Message from the Officer in Charge of Finance

Engaging with capital markets as an open company, we will use their feedback as a management input in executing our 2025 Business Plan.

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Strengthening dialogue with capital markets

In recent years, Toyoda Gosei has been placing more priority on IR activities, strengthening dialogue with institutional investors in particular. In FY2019, we launched a shareholder relations (SR) program to better engage with shareholders and institutional investors in line with their needs as gleaned through our dialogue with them and in accord with the intent of Japan's recently issued/revised Corporate Governance and Stewardship Codes.

We earnestly listen to shareholders and investors' opinions and advice through our SR program and adjust our management approach accordingly. In March 2020, we transferred chairmanship of the Executive Appointment Committee and Executive Compensation Committee from the president to an outsider director. We also split oversight of the Audit Division and Finance & Accounting Division, previously supervised by a single executive, between two executives. Additionally, we have taken steps to become a more open company, including holding an ESG briefing led by top management in April. We plan to hold ESG briefings on an ongoing basis.

Another topic that has come up in SR settings is our strategic shareholdings. We hold stock in 25 companies as of March 31, 2020. We fully divested equity stakes in three companies in FY2016 and five more in FY2019. We plan to continue to periodically pare down holdings of stocks deemed no longer worth owning from a strategic or investment standpoint.

Additionally, we have a debt IR program to engage with bond investors and rating agencies. It provides objective feedback on financial soundness and has reaffirmed the importance of cash flow generation. To utilize debt markets as a ready source of capital, we intend to deepen our engagement with investors with perspectives different than equity investors' and better balance our financial strategy.

Insights gained from such dialogue with capital market participants are proactively shared within our organization as feedback. Reports from IR staff are also shared among management down to the divisional general manager level, not merely presented at meetings of senior-most executives. We apply input from outsiders to business activities throughout our organization.

Senior management enthusiastically participates in IR activities. For example, the head of development has attended meetings with investors as the main presenter and the general manager of the e-Rubber business has held briefings. Since FY2019, sales division general managers have started attending meetings of analysts to discuss the state of our businesses on the front lines. By involving not only IR staff but also a company-wide cross-section of personnel in IR, we engage more fully with capital markets and incorporate their input into our business activities. Such an approach is conducive to an appropriate valuation for Toyoda Gosei.

The auto industry is currently in the throes of major change. Inwardly focused companies are at risk of falling behind the times and failing to survive let alone grow. Toyota Group founder Sakichi Toyoda famously once said, "Open the window. It's a big world out there!" We believe that continuing to earnestly listen to outsiders' point of view is especially crucial in times of change. While analysts and investors sometimes offer harsh criticism, much of their input is valuable advice for us and a reflection of big expectations for Toyoda Gosei. We engage in IR not only to gain recognition from capital markets in the form of an appropriate valuation but also because we believe that another key role of IR is generating internal feedback that keeps our workforce highly motivated.

Operating performance

FY2020 has gotten off to a tumultuous start, forcing us to urgently focus on short-term profitability for the time being. In the face of concerns about a second and even third wave of the COVID-19 pandemic, we have shifted to a more nimble footing to enable us to swiftly adapt to external changes.

Despite drastic deterioration in the operating environment, we ended FY2019 with an ample equity cushion. Specifically, equity attributable to owners of parent at fiscal year-end was equivalent to 48.7%

of total assets. We also supplemented our on-hand liquidity by raising additional debt capital. Additionally, we bolstered our cash-generative capacity by divesting chronically negative-cash-flowing subsidiaries in FY2019 in conjunction with restructuring the European business. We have sufficient wherewithal to successfully navigate the COVID-19 crisis. We have shored up our financial position to not only protect Toyoda Gosei and its affiliates but also to act responsibly from an SDGs/ESG standpoint, including by supporting suppliers and maintaining employment.

