Action to Implement Management that Is Conscious of Cost of Capital and Stock Price

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IZUMI CO., LTD.

(Securities code: 8273)

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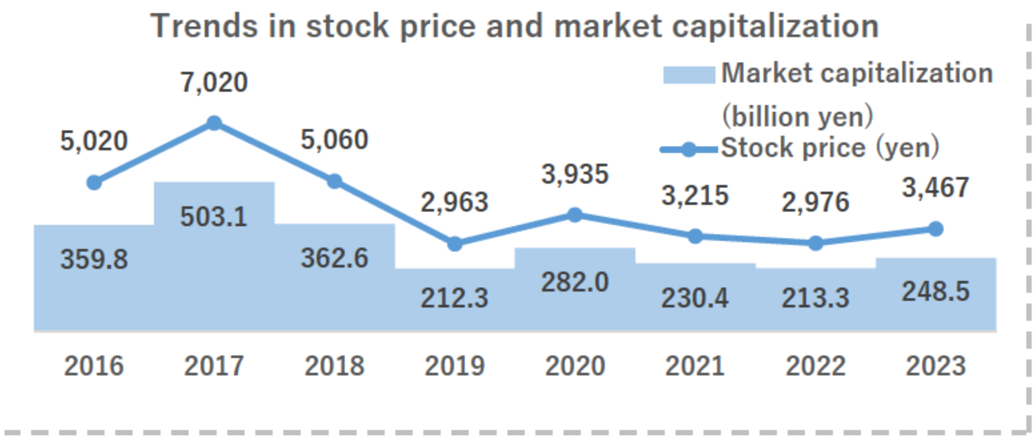
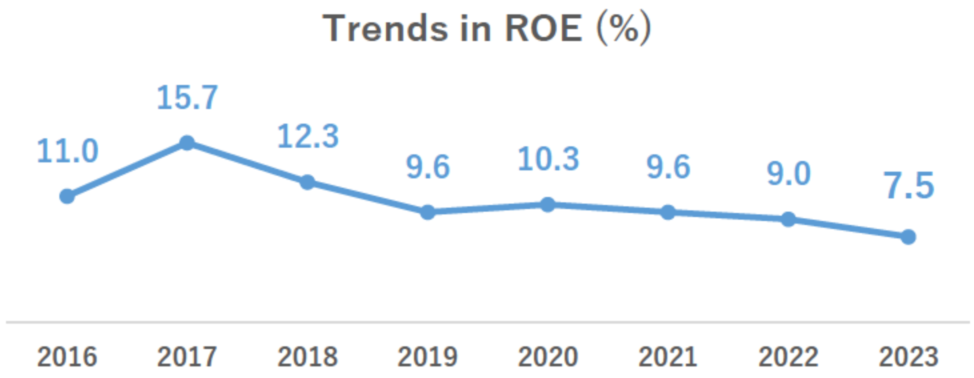
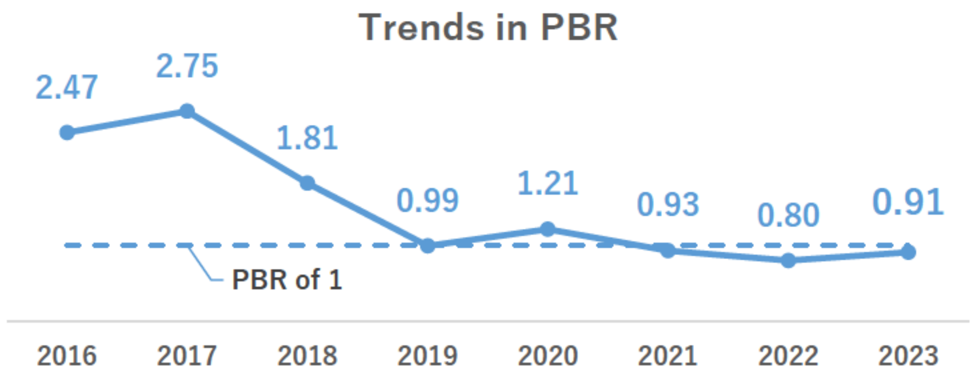
1. Analysis and Evaluation of the Current Situation

