

Measures to Improve Financial Performance

Financial strategy to achieve the long-term vision

Nabtesco has been working to increase its capital efficiency by implementing “Measures to improve our financial performance” as part of its management materiality. In the medium-term management plan, we uphold the improvement of ROIC as one of our management targets. To achieve this target, we are making efforts as described in the following.

Atsushi Habe

Representative Director
Managing Executive Officer
Corporate Planning, Accounting & Finance, Information Systems and Corporate Communication



We will build the optimal business portfolio for increasing our corporate value on a medium- to long-term basis.

Introduction of business portfolio management

Nabtesco formulated a medium-term management plan for three years from 2022 (hereinafter, “the MTMP”), upholding “ROIC: 10% or over” as one of the management targets with an eye to fostering optimal portfolio management for profitable growth, in addition to promoting capital efficiency-oriented management.

To this end, we set the Basic Policy on the Business Portfolio at the Board of Directors meeting held at the end of 2022. The policy requires us to carry out financial evaluation and business potential evaluation for each business unit to visualize the position of the unit within the business portfolio. We have been managing our business portfolio based on this policy since FY2023.

In financial evaluation, we evaluate whether or not each business has generated returns beyond the cost of capital and has achieved sustainable growth. For the evaluation, we classify each of our in-house companies and the group businesses into business units and map the units in a matrix comprising four quadrants, with the vertical axis showing ROIC and the horizontal axis the sales growth rate. We also show the average Economic Value Added (EVA) for the six terms by business unit to visualize the status of the unit.

According to the matrix showing ROIC and the sales growth rate, Nabtesco is lacking in business units categorized as belonging in the “Development and selection” quadrant, and we thus need to increase the number of such units, for which we should take both intangible and tangible measures. Accordingly, we have already been implementing intangible measures to optimize our human capital and create intellectual property, while establishing the intrapreneurship program “Light” and the in-house company innovation system in 2022 as tangible measures. We will also foster the use of the CVC fund and examine M&A to increase the number of business units included in the “Development and selection” quadrant.

Financial situation

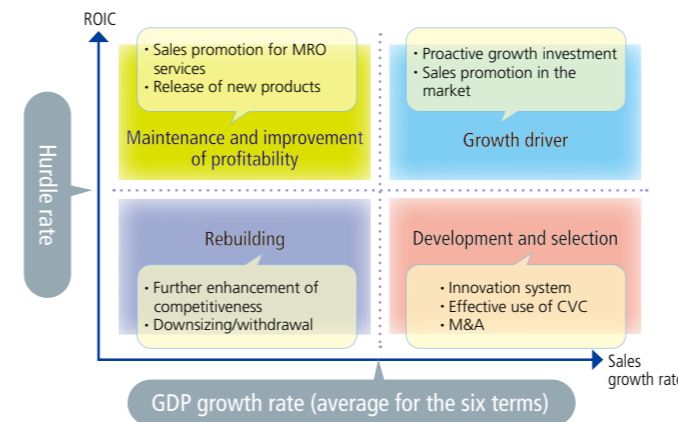
For the fiscal year ended December 31, 2022, our consolidated net sales hit a record high of ¥308.7 billion, being driven by the continued brisk demand for precision reduction gears used in industrial robots as well as by the impact of the weaker yen, and despite demand for hydraulic equipment used in construction machines dropping sharply in the Chinese market. On the other hand, operating income came to ¥18.1 billion, affected by decreased sales and profit in the hydraulic equipment business, sharp rises in materials prices in the Component Solutions Segment, a shortage of electronic components in the Accessibility Solutions Segment, and increased costs in the overseas platform screen door project.

For the fiscal year ending December 31, 2023, demand will continue to be brisk for precision reduction gears and marine vessel equipment. Also, in the automatic door business, demand for our products will expand for use in large commercial buildings in Japan, and demand will recover on a full scale for aircraft equipment in both the civil and national defense sectors. Accordingly, we expect that net sales will increase by 9.8% year on year to ¥339 billion. Operating income will also rise by 44.8% year on year to ¥26.2 billion thanks to increased sales as well as to the offsetting of rises in materials prices by the raising of our own prices and the recovery of production volumes due to the resolution of the shortage of electronic components.

