Chapter 2

Capital and Business Model

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PHOTO: Australia / The Ivanhoe Grammar School Senior Years and Science Centre
(Photographer: John Gollings)
Providing paint and coating technologies solving social issues for 140 years

The Nippon Paint Group has been committed to solving social issues by developing innovative technologies around the world over its 140-year history since we developed Japan’s first non-toxic zinc white. The Group mobilizes its comprehensive strength to carry out its common Purpose and pursue its ultimate objective of Maximization of Shareholder Value (MSV) while engaging and responding to the constantly evolving business conditions and changing global environmental and social issues.

Nippon Paint Group corporate action (global)

- 1881: Nippon Paint predecessor Komyosha founded (Japan)
- 1898: Nippon Paint Manufacturing Co., Ltd. established (Japan)
- 1918: DuluxGroup established (Australia)
- 1919: Bößig & Kemper (now Nippon Paint Automotive Europe) established (Germany)
- 1925: Dunn-Edwards established (U.S.A.)
- 1927: Renamed as Nippon Paint Co., Ltd.
- 1949: Wuthelam founded (Singapore)
- 1962: Pan Malaysia Paint Industries (now Nippon Paint (Singapore) Company) established
- 1967-1994: NIPSEA business actively expanded in Thailand and Malaysia, etc.
- 1988: Betek Boya established (Turkey)
- 1992: Business expanded into the China market (Nippon Paint (China) established)
- 1994: NIPSEA business expanded into the U.S. market (Nippon Paint (USA) established)
- 2014: Holding Company Structure adopted and Asian JVs consolidated
- 2015: Operating companies separated by lines of business
- 2016–2019: Globalization advanced through M&A
- 2017: Developed anti-viral and anti-bacterial paint
- 2020: Launched the PROTECTON anti-viral and anti-bacterial paint brand
- 2021: 100% ownership of the Asian JVs and Indonesian business acquired

Nippon Paint Group Purpose and New Medium-Term Plan (FY2021–2023) formulated
### Nippon Paint Group Management Resources

**Human capital**
- Systemic human resource evaluation
- Organizational capabilities that can immediately operate based on customer needs and provide effective solutions
- Essential for creating innovations and meeting customer needs and to enhance our competitive advantage
- Key to enabling stable product supply

**Manufactured capital**
- Industry-academic co-location
- Silos and collaboration with external parties on externally useful products and capabilities for improving products and services

**Social and relationship capital**
- Strong customer base based on long-term relationships of trust
- Customer and brand names carry a resource indispensable to operating a wide range of businesses worldwide

**Intelectual capital**
- Customers and consumer place importance on reliability of products and services
- The power that our Company and brand names carry is a resource indispensable to operating in a wide range of businesses worldwide

**External partners**
- Customers and consumer place importance on reliability of products and services
- The power that our Company and brand names carry is a resource indispensable to operating a wide range of businesses worldwide

**Customer base**
- Customers and consumer place importance on reliability of products and services
- The power that our Company and brand names carry is a resource indispensable to operating a wide range of businesses worldwide

**Brands**
- Developing sustainable growth requires abundant funds to continue growing in M&A, new businesses, and established the production facilities, and hence requires increasing the ability to generate cash flow and a sound financial base

**Financial capital**
- Developing sustainable growth requires abundant funds to continue growing in M&A, new businesses, and established the production facilities, and hence requires increasing the ability to generate cash flow and a sound financial base

**Natural capital**
- Developing sustainable growth requires abundant funds to continue growing in M&A, new businesses, and established the production facilities, and hence requires increasing the ability to generate cash flow and a sound financial base

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**Message from Management**

**Capital and Business Model**

**Medium- and Long-term Growth Strategy**

**Sustainability Information**

**Financial and Corporate Information**

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**Nippon Paint Holdings Integrated Report 2021**

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**Examples of the active use of management resources and generation of synergies**

- **Six categories of capital**
  - Human capital
  - Manufactured capital
  - Social and relationship capital
  - Intellectual capital
  - External partners
  - Customer base

- **Nippon Paint Group management resources**
  - Human resources/organizations
  - Technologies
  - Manufactured capital
  - Social and relationship capital
  - Intellectual capital
  - External partners
  - Customer base