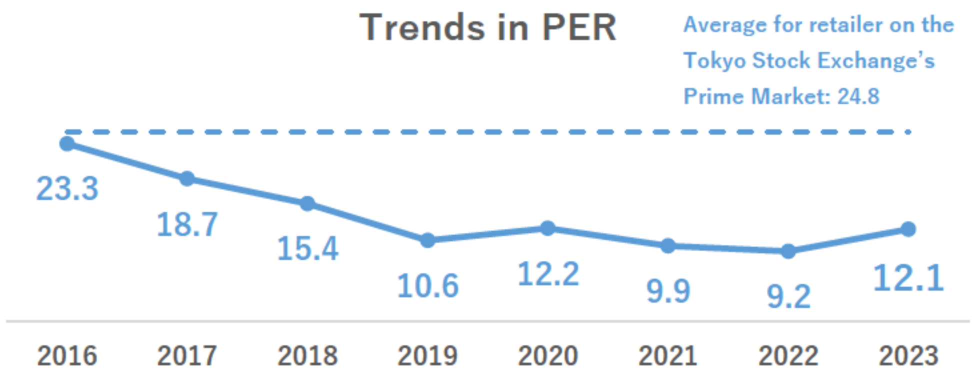
Analysis of the Current Situation: Stock Prices and Market Valuation

- We are operating under the framework of a risk-averse management style allowing us to improve profitability and financial stability but with poor prospects for future ROE increases.
- Current reduced investment in new stores and weak sales trends in existing stores offer little hope for growth.
- We see these as the significant factors behind our price-to-book ratio (PBR) of under 1.





