Our Finance and M&A Strategies to Achieve MSV Presented by Co-President Wakatsuki

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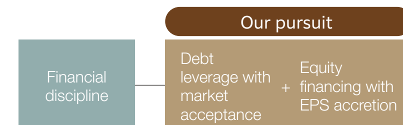
Director, Representative Executive Officer & Co-President

We are pursuing our medium to long-term management strategy based on our Asset Assembler model. In this section, Co-President Yuichiro Wakatsuki explains our approach, characteristics, and competitive advantages of our finance and M&A strategy.

Finance Strategy

How Shareholder Value Is Maximized

▶ See page 5.



Conscious of our cost of capital

While maximizing EPS and PER, we also maintain our policy to have ROIC (return on invested capital) surpassing WACC (weighted average cost of capital: approximately 6%) eventually for M&A.

Capital efficiency is on a slight decline as a result of recognizing goodwill linked to our M&A activities. With EPS accretion expected in Year 1 of acquisition, the acquired company is also expected to attain an ROIC surpassing the WACC (on a consolidated basis) within 3 to 4 years. This will be accomplished through post-acquisition profit growth and a shortened cash conversion cycle (CCC), leading to improved capital efficiency.

Vigilant monitoring of any decline in capital efficiency is essential, as it can result in increased risk. However, we also recognize the importance of striking a balance between ROIC and profit growth, as being excessively focused on ROIC might lead to opportunity losses for quality M&A. With the advantageous risk/return profile of the markets we operate in, coupled with our strong balance sheet and low funding costs, we are confident in our ability to effectively manage risk and accelerate EPS accumulation.

The table on page 55 shows the year-on-year improvement in individual ROIC for the major assets acquired since FY2019. This progress can be attributed to profit growth and effective balance sheet management following the acquisitions. Notably, Betek Boya achieved an ROIC above the consolidated WACC in its second year post-acquisition, while PT Nipsea is expected to reach this milestone in its fourth year of ownership, specifically in FY2024. DuluxGroup (Pacific) is projected to experience a gradual improvement in ROIC, with a positive spread anticipated in FY2024.

Finance strategy that drives our Asset Assembler model

Our capital policy revolves around enhancing TSR (Total Shareholder Return) by achieving consistent EPS growth, all the while upholding financial discipline and giving priority to growth investments.

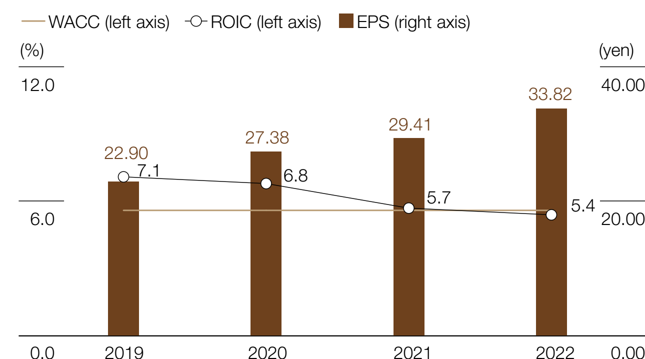
Our financial discipline rests on three key principles: (1) prioritizing debt financing, (2) maintaining leverage capacity, fostering communication with financial institutions and rating agencies, and (3) considering the option of raising equity only accompanied by EPS accretion. The paint and adjacencies businesses represent significant cash flow generation capacity, and we are actively capitalizing on our low funding costs to meet our capital needs actively pursuing M&A opportunities.

Regarding capital expenditures, we also take proactive measures to implement investments that foster sustainable growth in the future noting current businesses require relatively limited capex compared to scale of revenue and cash flow. We are, however, making new investments, such as expanding production capacity and reinforcing our DX (Digital Transformation) and R&D efforts around the globe with discipline. With that, M&A is indeed the main source for additional capital needs. Based on our Asset Assembler model, we will continue to accumulate "good and low risk M&A" at a reasonable valuation.

When it comes to shareholder returns, we give paramount importance to investing in growth mainly in M&A, with a primary goal of enhancing TSR through EPS growth.