- **Importance of management resources in value creation**
  - Diverse human resource evaluation
  - Organizational capabilities that can immediately operate based on customer needs and provide effective solutions
  - Essential for creating innovations and meeting customer needs and to enhance our competitive advantage
  - Key to enabling stable product supply

- **Competitive advantages (strengths) of management resources**
  - Overseas human resources and new business information
  - 22% of employees in overseas regions
  - Overseas employees and new business information
  - Overseas employees and new business information
  - High-level of employee satisfaction (2020)

- **Major external evaluations**
  - Selected as a constituent of the MSCI Japan ESG Universal Index (2020) for the second consecutive year (June 2021)
  - Selected for the GreenSE3I Technology Award (April 2021) for the artificial intelligence project "Artificial-AI" (2020)
  - Selected for the "Most Sustainable Paint Company in the World" by the World Paint Confederation (2020)

- **Particularly relevant materiality**
  - For more details on Materiality, see page 21
  - For more details on Materiality, see page 21

- **Increasing management sophistication and effectively using resources based on Powerful Partnerships**
  - For more details on Powerful Partnerships, see page 22

- **Examples of the active use of management resources and generation of synergies**
  - For more details on synergies, see page 30
Our strategic partnership boosted the Nippon Paint brand to a dominant position in Asia

Nippon Paint Holdings and the Wuthelam Group have steadily deepened and broadened our partnership since we established the Asian Joint Ventures (NIPSEA business) in 1962. This strategic partnership elevated Nippon Paint to a dominant brand in Asia and was further substantiated in January 2021 with NPHD’s acquisition of 100% ownership of the Asian JV. This page traces the history of our Japan-Singapore partnership for 60 years. The Wuthelam Group is now an asset management company engaged in investment activities.

**Maximization of Shareholder Value (MSV)**

- Boost to Nippon Paint brand power
- Boost to market presence (share gains)
- Boost to returns (sales and profits)

The structure of the Japan-Singapore partnership in the 1960s

**1962**
- Jointly established Pan Malaysia Paint Industries (the current Nippon Paint (Singapore) Co. Pte. Ltd.)
- Entry into the Malaysia market
- Entry into the Thailand market

**1969**
- Entry into the Indonesian market

**1970**
- Entry into the Hong Kong market (China)

**1976**
- Entry into the Philippines market
- Entry into the South Korea market

**1992**
- Development of Asian automotive coatings and industrial coolings markets

**2004**
- Entry into the Taiwanese market (China)

**2006**
- Entry into the Indian market

**2007**
- Entry into the Pakistani market

**2011**
- Entry into the Bangladesh market

**2014**
- Consolidation of the Asian JVs (NPHD ownership ratio: 100%)

**2021**
- Acquisitions of the Asian JVs and the Indonesia business (NPHD ownership ratio: 51%)

**Japan-Singapore partnership aimed at the growth potential of the Asian paint market**

The beginning of our partnership

Our partnership with the Wuthelam Group dates to 1962, when we jointly established Pan Malaysia Paint Industry (the current Nippon Paint (Singapore) Pte. Ltd.). Nippon Paint and the Wuthelam Group have evolved over the six decades, which have been significant for the development of the Asian paint market. Nippon Paint’s acquisition of 100% ownership of the Asian JV in January 2021 marks a milestone in our partnership.

In the in-house magazine, Chikki Obata, who was Nippon Paint Senior Managing Director at the time, expressed expectations for the new company, “Pan Malaysia Paint will establish Japan’s foothold in the fast-growing market in Singapore, right on the equator. This area has a potential to grow into a major market, which is a great delight for our Company as well as for Japan’s paint industry.” Commenting on the impression of the Wuthelam Group, he praised them saying, “The people are hardworking, thoroughly inquire into things, and perform their duties with a sense of responsibility. If we form simplistic assumptions about these people, we will fall behind them.” He also left prophetic comments for Nippon Paint employees, “Our playing field is not limited to the narrow market in Japan. We should be competing in the greater global marketplace. That should be our real objective.”