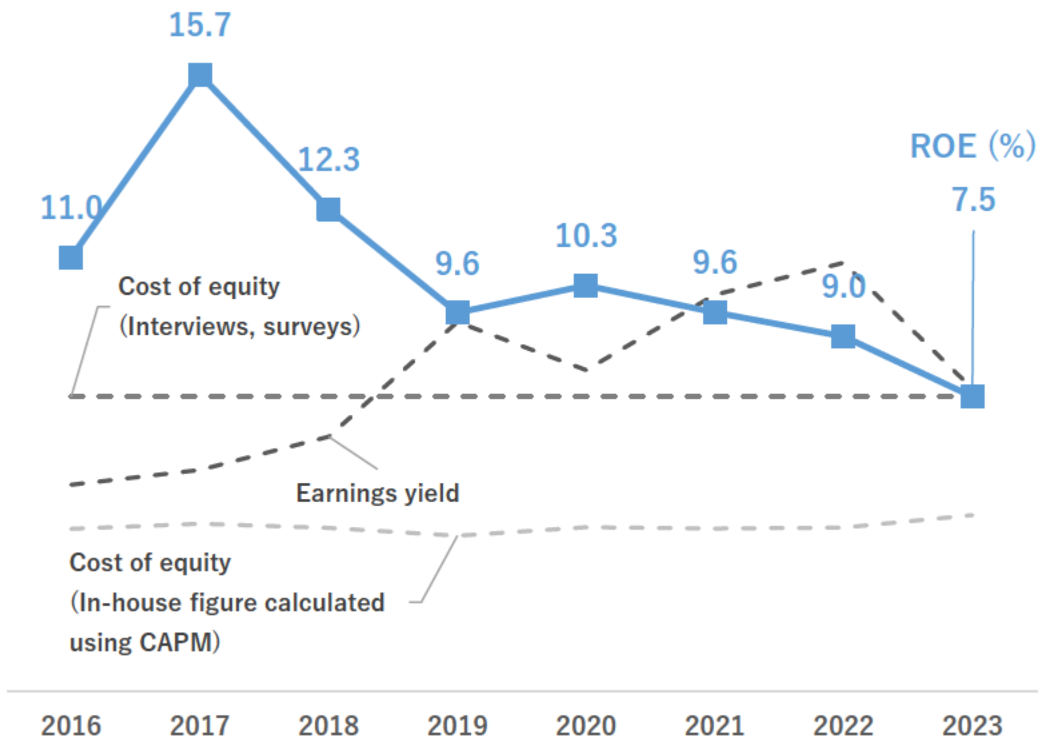




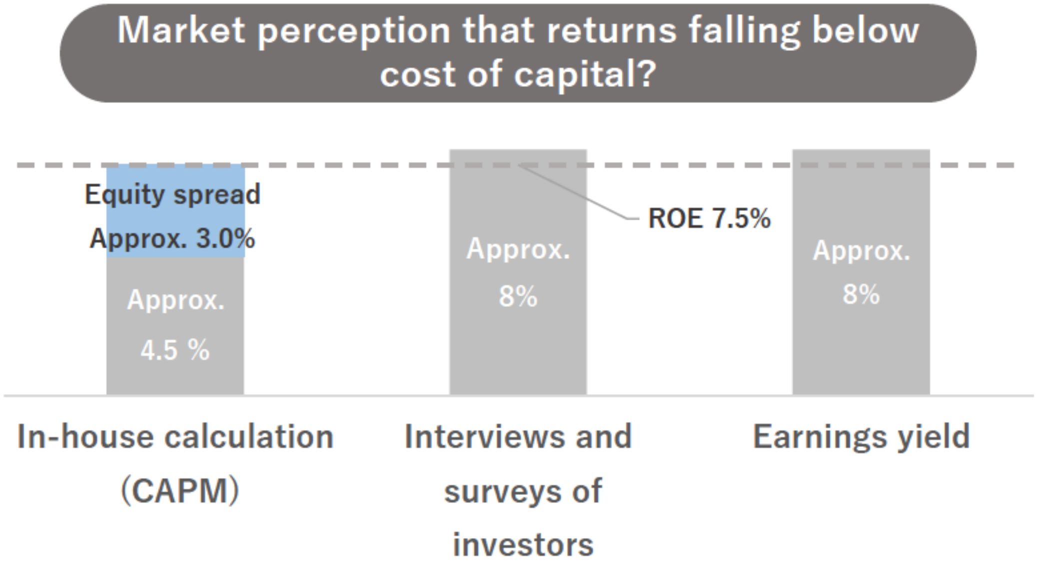
Analysis of the Current Situation: A Comparison of Cost of Equity and Ability to Generate Returns on Capital

- The difference between our ROE and cost of equity (equity spread) has narrowed in recent years, and recent measurements suggest that returns could fall below the cost of capital.
- A cost of equity that reflects the demands of the market requires a ROE of over 8%.
- Going forward, we can sustainably increase our corporate value by meeting our Second Medium-Term Management Plan ROE target of 8.7%, then aiming to further increase this figure to 10%.

Trends in ROE and cost of equity (%)



Cost of equity



Notes:
- CAPM (in-house calculation) = Japan's 10-year government bond yield + beta × market risk premium
- Sources for figures include interviews with investors and publicly available surveys
- Earnings yield

Analysis of the Current Situation: a Logic Tree for Increasing PBR

- To increase our PBR, we will make improvements to our ROE and price-to-earnings ratio (PER).
- To increase our ROE, we will raise our ROA by improving our ROIC and other measures, and optimize our financial leverage.
- To increase our PER, we will realize business growth to increase our expected growth rate, and both remain aware of and take action toward lowering cost of capital.

Stock price = PBR × BVPS (net assets per share)

- Stock price
  - BVPS
  - PBR (PBR＝ROE×PER)
    - ROE (ROE ＝ ROA × financial leverage)
      - ROA
        - Operating assets (ROIC)
          - Operating profit margin
            - Optimization of pricing policies to improve gross profit margin
            - Improvement of productivity per person-hour through material return on DX investment
          - Invested capital turnover ratio
            - Optimization of property, plant, and equipment & working capital turnover ratio
        - Non-operating assets
          - Disposal of unnecessary assets
            - Disposal of/other action on cross-shareholdings & unused real estate
      - Financial leverage
        - Net D/E ratio
          - Search for optimal capital structure
            - Shareholder returns (dividends & repurchases of treasury stock)
            - Securing of financial buffer & maximizing of corporate value
    - PER (PER ＝ 1 ÷ (cost of equity － expected growth rate))
      - Cost of equity
        - Sustainability
          - Environment & society
            - Engagement with materiality (key issues)
            - Improvements to human capital management
          - Improvements to governance
            - Voting rights on the Information Security and Appointment & Remuneration Committees
        - Accountability
          - Enhancement of IR activities
            - Active participation of Directors, feedback on content of dialogue
            - Updates to IR tools
      - Expected growth rate
        - Investment for growth
          - Organic
            - New store openings, revitalization of existing stores
          - Inorganic
            - M&A & alliances

Business portfolio changes & optimization

Summary of Analysis of the Current Situation: Overview of Policy for Management that Takes into Account Cost of Capital

Business strategy

Challenges

- Potential that maintaining and improving growth and profitability in our currently strong GMS business will become challenging due to future demographic shifts and other changes.
- Little hope for growth offered by reduced investment in new stores and weak performance at existing stores.