Our dividend policy is to maintain stability with a payout ratio of approximately 30%, also considering various factors such as performance trends, future investment opportunities, and dividend payout ratio in a comprehensive manner.

WACC / consolidated ROIC / EPS



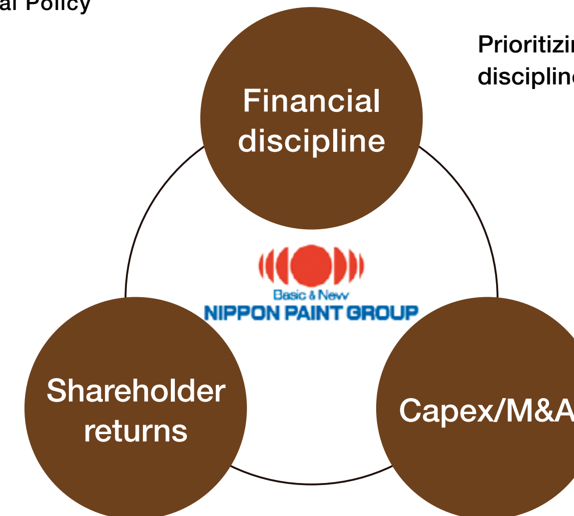
ROIC of individual companies[*1]

	Year 1[*2]	Year 2	Year 3	Year 4
DuluxGroup (Pacific)	1.2%	3.2%	3.9%	5.3%
Betek Boya	3.5%	9.4%	11.8%	8.1%
PT Nipsea	3.7%	5.3%	-	-

*1 ROIC (IFRS): after-tax operating profit (after PPA amortization on intangible assets) / acquisition cost (including transfer consideration and subsequent capital increase, etc.) After conversion into the Japanese yen using actual exchange rates

*2 ROIC for DuluxGroup (Pacific) is calculated based on four months' results and for Betek Boya six months' results

Capital Policy



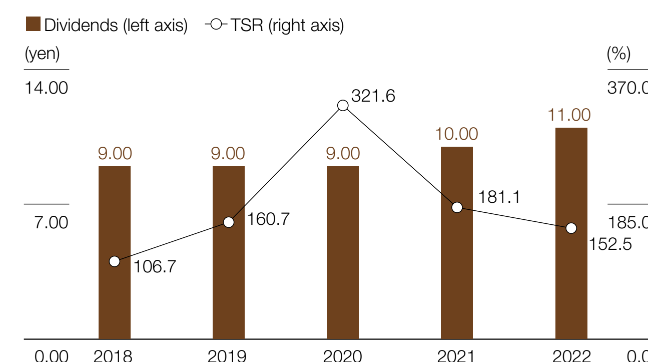
Prioritizing growth investment and M&A while maintaining financial discipline with the focus of increasing TSR through EPS accretion

Financial discipline
- Pursue optimal capital structure with balanced leverage
- Allow for temporarily higher leverage for strategically important M&As

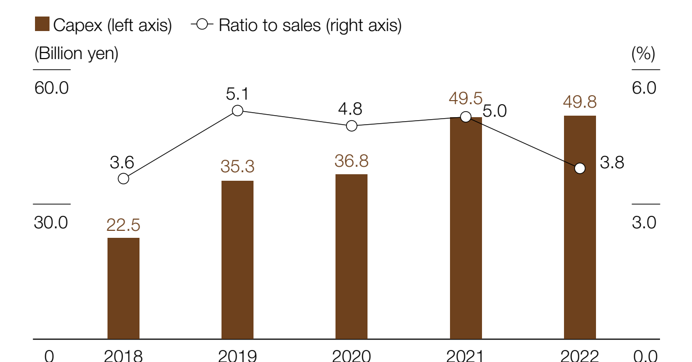
Capex/M&A
- Proactively implement capex and M&A for future sustainable growth

Shareholder returns
- Maintain a dividend payout ratio of 30%
- Increase TSR through growth investment and M&A

Dividends / TSR



Capex / Ratio to sales



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Effective balance sheet management achieved by adhering to financial discipline and building optimal capital structure

Regarding financial discipline, we prioritize debt financing over equity while maintaining leverage capacity to continuously secure low-cost financing.