The new factory operations as the first modern factory in Singapore with a site area of 8,000m² and
**Dominating the Asian market with the Nippon Paint brand and local marketing capability**

Production capacity of 300 tons per month. The factory’s completion ceremony on April 15, 1965 was attended by some 600 people, including senior government officials from both Japan and Singapore, management and employees of Nippon Paint and the Wuthelam Group, and customers. The event was widely reported in local newspapers with comments including, “the new factory will significantly contribute to the economic development and friendship of the two countries,” and “all Southeast Asian nations have an interest in its success.”

**Leveraging mutual strengths to methodically expand across Asia**

Nippon Paint first entered the broader Asian market in 1933, and the partnership with the Wuthelam Group enabled us to leverage the strengths of both companies to further that expansion. Nippon Paint has promoted the sales growth of the Nippon Paint brand products by dispatching Japanese paint engineers to local production sites to provide paint technologies and production know-how, and Wuthelam uses its expertise and network in the Asian market to manage local operations, sales, and marketing. The partnership has also led to expanding operations into Thailand, Malaysia, the Philippines, South Korea, and other countries through the 1970s. In the 1980s, business grew beyond the decorative paints business with the growing Asian operations of Japanese automobile and home electronics manufacturers into the automotive coatings and industrial coatings markets. In 1992, we expanded into the huge mainland China market and also established operations in Vietnam, India, Sri Lanka, Turkey, and Egypt. We have achieved high growth by actively meeting the brisk paint demand in the rapidly growing Asian market.

The Japan-Singapore partnership between Nippon Paint and the Wuthelam Group has evolved over the six decades of the NIPSEA business. Nippon Paint Holdings made the NIPSEA business a consolidated subsidiary in 2014 and a wholly-owned subsidiary in January 2021, thereby bringing the partnership to full maturity. (See “Discussion by the Board of Directors” on page 85). We plan to further accelerate the development of globally integrated operations.

**Achieving dominant market position in the Asian market and MSV**

The NIPSEA business has generated continuous high growth, by establishing a dominant market position based on the powerful LiBang brand and extensive distribution channels to capture the particularly strong market growth in China, where we estimate CAGR for 2019-2024 will be a brisk 5.3% (See “The Global Paint Market” on page 05).

We will continue solidifying our dominant position in the Asian market using the unique management resources of our 60-year partnership with the Wuthelam Group as we seek to achieve Maximization of Shareholder Value (MSV).
Pursuing Maximization of Shareholder Value (MSV) based on Powerful Partnerships with Group partner companies around the world.
Pursuing innovation to solve social issues

PROTECTON anti-viral and anti-bacterial paint brand was specifically developed to address the global social issue of infectious diseases. Our commitment to addressing social issues is expressed in the Nippon Paint Group’s ESG Statement. “Finding solutions to global sustainability challenges is our responsibility to future generations and is a driving force for our continued growth and success.” (See “Toward a Sustainable Future” on page 118) (as well as by reinforcing our human resources and organizations (human capital) by developing R&D engineers around the world, while leveraging our sound financial base (financial capital) to procure any necessary financing. In addition, following our Purpose, we are sharing within the Group the expertise and know-how gained while developing the PROTECTON products as we continue to contribute to solving social issues around the world by closely collaborating with internal and external stakeholders that are tightly linked together through our Purpose and demonstrating our Group’s four unique strengths (see page 45).

PROTECTON products created through the power of “Science + Imagination”

Our Group’s initiatives to generate innovation are conducted with an emphasis on the Purpose of defining the shared identity of our Group. The Purpose expresses our commitment to “Enriching our living world through the power of Science + Imagination.” PROTECTON products embody that Purpose. Their outstanding anti-viral and anti-bacterial technologies were developed by combining our Group’s existing paint technologies with the latest photocatalyst technology. The PROTECTON technologies were created by applying “Science + Imagination”.

At the same time, finding the best applications for the superior technologies (Science) requires the ability to use “Imagination” to envision and accurately understand situations in which society, customers, and end users will use the products. PROTECTON products were designed for the social issues arising from COVID-19, and were developed for specific situations of creating safe indoor living environments. Based on that vision, we used technology with a visible light responsive photocatalyst that provides strong protection against virus transmission. We are now working to expand the PROTECTON lineup with products for various situations, such as for use in homes, offices, medical institutions, schools, cars, trains, entertainment facilities, and ships.