Policy for increasing our market share using our area strategy

Solutions

- Implement a business portfolio policy that will grow our business by promoting our area strategy.
- Follow a business portfolio policy that keeps the company in an optimal financial position to maintain high profitability and improve our ROIC.

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Financial strategy

Challenges

Risk-averse management style means operating in a framework allowing us to improve profitability and financial stability, but with poor prospects for future improvements in our ability to generate returns on capital (ROE).

Policy for capital strategies to achieve an optimal capital structure

Solutions

- Implement capital strategies that will achieve a balance sheet with an optimal capital structure.
- Specifically, clearly set out and implement a shareholder returns (dividends, treasury stock) policy.

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Policy for dialogue & related commitments

Challenges

- Ensuring measures for business sustainability and governance structures able to implement them.
- Disseminating information on policies relating to our business and financial strategies and dialogue with the market.

Policy on dialogue with the market & commitment to various plans

Solutions

- Enhance our sustainability management
- Enhance our IR activities
- Link KPIs relating to ability to generate returns on capital and sustainability to remuneration
- Create systems allowing content of dialogue to be fed back to management

2. Policy for Management that Takes into Account Cost of Capital

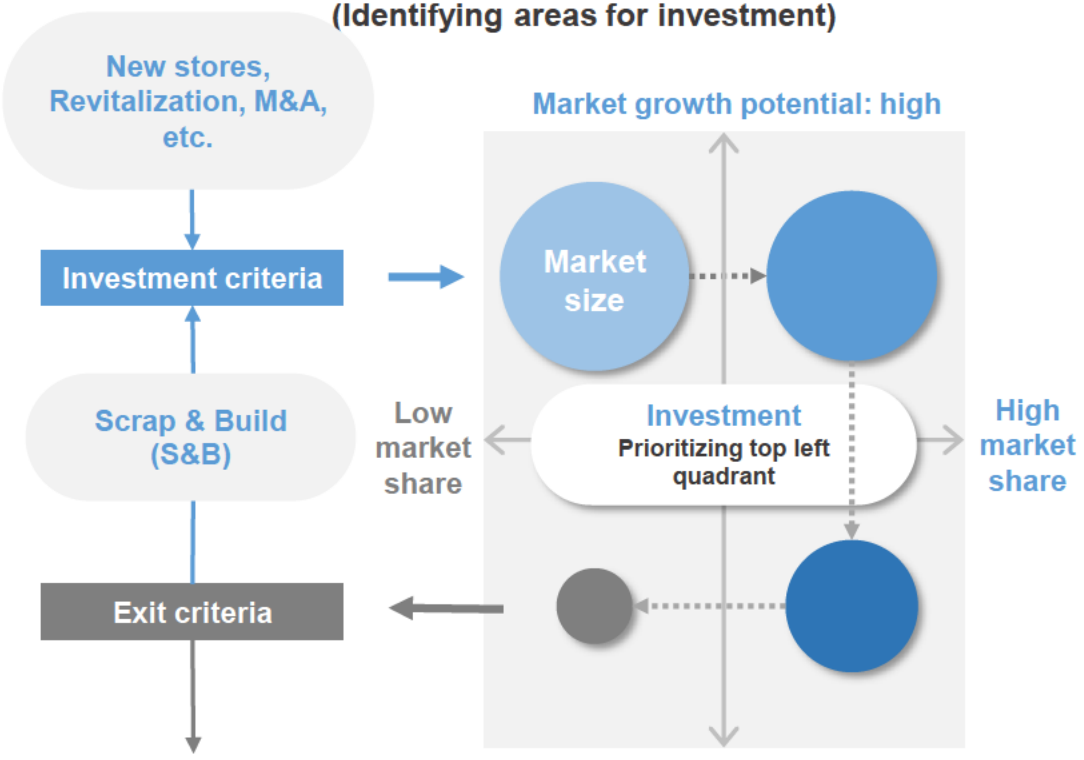
(1) Business Strategy

Approach to Our Business Portfolio: (1) Evaluating Business Feasibility

- We will aggressively pursue the area strategy set out in our Second Medium-Term Management Plan.
- Key areas: areas with a sizeable market and where we already have some share in that market. We will accelerate our strategy aimed at achieving dominance in these specific regional markets through opening stores, revitalization of existing stores, M&A, and other measures.
- Other areas: we will focus on opening stores, M&A, and similar measures as our core strategies.