It is crucial to seek proper understanding of our risk nature from financial institutions and rating agencies. We actively engage in active dialogues with these institutions while continually enhancing our disclosure materials.

Regarding our balance sheet management, we also take CCC as a key performance indicator (KPI). Our partner companies strive to shorten CCC by reevaluating transaction terms across different regions and business units. Additionally, we have continuously undertaken measures to reduce cross shareholdings through their recent sale.

Fixed assets (tangible, intangible and goodwill) have been growing driven mainly by our M&A endeavors and we actively monitor asset efficiency and profitability and occasionally take strategic actions such as the transfer of the European automotive business and the India businesses, along with implementing structural reforms in Japan Group and the marine business.

We also endeavor to mitigate goodwill impairment risk through a smooth PMI (Post-Merger Integration) backed by autonomous and decentralized management practices while maintaining discipline to accumulate high-quality M&As at reasonable valuation.

Our financial leverage is anticipated to be 3.4x net debt/EBITDA (adjusted for one-off items) by the end of FY2022 and approximately 2.9x by the end of FY2023, assuming no further M&A activities. (See "Overview and Updates on Medium-Term Plan (FY2021-2023)" on page 51.)

All debt financing is primarily denominated in yen, boasting an average maturity of 3.5 years and an average pre-tax interest rate of 0.35% as of 2022 year end. Our focus remains on achieving an optimal capital structure, ensuring enough debt capacity to pursue new opportunities, also establishing strong trust and confidence among borrowing financial institutions and rating agencies.

Capital allocation approach for sustainable growth

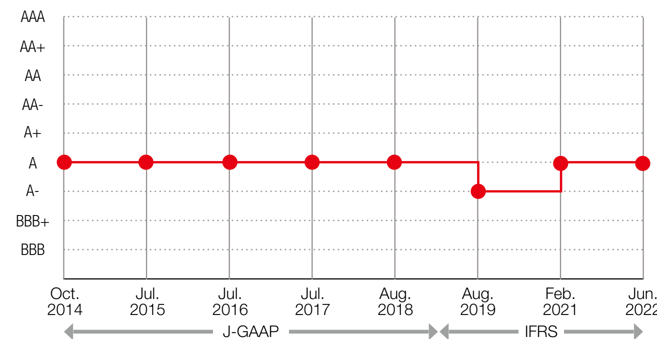
In comparison to the previous Medium-Term Plan (N-20, FY2018-2020, "MTP"), which saw an operating cash flow of approximately JPY240 bn, the current MTP (FY2021-2023) showcases an enhanced cash flow generation capability. This improvement can be partially attributed to the elimination of minority interest outflows, achieved by the full integration of the Asian JVs in FY2021.

Throughout the three years of the current MTP our projections indicate an anticipated operating cash flow of approximately JPY300 bn. To achieve continuous revenue and profit growth we plan to invest around 3% of consolidated revenue in capital expenditures, leaving us with the remaining JPY170 bn in cash flow. Approximately half of this operating cash flow will be distributed to shareholders as dividends with a payout ratio of around 30%.

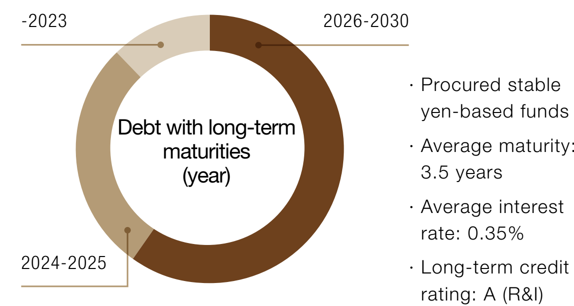
The remaining cash flow will either pay down existing debt, or be spent directly for emerging opportunities, with the former and latter difference being a matter of timing.

With the support and understanding of financial institutions and rating agencies, as well as our equity investors, we are committed to actively pursuing M&A opportunities that align with our growth strategy beyond FY2024.