The PROTECTON technology is an example of the Nippon Paint Group actively leveraging its technological strengths to solve social issues with the aim of making a sustainable and flourishing world and contributing to the creation of wealth.

Driving MSV by fulfilling duties to stakeholders

Since launching of the PROTECTON brand in September 2020, we have been steadily expanding the product lineup through our marketing efforts and product development. New PROTECTON anti-viral and anti-bacterial products for professional use and DIY/home use. We will continue to expand the lineup of anti-viral and anti-bacterial products for professional and home use that go beyond paint and coatings, and will aggressively market the products to pursue top-line growth. Increasing revenue will increase customer trust in the Company while also fulfilling our duties to stakeholders by generating high profits to our raw material suppliers and employees as well as to contribute to the environment and society. Our ultimate objective of MSV is to maximize the shareholder value that remains after fulfilling our duties to our customers, employees, society, and other stakeholders. (See page 21).

Our Group is committed to practicing value creation initiatives through the expansion of ESG-driven business opportunities such as the development of PROTECTON products. We will pursue the achievement of MSV after fulfilling our duties to stakeholders based on Powerful Partnerships (see page 22) with our partner companies around the world.

For more information about the PROTECTON brand, please see the PROTECTON brand site on our website and NIPPE HOME ONLINE shopping site for paint for DIY use.

PROTECTON brand site: https://www.protecton.jp/en/
NIPPE HOME ONLINE (Japanese only): https://nape.nipponhome-online.jp/
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Financial Highlights

- **Revenue (Billion yen)**
  - 2016: 470.2
  - 2017: 605.3
  - 2018: 627.7
  - 2019: 692.0
  - 2020: 781.1

- **Operating profit / Operating profit margin**
  - 2016: 11.4
  - 2017: 12.4
  - 2018: 13.8
  - 2019: 11.1

- **Dividends per share**
  - 2016: 29.1
  - 2017: 27.6
  - 2018: 31.5
  - 2019: 32.3

- **Return on equity (ROE)**
  - 2017: 11.1
  - 2018: 11.5
  - 2019: 11.5
  - 2020: 8.0

The Nippon Paint Group has grown steadily through the acquisitions of a paint manufacturer in the United States in FY2017 and in Australia and Turkey in FY2019 along with the successful growth of the decorative paints business in China and other Asia. This rapid growth has enabled us to increase revenue for four straight years and, despite the impact of COVID-19, reached a record high for revenue in FY2020.

Group operating profit decreased in FY2019 due to one-time factors, including recognition of impairment loss, but rose to a record high in FY2020 supported by contributions from acquisitions and the growth of the Chinese business. While operating profit increased, the operating profit margin remained flat compared with the previous fiscal year due to a higher ratio of SG&A expenses to sales due mainly to higher personnel expenses associated with the accelerating global growth.

Our basic policy is to distribute stable and consistent dividend amounts and aim to maintain a dividend payout ratio of 30%. Following this policy, we maintained our dividends per share distribution at ¥45 in FY2019 despite the decline in operating profit of 32.3%.

Total shareholder return has been increasing each year in line with the increasing dividends and share prices. Although the dividend amount did not change from FY2019 to FY2020, the solid rise in the share price lifted TSR to around two times higher than TOPIX (including dividends).

Due to the relatively low capital investment costs in the paint industry, positive cash flow is the norm, and we continued to have negative net debt. In FY2019, net debt decreased significantly to a positive figure of ¥309.2 billion as operating profit increased despite the COVID-19 conditions.

Financial and Corporate Information
Value Creation Achievements

Non-financial Highlights

Awarded the Gold Brand from a Chinese brand evaluation institution

Award winner for five consecutive years

Awards from Nippon Paint Labor Union

Non-financial Highlights

Number of countries/regions where the Nippon Paint Group has the No.1 market share in decorative paints

Number of countries/regions: 10

2016 2017 2018 2019 2020

Customer Base

Value Creation Achievements

Employee satisfaction level (Japan)

Employee satisfaction level (Japan) (%)

2016 2017 2018 2019 2020

90

Employee satisfaction level (Japan) (%)

90

83

83

82

80

Our Group has long held the top market position in Japan. The aggressive expansion of the NIPSEA business since 1967 has also steadily increased the number of countries and regions where our Group has the top market share. The acquisitions of DuluxGroup and Betek Boya also established us as No.1 in Australia, Turkey, and Indonesia in FY2019.