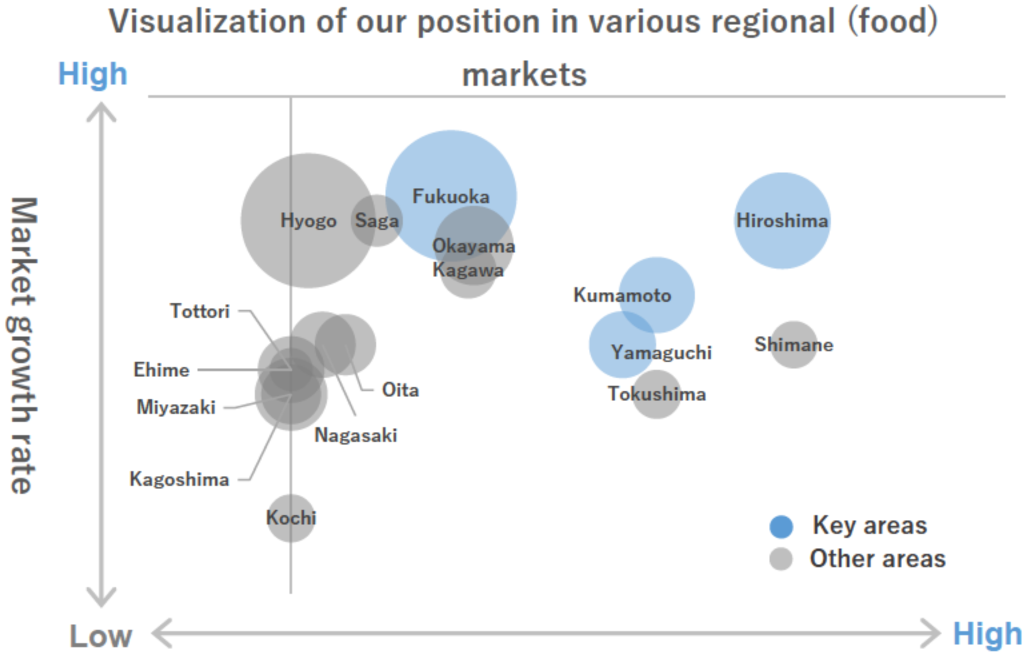
Evaluating business feasibility

(Identifying areas for investment)



Area strategy

(Definition of area strategy)