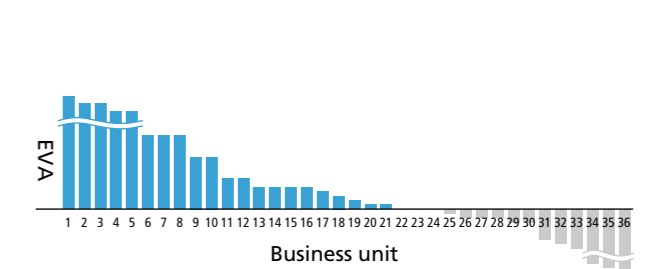
Financial evaluation

- Categorize all of the businesses into 36 business units
- Evaluate whether or not each of the units has generated returns beyond the cost of capital and has achieved sustainable growth
- Speed up the actions to increase the number of business units included in the “Development and selection” quadrant

Matrix showing ROIC and the sales growth rate



Distribution of EVA by business unit



In the business potential evaluation, we evaluate whether or not each of the business units has objective market potential and possibilities that cannot be identified through financial evaluation as well as the ESG-related risks and opportunities posed to the business unit. Based on the results of the financial evaluation and business potential evaluation as described above, we will engage in deeper discussions on the direction of our business portfolio at Board meetings. We will then conduct examinations to set an action plan for each business unit so that we can proactively make growth investments and promptly take necessary actions, including the downsizing of or withdrawal from a business, toward building a business portfolio that is optimal for Nabtesco.

Business potential evaluation

- Evaluate whether or not each of the business units has objective market potential and possibilities that cannot be identified through financial evaluation
- Evaluate ESG-related risks and opportunities posed to the business unit

Industry attractiveness	<ul style="list-style-type: none"> • Market size • Growth potential • Attractiveness of the industry
Strength of the Company	<ul style="list-style-type: none"> • Market share, competitive advantage • Inimitability • Brand value • Synergies with other businesses
ESG-related risks	<ul style="list-style-type: none"> • Environment (Amount of CO₂ emissions and others) • Social (Occupational accidents and others) • Governance (Frequency of product defect-related incidents and others)
ESG-related opportunities	<ul style="list-style-type: none"> • Initiatives implemented to solve social challenges through business

Approach to capital allocation

In the MTMP, we attribute importance to financial discipline for long-term growth. We sold part of our shares in Harmonic Drive Systems in 2021 and the remainder in 2022. As for the allocation of capital including the cash gained through the sale of the shares, we prioritize the use of funds for growth investment toward the achievement of the long-term vision. For capital investment, we are making a large investment in FY2023 in the new plant to be completed in Hamamatsu city to increase our production of precision reduction gears. We will also make proactive R&D investment for the electrification and systemization of our products.

For shareholders’ return, we uphold the policy of keeping our consolidated dividend payout ratio at 35% or over. We purchased our own treasury stocks in the amount of ¥20 billion in 2021 while paying dividends in line with the policy.

Due to the deposit related to the sale of our shares in Harmonic Drive Systems, we now have cash on hand at a level higher than usual, whereas we make it a rule to secure cash on hand at the amount equivalent to our average sales for two months. Also, for flexible borrowing, we will maintain our “A” rating from credit rating organizations, for which we will keep our equity ratio at around 50%.

CEO Dialogue

Exceeding the expectations of customers and society through human capital management



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What will it take for Nabtesco and its people to become the next generation of "Leaders in Innovation" able to exceed the expectations of customers and society? The CEO and an outside director of the Company talked about this question with two guests, one of whom led the formulation of the Guidelines on Disclosure and Governance of Strategies for Investment and Utilization of Intellectual Property and Intangible Assets and the other an investor who makes investments from a long-term perspective.

Mindset gap between companies and investors

Kimura: Thank you for providing us with a precious opportunity to talk with you today. We would like to talk about what it will take for Nabtesco to achieve sustainable growth. Dr. Kagaya, you chair the group that formulated the Guidelines on Disclosure and Governance of Strategies for Investment and Utilization of Intellectual Property and Intangible Assets. Could you brief us on the revised Guidelines that were released as Ver. 2.0 in March 2023?

Kagaya: Following the revision of the Corporate Governance Code in 2021, we formulated Ver. 1.0 of the Guidelines in January 2022. The Guidelines represented summarized findings of discussions I had had with investors and business leaders in the group with the aim of fostering investment in intellectual property, intangible assets and



Kagaya
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human capital. Subsequently, however, it was revealed that there was a mindset gap between companies and investors regarding the details that the parties think should be disclosed. We released Ver. 2.0 to narrow that gap.

Matsubara: For example, companies tend to emphasize that they have very competitive intellectual property, but in order to make investments in companies from a long-term viewpoint, we need to focus more on how companies will make use of their intellectual property for value creation rather than on the value of specific intellectual property. There is indeed a gap between the information that we need and the explanations companies provide to us.

Takahata: I agree with what you have pointed out. Many Japanese companies disclose the details of the patents they own, wanting to help stakeholders gain a better understanding of their intellectual property. However, what is important for investors is the "stories" the companies tell about how they will make effective use of the intellectual property in their business.