Transition of credit ratings (R&I)



Status of debt



Balance sheet management policy

As of December 31, 2022

Assets

"Cash and equivalents"
"Trade and other receivables"

- Review the CCC to reflect the impact of the pandemic and deterioration of the conditions in the Chinese real estate market (e.g., review the trade terms and conditions)
- Take actions to respond to future credit collection risk (e.g., recording a provision for possible credit loss in China)

"Other financial assets (non-current assets)"

- Examine the rationality of continuing to hold cross-shareholdings every year (disposed of some cross-shareholdings also in FY2022)

"Property, plant and equipment"

- Take actions to improve asset efficiency and profitability through business divestiture and structural reform (e.g., transfer of the European automotive business and the India businesses, structural reform of Japan Group and the marine business)

"Goodwill" and "Other intangible assets"

- Minimize PMI risk based on autonomous and decentralized management and reduce impairment losses by accumulating "high-quality M&A"

Assets	
"Cash and cash equivalents"	¥242.6 bn
"Trade and other receivables"	¥311.3 bn
"Other financial assets (non-current assets)"	¥26.1 bn
"Property, plant and equipment"	¥376.8 bn
"Goodwill"	¥825.5 bn
"Other intangible assets"	¥400.1 bn
Total	¥2,442.3 bn

Liabilities	
"Trade and other payables"	¥256.8 bn
"Bonds and loans payable"	¥722.1 bn
Total	¥1,287.0 bn

Equity	
"Capital"	¥671.4 bn
"Retained earnings"	¥272.5 bn
Total	¥1,155.4 bn

Liabilities

"Bonds and loans payable" (Interest-bearing debts)

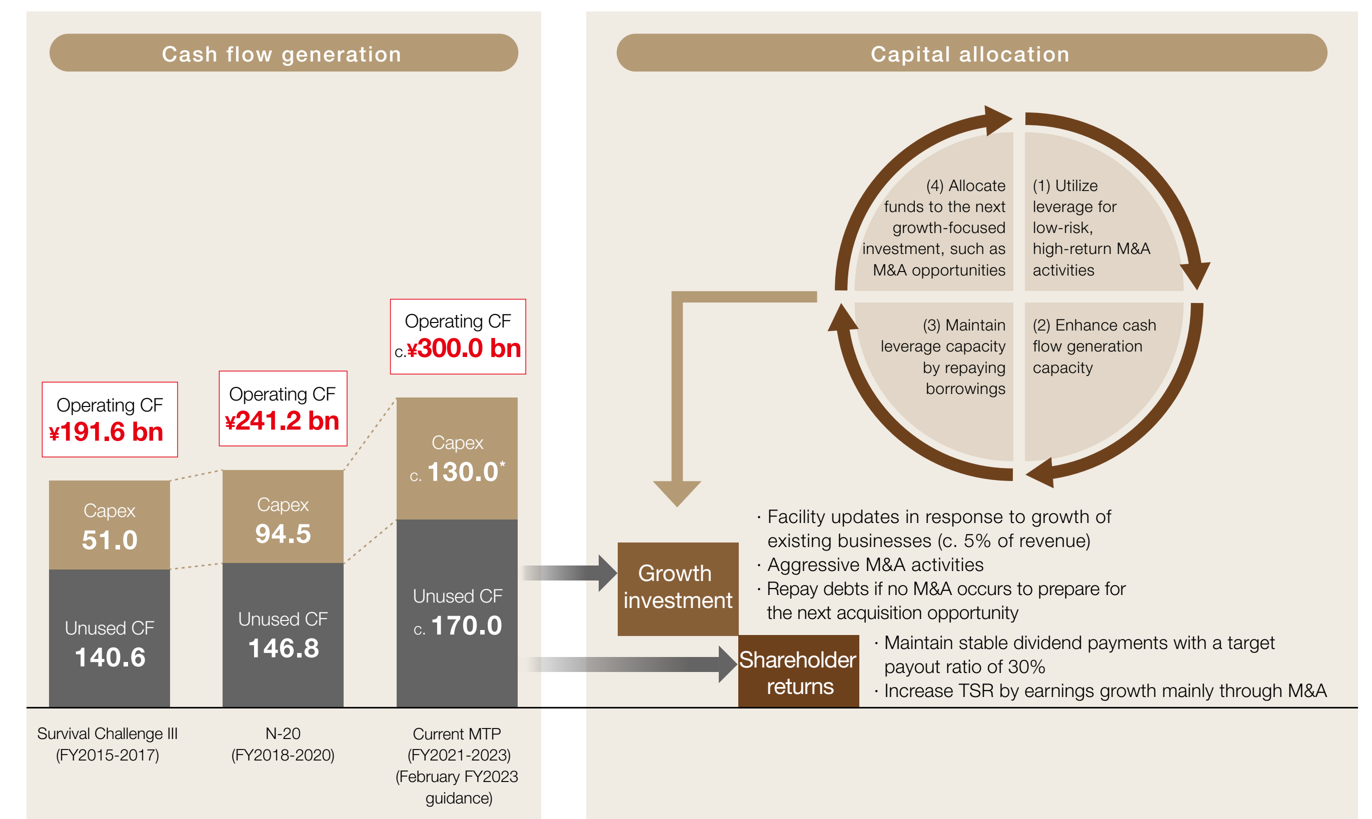
- Prioritize debt financing and maintain the leverage capacity (the expected net debt/EBITDA at the end of FY2023 is around 2.9 times assuming no further M&A activities)
- Evaluation from credit rating agencies (maintained the "A" rating from R&I)
- Stable finance procurement capability in yen (low interest rate/long-term maturity)