Shipment ratio of water-based paints in the decorative paints business (global)

Shipment ratio of water-based paints (global) (%)

87.5

Our Group’s employee satisfaction level began rising in Japan in FY2017 and reached a record high in FY2020. Although surveys show that we need to improve in the area of comfortable workplace environments, employee satisfaction is rising to understanding of the Group vision and policies and for employee satisfaction, trust, and sense of comfort in their companies.

Our Group has established a solid structure to support acquired companies and their management teams and employees to bring out their best performance in local operations, taking into account the characteristics of the paint market. We will continue aggressively pursuing further synergies by taking actions including identifying new growth opportunities generated through the collaboration between the acquired companies and the existing Group companies, reducing costs by sharing raw material procurement sources, acquiring competent human resources, and sharing best practices. See “M&A Strategy” on page 79.

The Nippon Paint Group is building an advanced corporate governance structure to solidify its sustainable growth as a global company. We shifted to a Company with Three Committees structure following approval at the General Meeting of Shareholders in March 2020. Six of the eight Board of Directors members are now independent directors. We will continue working to ensure the transparency, objectiveness, and fairness of the Board of Directors to protect the interests of minority shareholders. See “Corporate Governance Structure and Initiatives” on page 93.

Four Strengths of the Nippon Paint Group

1 Leading player in the growing paint industry

The paint industry is growing around the world, and we anticipate steadily rising demand as the global population increases. Our Group has the top market share in Asia and is the fourth largest paint manufacturer in the world, but small and medium-sized paint manufacturers represent roughly half of the global market. At the same time, the paint industry is facing increasing issues that can only be addressed by environmental technologies and financial strengths held by large companies. We believe these circumstances provide significant room for the Nippon Paint Group to increase its market share.

2 Unparalleled market position in Asia and China

Our Group’s growth is being driven by our businesses in China and other Asian regions, which account for 46% of consolidated revenue. The Chinese paint market is the world’s largest and is expected to continue rapidly growing with an average CAGR of 5.3% from 2019 to 2024. We have been leveraging the strengths of the Libang brand and our extensive distribution network to generate high growth and establish a dominant market position in this growing market.

3 Powerful Partnerships supporting aggressive M&A

Our Group has established a solid structure to support acquired companies and their management teams and employees to bring out their best performance in local operations, taking into account the characteristics of the paint market. We will continue aggressively pursuing further synergies by taking actions including identifying new growth opportunities generated through the collaboration between the acquired companies and the existing Group companies, reducing costs by sharing raw material procurement sources, acquiring competent human resources, and sharing best practices. See “M&A Strategy” on page 79.

4 Advanced governance

The Nippon Paint Group has a long history of contributing to its local communities and society. The Group is committed to reporting its activity and significant achievements in our Integrated Report. We believe that implementing an integrated reporting system will enable our Group to better understand the environmental, social, and governance (ESG) issues facing our businesses and society and to contribute to society in the future.

Effects of the acquisitions of DuluxGroup and Betek Boya (in FY2019)

Revenue

FY2019

FY2020

YoY

1,805

1,518

11.6%

2,015

2,383

56.2%

1 DuluxGroup’s revenue is the discounted amount in British pounds as of December 31, 2019.

* Data compiled by Nippon Paint Labor Union. *1 Calculated as water-based paint shipments divided by total paint shipments in units of 10,000 tons. Data for four companies: Nippon Paint (beginning in FY2016) and NIPSEA (FY2016), Dunn-Edwards (FY2017), and DuluxGroup (FY2019)

*2 Our Group’s revenue is the adjusted discounted amount in British pounds as of December 31, 2019.