Importance of an integrated story

Kimura: Let me talk about Nabtesco's story. This year we celebrate the 20th anniversary of our founding. In the course of the past two decades, we formulated and implemented a long-term vision spanning a period of about 10 years. The theme set for our previous long-term vision was "Global Partner with Best Solution" and for 10 years we continued to focus on meeting customers' needs and achieved our own growth. We are conducting a range of businesses, in which we fortunately have excellent customers, and have taken the top spots in our niche markets. However, when discussing the formulation of a new long-term vision, we discovered a shared sense of crisis about the fact that Nabtesco had not been able to generate any really great innovations recently. Based on this recognition, we set a new long-term vision with the theme, "Leaders in Innovation for the Future." We aim not only to "meet" but also to "exceed" the expectations of customers to contribute to solving social issues while achieving our own growth.

We regard new/renewable energy, smart robotics and next-generation mobility as growth fields, and as a precondition to doing business in these domains, we need to advance our core motion control technology to "smart motion control technology." The key to meeting this requirement is intellectual property. Human capital is also important, as it provides us with a primary source of reforms and a foundation for value creation. In order to take a more integrated approach to human resources-related themes, we reviewed our management materiality last year to address issues related to human capital



Kimura
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management more squarely.

Kagaya: It is indeed important for companies to tell their stories, just like the one that you have just told. Many companies tend to regard human capital as just one of their disclosure items and do not think about why the capital is important for them. In order to "meet" and "exceed" the expectations of your customers and society, how will you foster human capital management?

Human capital strategy implemented through close cooperation between three actors

Kimura: Companies used to be managed mainly through a top-down approach, but this tends to make for passive employees. For the achievement of the long-term vision, I have been saying, "Individual employees need to commit themselves to becoming innovators." We must pursue our ideal state toward innovation through close cooperation between three actors, or the company & top management, organizations & managers, and individual employees. We specified the gap between reality and vision and set out a hypothesis for narrowing the gap. Based on the hypothesis, we set our innovation, linkage and engagement indexes and aim to increase the score of each index from the present roughly 60 points to 75 points. We thus have room to make improvements on these three KPIs and will implement multifaceted measures to this end.

Matsubara: I have the impression that you have been formulating your strategies carefully and meticulously. By identifying any gaps between reality and vision and working to narrow them, you are making plans for your next strategies.

Takahata: In my capacity as an outside director, I think it is important for Nabtesco to repeat the process of making a hypothesis and verifying it. If you find a mistake in the verification process, you need to take corrective actions promptly and boldly. The same applies to DX. The term "digital" tends to be contrasted with the term "analog," but for me digital transformation is highly related to people as

CEO Dialogue

it plays a range of roles to benefit people, including making digital technologies more friendly for users and providing them with more comfort and happiness. I think Nabtesco will be able to advance its human capital management by making both DX and human resources function well. What is important is to foster close cooperation between the three actors, for which it is essential to provide the actors with opportunities for such cooperation. It is commendable that Nabtesco created the intrapreneurship program "Light" as the first step to this end. I also think it is necessary for the Company to take an integrated approach rather than implementing individual measures separately.

Kagaya: Concerning "Purpose" and "Visionary," which have often been mentioned in relation to corporate management, what you have said to us today assures me that you are committed to managing the Company based on its Purpose and in a scientific manner.

Matsubara: We are interested in the value that provides a source of growth. You can provide such value not only through individual technologies but also by sharing



Takahata

Sustainability is positioned at the top of a corporate value creation story. To achieve sustainability, you need intellectual property and DX, which are supported by human capital.

your commitment to exceeding expectations across the Company and having the systems to support the fulfillment of the commitment. And the value is also related to intellectual property and human capital. You are indeed creating your "story" based on integrated thinking.

Kagaya: You are taking the top spot in multiple niche markets. It is important for you to tell a story to promote human capital management to revitalize your "niche top" strategies.

Causal path for value creation by precision reduction gears

Kimura: As for our "niche top story," our precision reduction gears used in industrial robots represent a product that serves as a growth driver. Let me therefore tell our story about this product as an example.

Industrial robots are operated on automobile produc-

tion lines and if the operation of even one of them is suspended, it will have a big adverse impact on the entire production. Based on this recognition, we independently developed precision reduction gears with high positioning precision and durability. Because of these features, which are indispensable for the stable operation of production robots, we were able to gain a roughly 60% share of the global precision reduction gear market. Subsequently, as industrial robots became used more widely and got more advanced, we also advanced the performance of our precision reduction gears to achieve further growth in the business.