Equity

"Capital" "Retained earnings"

- Reinforce financial base to prepare for growth investment such as M&A (capital increase based on new share issuance through a third-party allotment)
- Equity-based capital raising remaining an option with EPS accretion as a premise
- Take capital efficiency into the consideration of M&A decisions, including achieving ROIC that exceeds WACC
- Aim to maintain the dividend payout ratio at 30%

Capital allocation approach

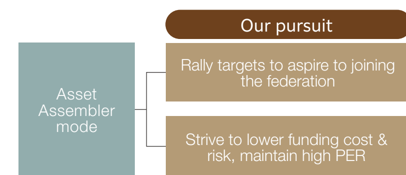


* Excluding capital expenditures on leased assets

M&A Strategy

How Shareholder Value Is Maximized

▸ See page 5.



M&A basic policy

Our M&A basic policy is to promote M&A activities by leveraging our three pillars of competitive advantage underlying our Asset Assembler model as outlined on page 37: (1) our ability to harness the low funding cost, (2) our ability to maintain and boost the EPS contribution from assets companies without intervention and (3) our unique appeal to management-class talents who empathize with our modus operandi. Based on this policy, our current focus lies in promoting M&A activities in the paint and adjacencies areas, which offer a compelling risk/return advantage. (▸ For more information, see "The Basis of Our Asset Assembler Model" on page 37.) Notably, the decorative paints market represents a significant portion of the paint and coatings market. It operates on a local production for local consumption basis, with each country and market adopting unique business models encompassing raw material procurement, consumer preferences, sales networks, and environmental regulations. Apart from facing a low threat of substitute products, paints, particularly decorative paints, exhibit significant regional characteristics. Critical success factors in this market are as follows: (1) strong brand power; (2) a well-established distribution network; and (3) the establishment of operations with local expertise. Achieving the No. 1 market share based on these factors provides a substantial advantage, making it challenging for competitors to reverse the trend. This market leadership enables further expansion in market share, followed by increased profits, creating a virtuous cycle of growth.

The key points of our M&A based on Asset Assembler model is outlined in the table below. We select acquisition targets which (1) contain low risk and stable earning flow, (2) possess strong brand and talented management teams, and (3) is expected to show EPS accretion from year one.

Key partner companies which joined our Group since FY2014 have achieved strong growth in both high growth and mature markets as outlined in "Asset Management Report" on page 23.