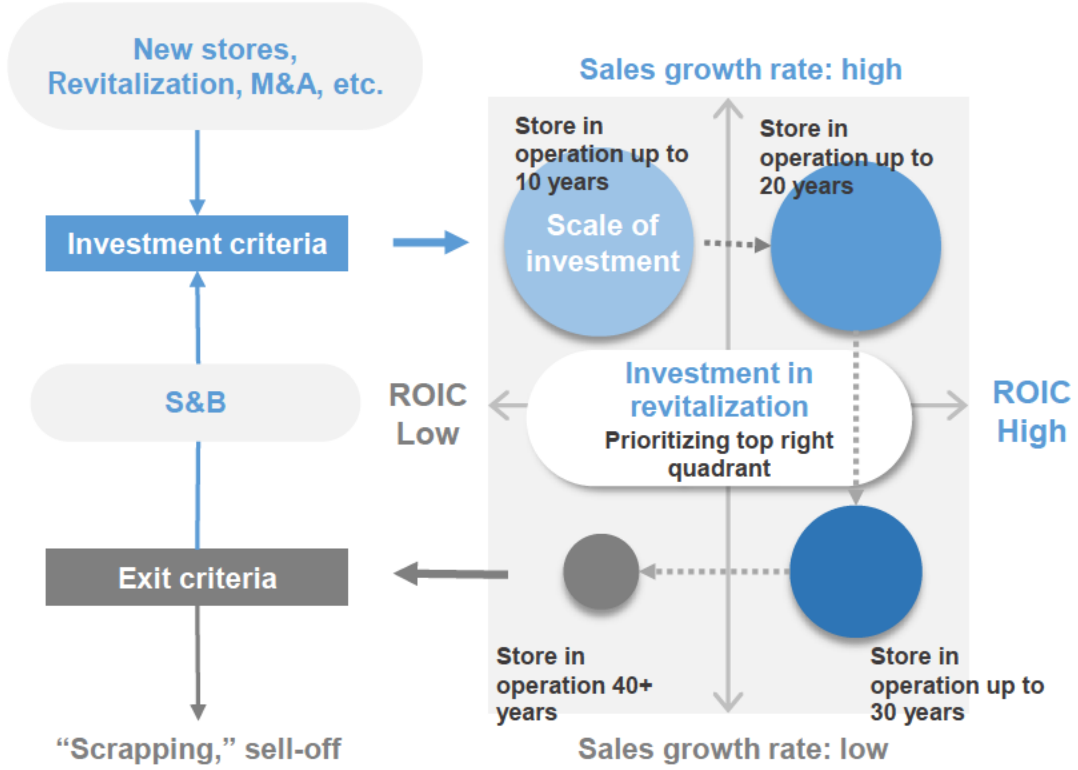


Approach to Our Business Portfolio: (2) Evaluating Financial Feasibility

- Our general rule will be to direct store investment toward projects that fulfill certain investment criteria.
- When analyzing existing store profitability (ROIC), we see that stores that have been in operation for up to 20 years occupy the top spot, and our various investments will concentrate on the aim of shifting, maintaining, or rejuvenating stores in(to) this position.
- The hurdle rate in our key areas is set to the company's WACC, and to our WACC + 2% in other areas.

Evaluating financial feasibility

(Maintaining or lowering years-of-operation average)

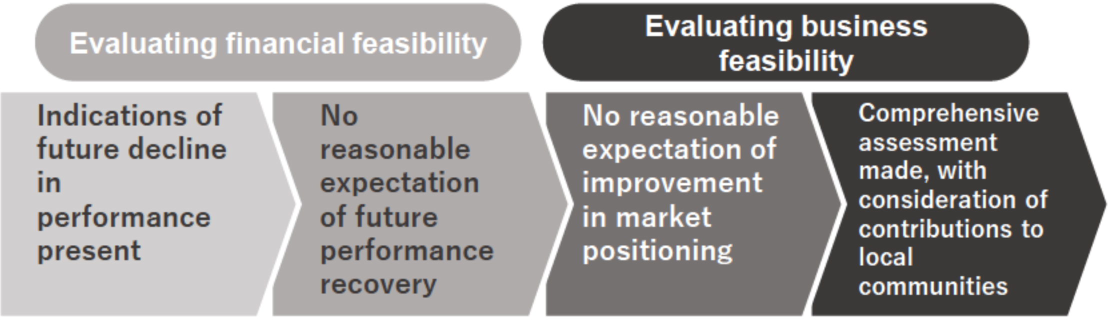


Investment criteria & monitoring

- Investment criteria: NPV > 0, payback period < basis period

Category	Area	Hurdle rate	Payback period
New stores	Key	WACC	15 years
	Other	WACC + 2%	11 years
Revitalization of existing stores		-	3 years

- WACC: approx. 4–5%
- Monitoring (continuation/exit decision process)



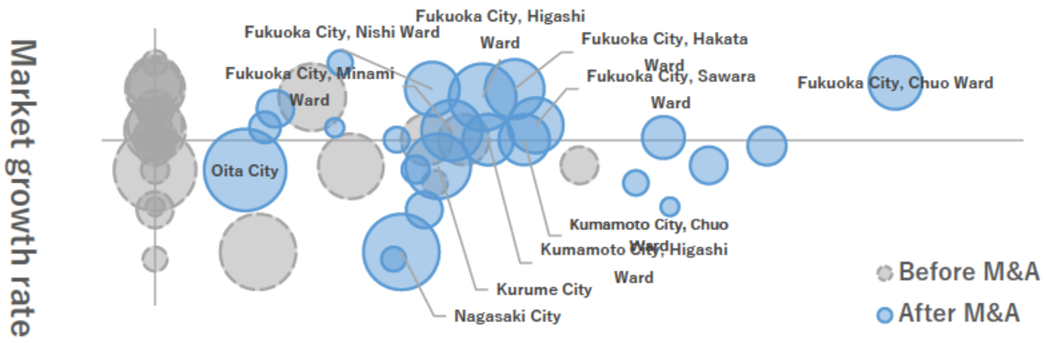
Structural Reforms in Our SM Business

- Our latest M&A will expand our store network in highly populated areas where a high proportion of the population lives in Densely Inhabited Districts (urban areas meeting certain population-related criteria) and which present a high potential for growth.
- This will give a rapid boost to our market share in areas where we have no existing stores—such as the center of Fukuoka City and Oita City—in particular.
- We will also adopt any highly efficient business structures utilized by the companies we acquire in order to improve the revenue structure of our entire SM business.