Going forward, industrial robots will need to be more compact and multifunctional. Accordingly, precision reduction gears used in them will need to be smaller and lighter without compromising their performance, for which manufacturers of the gears need to foster technological innovation and have technologies to mass-produce high-precision products. Nabtesco has competitive strength in this regard as its core value. In addition to the technologies required to develop products, we also have production technologies to manufacture the developed products, which is indeed an important factor. Moreover, based on the relationships of trust we enjoy with industrial robot manufacturers across the world, our sales personnel can identify various customer needs, and this kind of relationship capital is also an important factor to keep up the cycle of developing new technologies and intellectual property. Innovation initiated by human capital is thus supported not only by technologies but also by all of its people, including those engaging in sales, procurement and other activities. Unless individual employees take on new challenges as innovators, we will not be able to follow a causal path in any of our businesses.

Takahata: It is important that Nabtesco includes strengths and know-how for which the Company intentionally does not apply for patents in its core value. Production technologies, invisible know-how, and relationships with customers and suppliers are all deemed important as part of the comprehensive strength of the Company.

Kimura: We have a limit on our growth potential in each of the niche markets in which we boast the top share. Because customers purchase from multiple suppliers in principle for reasons including ensuring BCP, it is difficult for us to increase our share in a niche market beyond 60%, and in order to exceed this limit we have no choice but to depend on the growth of the entire market. We are at a turning point to overcome this hurdle, for which it is essential for us to create intellectual property for smart motion control.

We are also formulating our intellectual property strategies toward the achievement of the long-term vision and define our core value from present and future

perspectives. The results of the cross-functional intellectual property-related activities are reported to the Board of Directors once a year, including the results of deliberations made by the departmental heads including myself and the activities of the relevant committee and others. The company & top management, organizations & managers and individual employees are closely cooperating as three actors to increase the number of notifications made for the creation of intellectual property and to increase the number of inventors who lead innovation, with these two KPIs being included in the criteria to give incentives to employees and executives.

Establishment of the Basic Policy on the Business Portfolio

Matsubara: Your story is reproducible and has room for further development and is therefore quite persuasive. Moreover, the stories about your intellectual property and human capital are not "short stories" but the chapters of a long novel.

Kagaya: The market strength of your precision reduction gears has been built through a complex causal path, and for the governance of your intellectual property, you have well-aligned strategies. What you said has helped me understand these facts, but for investors to get more interested in your story, you also need to share a message about your business portfolio, which includes businesses other than the precision reduction gear business.

Kimura: We set a target for ROIC in the medium-term management plan, and the improvement of ROIC depends on how we deal with our business portfolio. We engaged in a lot of discussion at Board of Directors meetings to formulate the Basic Policy on the Business Portfolio. We will roll out the policy in and after this year.

Takahata: ROIC is of course a very important management indicator, and it is critical for employees to understand it appropriately. If they can understand the positioning of their business within the business portfolio and want to reform the business based on that understanding, it will lead to the birth of new innovators.

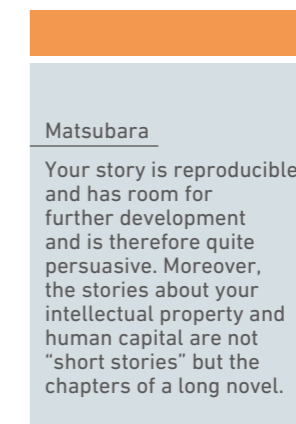
Matsubara: From a long-term perspective, corporate value is composed of employee value, customer value, intellectual property value and various other types of value. Based on this recognition, you need to discuss how to make use of your future core value for your portfolio management, which I think will help you narrow the mindset gap between companies and investors.

Sustainability and public interest

Kagaya: Value creation and sustainability are two inseparable concepts. If you can foster close cooperation between the three actors as you have described, I think you will be better able to share a commitment to sustainability across the Company toward more sustainability-oriented business.

You face issues and address them steadily by coming up with hypotheses to solve them, which is quite aggregable. I think you can have more "fans" of your company by disclosing your story and inviting more people to engage with it.

Matsubara: You make effective use of your intellectual property and human resources for value creation basically for your own benefit. However, from the viewpoint of sustainability, you can also contribute to the public interest by the effective use of your intellectual property. Meeting and exceeding social expectations could also mean fostering a shift from closed to open strategies.



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Finally, as an investor I would like to read a corporate "novel" that is supported by strategic consistency and integrity. Please continue to tell a story that increases expectations for the future among your stakeholders and leads to an increase in your stock prices. I would like to be a reader of such a story.

Takahata: Sustainability is positioned at the top of a corporate value creation story. To achieve sustainability, you need intellectual property and DX, which are supported by human capital. As an outside director of the Company, I would like to talk a great deal with employees working at the forefront of business and would like to give some advice for the creation of an attractive story.

Kimura: Thank you very much for giving us such a precious opportunity today. As the saying goes, "People make a company." We are at a turning point and will steadily foster human capital management, thereby achieving sustainable growth going forward.