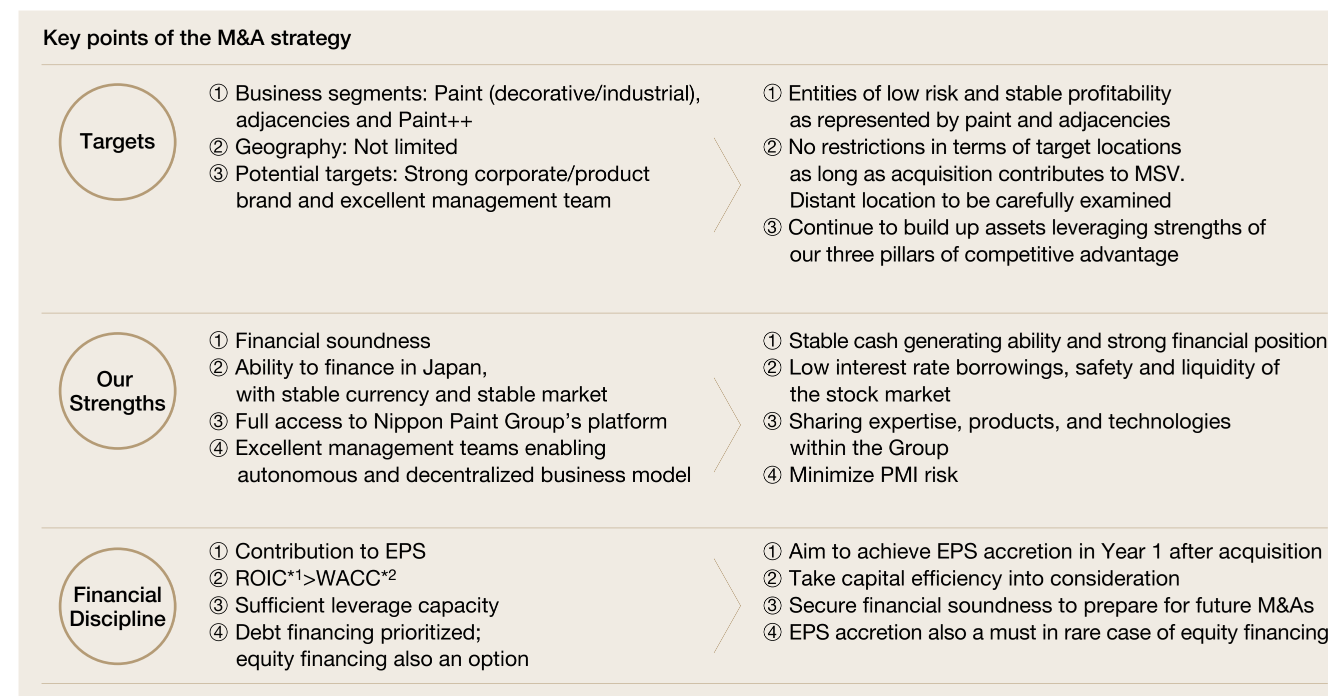
We will strive to maintain our track record of accumulating successful M&A deals to widely convey the benefits of joining our Group to acquisition targets, while at the same time building expectations from the stock market as a company capable of consistently accumulating and expanding EPS.

M&A selection process

The diagram on the right page illustrates our M&A selection process. After creating a long list of target companies, we assign priorities, examine feasibility, and hold thorough discussions, going into details such as the timing and proposal structure of M&A. When choosing targets, the sole criterion is their potential contribution to MSV. Notably, personal egos, such as the desire to just pursue size or personal achievements, do not influence our decisions. For our Company, achieving the title of the world's largest company in terms of sales would hold little significance if the journey towards that goal were to harm shareholder value.

Therefore, when we examine a specific acquisition, we make judgment after holding multifaceted discussions on the degree of PMI led by Partner Company Groups and other risks involved with sound vigilance at all times. In the context of "Asset Assembler" model, human capital holds significant importance. To mitigate risks effectively, we have implemented mechanisms that involve commitments with local management and succession plans.

One essential financial discipline for us is to contribute to EPS accretion from the very first year. We refrain from making overly optimistic assumptions about justifying acquisition synergies, e.g. hoping for positive EPS only after three years of acquisition. In our value calculations, we take into account not only metrics like PER and EV/EBITDA but also evaluate how executing the deal will impact the cushion in the Group's balance sheet.