Seiyu Co., Ltd.'s Kyushu stores (absorption-type company split)

- Youme Mart Kumamoto Co., Ltd., one of our consolidated subsidiaries, will take over this business following an absorption-type company split.
- This will rapidly boost our market share in central Fukuoka City, an area we have long hoped to move into.
- We will operate these stores using a low-running-cost, high-profit structure centrally managed from our company headquarters.
- By shifting our existing SM business to a low-cost operating model, we will adopt a system that increases profitability across this whole segment of our business.

Changes in our (food) market position in target areas



サンライフ (becoming a wholly-owned subsidiary)

- SUNLIFE operates four community-based food supermarkets in Oita Prefecture.
- The company will become a wholly-owned Izumi subsidiary, creating synergies in store management, sales promotions, SCM, and other areas, and thereby contributing to revitalizing local communities.
- This will boost us to a dominant position in the Oita City market, where we have had no foothold until now.



Kyushu region

Kyushu population rankings

Unit: thousands of persons

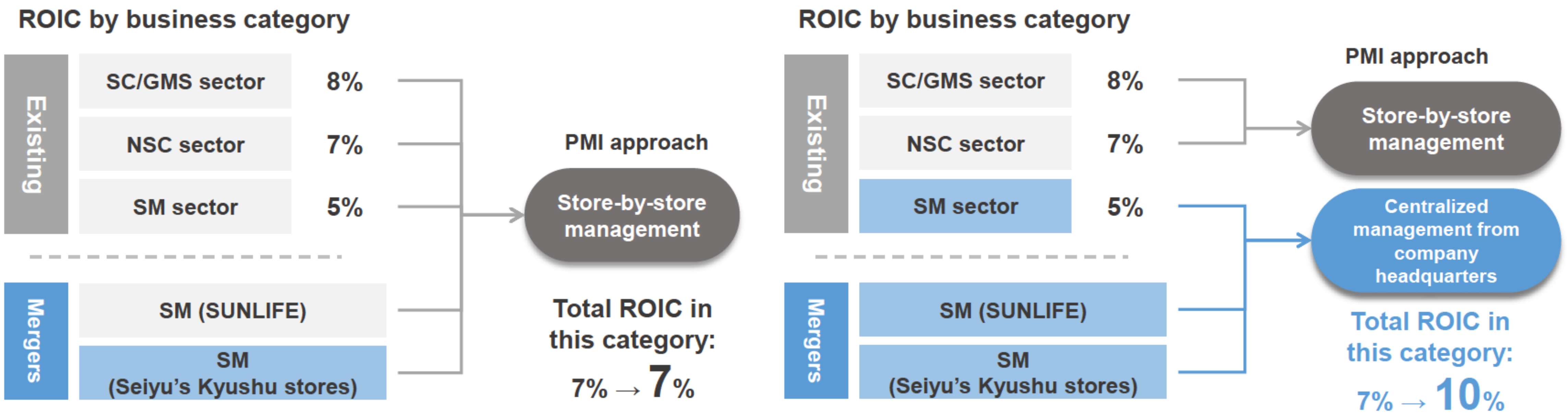
	Area	Total population
1	Fukuoka City	1,612
2	Kitakyushu City	939
3	Kumamoto City	739
4	Kagoshima City	593
5	Oita City	476
6	Nagasaki City	409
7	Miyazaki City	401
8	Kurume City	303
9	Sasebo City	243
10	Saga City	233

Structural Reforms in Our SM Business

- Alongside maintaining the high profits of our GMS business, we will increase investment in our SM business through opening stores and M&A in the aim of achieving radical growth.
- Our post-merger integration (PMI) approach from FY2024 onward will involve incorporating know-how from highly effective stores among those we acquire into our existing SM business to increase total profitability (ROIC) and thereby improve our ROA.

Previous approach → **Approach going forward**

(Up to and including our Second Medium-Term Management Plan) → (Third Medium-Term Management Plan and beyond)



Notes:

- The SC/GMS business category includes Youme Towns and LECT; the NSC business category includes Youme Malls; and the SM business category includes Youme Marts, Yours, and Dailymarts.
- ROIC = net operating profit after tax (NOPAT) ÷ operating assets. These calculations do not include goodwill amortization associated with our acquisitions.