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Materiality / Risks and Opportunities

Applying our strengths to items of materiality to solve social issues and create business opportunities

Accompanying the expansion of our overseas operations, we reviewed our materiality in August 2020 based on our policy of integrating SDGs and ESG initiatives into our corporate management.

We identified items of materiality by creating a list of material issues which society requires us to address and by referencing international guidelines such as the Global Reporting Initiative (GRI), Sustainability Accounting Standards Board (SASB) as well as items required by ESG research organizations. We then performed quantitative evaluations of each issue and verified their significance in terms of the degree of importance to stakeholders and the degree of importance to our businesses. We engaged external experts to gain objective viewpoints on the issues and held discussions with our partner companies around the world to identify material issues associated with our business model and the business environment. The issues were then designated as our items of materiality.

Cross-functional teams under the ESG Committee were assigned to each materiality to discuss and develop materiality initiatives (See “ESG management system” on page 7). We have started gathering information on important topics and sharing the latest issues and ideas with our Group’s partner companies worldwide.

We are applying our Group’s technological strengths and actively collaborating with external partners to address social issues. We are also contributing to achieving the Sustainable Development Goals (SDGs) adopted by the United Nations in 2015.

Materiality map
Opportunities

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ESG Action Examples

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Materiality / Risks and Opportunities

Climate change

- Expansion of the market for environmental products such as products contributing to de-carbonization
- Development of new businesses through research and development
- Reduction of greenhouse gas (GHG) emissions
- Identification of risks and opportunities

Resources and environment

- Impact on business activities from depleting of energy and water resources
- Tightening of regulations on wastes and increase of waste disposal cost
- Changes in customer needs related to raw materials

Diversity & inclusion

- Difficulty of securing human resources that satisfy diversity requirements with a decrease in the university graduate population
- Sharing of business activities that reflect diversity in customer needs

Safe people and operations

- Significant impact on operations if a major accident occurs at a production site
- Impact on safety assurance due to changes in manufacturing processes accompanying substantial increases in production

Growth with communities

- Significant damage to the corporate brand if the company is not perceived as a corporate citizen by local communities
- Damages to the public image of the paint industry caused by activities oriented toward the local community

Innovation for a sustainable future

- Significant trending to future corporate earnings swing to industry to generate profits due to slow response to new markets
- Expansion of market for products that contribute to de-carbonizing and adapting to climate change
- Products and services that address social issues contribute significantly to society and help boost corporate earnings in the long term

Future

- Innovation for communities
- Growth with operations

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Materiality (Relevant SDGs) 

Risks

Opportunities

ESG Agenda

ESG Action Examples

Progress in FY2020-2021

- Announced endorsement of the TCFD recommendations (first report), disclosed information in accordance with the TCFD framework, and calculated the financial impact of a carbon tax.
- Performed simulation of carbon emissions in our operating regions worldwide and began considering long-term carbon emission reduction measures.

- For more details, see “Climate Change” on page 105.

- Started waste management activities using a total waste management system, which includes the effective utilization of waste, as a supplement to the existing waste generation management and proper disposal activities.

- For more details, see “Resources and Environment” on page 106.

- NPPSEA Group provides training programs at different stages to secure diverse human resources. In FY2020, if external collaboration hours (228% compared to FY2019) for our employees.

- In Japan, we introduced a career drive program with the aim of developing human resource for job separation by aggregating disclosing input/output and impact data

- For more details, see “Diversity & Inclusion” on page 111.

- Group responsible care activities and solely education activities were expanded to reflect the Group’s growth and the increasing number of occupational accidents in recent years.

- In FY2020, the frequency rate of accidents with lost time declined in Japan.

- For more details, see “Safe People and Operations” on page 114.

- Social contribution activities under the SE (Education/ Empowerment/Engagement) action policy were increased with the launch of the NPPSEA Group Global Outreach Program. In FY2021, we also began aggregating disclosing input/output and impact data on a global basis.

- For more details, see “Growth with Communities” on page 115.

- In FY2021, we established a framework designating Sustainable Products to address social issues.

- We started disclosing data on product sales status, NPPSEA expenses, and on external collaboration and innovation geared toward long-term value creation.

- For more details, see “Innovation for a Sustainable Future” on Page 116.