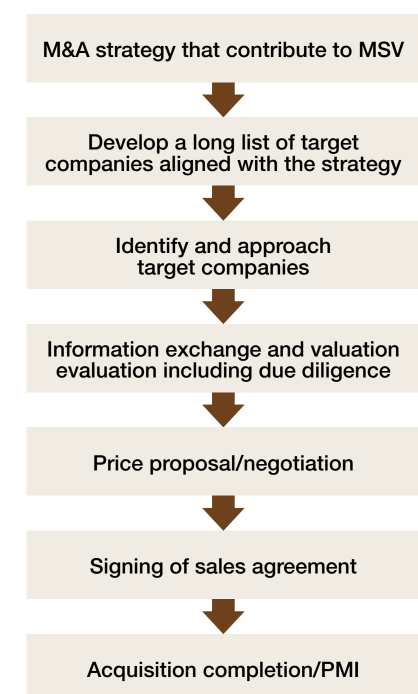


Key points of the M&A strategy

Targets	① Business segments: Paint (decorative/industrial), adjacencies and Paint++ ② Geography: Not limited ③ Potential targets: Strong corporate/product brand and excellent management team	① Entities of low risk and stable profitability as represented by paint and adjacencies ② No restrictions in terms of target locations as long as acquisition contributes to MSV. Distant location to be carefully examined ③ Continue to build up assets leveraging strengths of our three pillars of competitive advantage
Our Strengths	① Financial soundness ② Ability to finance in Japan, with stable currency and stable market ③ Full access to Nippon Paint Group's platform ④ Excellent management teams enabling autonomous and decentralized business model	① Stable cash generating ability and strong financial position ② Low interest rate borrowings, safety and liquidity of the stock market ③ Sharing expertise, products, and technologies within the Group ④ Minimize PMI risk
Financial Discipline	① Contribution to EPS ② ROIC*1>WACC*2 ③ Sufficient leverage capacity ④ Debt financing prioritized; equity financing also an option	① Aim to achieve EPS accretion in Year 1 after acquisition ② Take capital efficiency into consideration ③ Secure financial soundness to prepare for future M&As ④ EPS accretion also a must in rare case of equity financing

*1 Return on invested capital (after one-off expenses) *2 Weighted average cost of capital

M&A target selection process



A Platform that drives growth of both existing businesses and acquired companies

The strength of our platform based on Asset Assembler model lies in its ability to generate growth synergies for both existing and acquired businesses. This leads to higher earnings growth compared to the pre-M&A period. Notably, our approach goes beyond mere cost-cutting synergies often seen in the Western model.

Unlike many failed M&A by Japanese companies where impairments are often observed after several years post acquisition, all of our deals since FY 2019 when we accelerated our M&A efforts have surpassed our expectations. This success in of itself is the evidence of our strength in platform. In the following, I will elaborate on the key success factors.

Co-Presidents maintain constant communication with local management while delegating authority and defining responsibilities for achieving results only after establishing a high level of trust based on factors such as their track record and commitment to growth. A streamlined decision-making process with local approval is adopted, ensuring swift and effective actions. Having management dispatched from headquarters can create a disconnect with the local staff, while a top management composed solely of e.g. Japanese may lead to a loss of motivation among talented local employees.

The role of our headquarters is to offer support to talented local management. In addition to fostering a direct consultative relationship with Co-Presidents, we provide Japanese yen-based funds for growth investments, leverage the Nippon Paint brands, and facilitate an autonomous collaboration platform among the partner companies.

Of course, we do maintain certain aspects of control. Co-Presidents oversee the governance of our key subsidiaries. Headquarters retains its say in certain level of capital expenditures, as well as compensation and appointment/dismissal of CEO-class senior executives at subsidiaries.

The strength of our platform extends beyond associates collaborating across borders, if needed, to achieve the common goal of MSV. It also encompasses active sharing of growth strategies for countries with both mature and emerging markets, brands and know-how from existing and new businesses, and raw material purchases among partner companies. Moreover, these partner companies have the freedom to make choices without being forced by headquarters. This blend of trust and accountability for results empowers us to foster growth through both existing businesses and M&A.

As a result, local management with a passion for growth can fully showcase their management skills, leading to an increase in companies that express interest in joining our Group.