Meanwhile, we have our sights set on further profit growth after the pandemic has subsided. We will use the crisis as an opportunity to further solidify our profitability by globally overhauling our cost structure with respect to fixed expenses that have swelled over the course of our growth to date. For subsidiaries too new to have experienced the 2008–09 Global Financial Crisis (GFC) in particular, we see the pandemic as a sort of stress tests that affords an opportunity to improve efficiency.

One challenge we must address to achieve the 2025 Business Plan's targets is to improve profitability. In FY2019, our operating profit margin, adjusted to exclude one-time factors, was around 5%, three points below our 8% target. We plan to rectify this three-point shortfall through three steps. The first is restructuring of unprofitable businesses. The second is growing the existing automotive parts business in lucrative markets with promising growth prospects. The third is achieving high profitability in new businesses such as e-Rubber.

The restructuring of unprofitable businesses was largely completed with our European restructuring in FY2019. We expect it to boost annual operating profit by roughly ¥5 billion. In terms of the other two steps, we will accelerate initiatives to increase the profitability of the existing automotive parts business in particular. To do so, we will strategically allocate limited resources and improve the business's portfolio in terms of both geographic and product mix in the aim of boosting the automotive parts business's operating profit margin to 7%.

At our FY2019 financial results briefing, we presented a 4 × 4 matrix of product domains and regions that was appended with an extra column representing new businesses across all regions. We explained to investors which of the matrix's 17 cells we are targeting for growth. We plan to use this 17-cell matrix concept in future IR communications while allocating strategic resources and controlling operations more effectively than in the past.

Capital cost

To achieve capital efficiency that sustainably exceeds our cost of equity, we have set a 10% ROE target in our 2025 Business Plan. Achieving a 10% ROE requires a certain degree of control from a financial leverage standpoint in addition to improved profitability. We have formulated financial policies on matters such as shareholder returns and investment and disclosed them in November 2018.

In talking with investors since publishing the ROE target in the 2025 Business Plan, we have found that they have even more questions than before about cost of capital. For example, we have been asked not only whether the European business restructured in FY2019 have turned profitable but whether they will achieve capital efficiency commensurate with cost of capital. We have been asked the same question about other low-margin businesses also.

To turn such input from capital markets into grist for growth, we must internally step up our efforts to increase profitability further. We believe strategic management is also essential to asset efficiency, particularly in terms of how to most efficiently allocate resources, starting with capital investment.

Financial policy

Even amid the current extremely adverse environment, we will stay committed to capital efficiency without erring too much on the side of safety. Our financial policy unveiled in November 2018 remains unchanged.

With respect to shareholder returns, we will basically adhere to our financial policy despite the recent severe deterioration in our operating environment due to the pandemic.

Regarding capital investment, we will stringently screen prospective cash outlays for necessity until further notice, but our policy of setting aside ¥50 billion per year to fund growth investments to achieve the 2025 Business Plan's targets remains unchanged.

Regarding cash reserves, we borrowed emergency loans to secure ready liquidity in response to the pandemic. We borrowed ¥20 billion of long-term funding from banks and arranged a ¥30 billion committed line of credit. We did so to raise cash in response to greater risks than during the GFC and topped up cash reserves to its baseline level of ¥30 billion more than consolidated monthly sales.

In recent years, Toyoda Gosei has been strengthening its IR program under the leadership of top management. As disclosure has improved, we have been receiving even higher-quality feedback from investors than before, leading to further improvement in our management and IR. We will continue to unremittingly upgrade our IR as an open company.

Financial Policy		
	Shareholder returns	Regarding shareholder returns for the time being, we will work wholly to reward shareholders based on a consolidated payout ratio of 30% or greater, from a variety of perspectives.
	Capital investment	We will secure 50 billion yen by FY 2025 as funding for capital investment for growth.
	Cash reserves	In view of the prevailing circumstances, we will secure cash reserves* of consolidated monthly turnover + 30 billion yen including funds to cover risk. * Short-term borrowings (less than one year) are excluded.