think this is why we have been able to earn an A- rating for three years in a row.

### **Q&A about other issues (Medium- to Long-term Sustainability Management Plan, shortage of electronic parts, CSI business, other)**

**Q: What kind of conditions are the CSI business and Other business in at present?**

A: The CSI business is seeing growth in PC and software sales. Sales of PCs and software for new students at high schools, vocational schools, and universities (not as part of the GIGA School Program) have shown substantial growth every year. Increasing the number of schools we handle would result in higher sales, so we are boosting the number of sales employees and increasing the number of schools we serve.

**Q: How long do you think the shortage of electronic parts will last?**

A: I always answer this question by saying that it will probably last throughout 2022, but it could actually end sooner than expected. In the past, we were often required to order parts one year ahead due to the semiconductor shortage, but now we are sometimes asked for final orders through March 2024 at the longest, and I think this state of affairs is just too unusual.

I think that companies using parts are ordering 10%–20% more than they actually use, and we will be monitoring conditions closely to see how long this lasts.

**Q: With Toyota catching up on production, finished vehicle manufacturers are also frantically trying to procure semiconductors. Has this had any impact that has led to shortages of electronic parts in other fields?**

A: Manufacturers that use semiconductors are facing parts shortages not only in automotive, but in all industries.

**Q: What are the key points of the Medium- to Long-Term Sustainability Management Plan?**

A: First of all, we will address environmental issues primarily with a focus on changing our existing power to renewable energy. There are many environmental issues we could target, and a range of responses we could take, but our first goal is to use 100% renewable energy, while limiting costs as much as possible, at our bases in Japan and overseas.

We have been working on replacing our sales vehicles with hybrid vehicles, and we have now reached the high level of 78.5% hybrid vehicles, which is an excellent figure. We have not been able to replace the remaining vehicles because they are cargo vehicles for which hybrid versions do not exist or there would be insufficient room in the parking lot if we switched to a hybrid.

On social issues, we had already been promoting telework and limiting commuting and coming into the office in March 2020, before the state of emergency was declared. I think this is quite an innovative initiative, considering the size of our company. Even now, the attendance rate is only about 40%, and we have not relaxed these standards even now that the state of emergency has been lifted, but continue with telework as before. We hope that this continues to lead to better work-life balance and management for employees.

Finally, in terms of governance, we changed our system with the aim of being fully compliant with the changes in the CG Code. We will consider shifting to a delegation-based executive officer structure and a company with committees in the future, but we have already ensured that one-third or more of our directors are independent directors and have established a Nomination and Compensation Committee.

The recently released Medium- to Long-Term Sustainability Management Plan was prepared in-house, without relying on an external consulting company, and I think there are almost no other examples of small- or mid-cap companies that have produced such a succinct and well-organized plan. Even if we are listed on the Prime Market next spring, I am confident that we have created a structure that meets the demands of Japanese and overseas investors.

**Q: Thank you for spending so much time answering our questions. Do you have any closing words for investors?**

A: We have decided to move the current factory in Turkey and set up a new factory that is capable of local production for local consumption with the addition of a line that can assemble parts at this site.

We ask for your ongoing support as we continue to take on a wide range of challenges.