(2) Financial Strategy

Financial Strategy: Shareholder Returns and Maintaining Financial Stability

- Up to the present, we have set our dividend payout ratio at 30% (target), and will set it to 30% or more going forward.
- We will carry out repurchases of treasury stock in the aim of achieving an optimal capital structure and implementing flexible capital strategies.
- In the aim of achieving an optimal capital structure, we will adjust our net D/E ratio and equity ratio, with targets of 0.5–1.0 and (for the present) 50%, respectively.
- Required funding will first come from company funds, then interest-bearing liabilities.

		Up to present	Going forward
Shareholder returns	Dividend payout ratio	30% (target)	30% or more (progressive dividend policy)
	Repurchases of treasury stock	–	Carry out repurchases in the aim of achieving optimal capital structure & implementing flexible capital strategies
Maintaining financial stability	Net D/E ratio	Maximum 0.5	Goal of 0.5–1.0
	Equity ratio	–	50% (for the present)
Financing		Utilize company funds & interest-bearing liabilities	Utilize company funds & interest-bearing liabilities

Cash Flows and Allocation

- Our purchase of Seiyu's Kyushu stores will increase our cash flow from investing activities (CFI), as compared to initial projections, to 200.0 billion yen or more.
- Our cash flow from operating activities (CFO) of 180.0 billion yen must be supplemented by 60.0 billion yen or more of external funding to cover shareholder returns and cash outflow.
- We intend to secure the entirety of this external funding in the form of interest-bearing liabilities.

Revised Second Medium-Term Management Plan (FY2021–FY2025)

CFO		• New stores, M&A, etc. based on our area strategy • Investment for revitalization/S&B of existing stores
CFI		Capital investment, DX, sustainability: 155.0 billion yen, of which 20.0 billion yen is reserved for M&A
CFF	Shareholder returns	Dividends: dividend payout ratio of 30% (target)
	Financing	• Financing through company funds & interest-bearing liabilities • Net D/E ratio: up to 0.5

Current prospects

CFO			• Boosting radical growth by opening stores, M&A, etc. based on our area strategy • Optimizing our business portfolio through investment for revitalization/S&B of existing stores
CFI			Capital investment, DX, sustainability: 200.0 billion yen or more (including M&A & other activities)
CFF	Shareholder returns	• Dividends	Dividend payout ratio: 30% or more
		• Treasury stock	Carrying out repurchases in the aim of achieving optimal capital structure & implementing flexible capital strategy
	Financing		• Financing through company funds & interest-bearing liabilities • Net D/E ratio: goal of 0.5–1.0 • Equity ratio: 50% (for the present)

(3) Policy for Dialogue and Related Commitments

Initiatives for Dialogue with Shareholders and Investors

- **We will aim to fully disclose the content of our dialogue with shareholders and investors by creating systems allowing this information to be fed back to management.**
- **Management and our Board of Directors will participate actively and independently in the course of this dialogue, thereby further enhancing the company's IR activities.**

Creating systems allowing content of dialogue to be fed back to management

- Internal feedback and integration into our management systems through constructive dialogue
- Full disclosure of content of dialogue, status of its integration into management, and progress of outcomes

Strengthening our IR activities

- Active and independent participation of management and Board of Directors in dialogue
- Enhancement of our IR tools (IR website, disclosure in English, etc.)
- Briefings for individual investors, expansion of shareholder benefits

Our Commitments

- In order to build the sustainable society without which our business cannot operate, we will move ahead with improvements to our sustainability management, with ongoing contributions to local communities and our customers’ lives at the heart of our approach.
- We will consider linking remuneration to KPIs relating to sustainability and the ability to generate returns on capital, in order to increase effective meeting of targets.

Enhancing our sustainability management

- Environment: reduction of CO2 emissions, action on plastics, action on food waste and recycling
- Society: strategy for investment in human capital and implementation of full disclosures
- Governance: measures including improvements to effectiveness of the Information Security and Appointment & Remuneration Committees

Considering link of remuneration to KPIs relating to sustainability and ability to generate returns on capital

- Remuneration system linked to achievement of targets relating to sustainability and ability to generate returns on capital (ROE, ROIC)
- Expansion of eligibility for remuneration through restricted stock

*For further details, see our sustainability website https://www.izumi.co.jp/sustainability/ (in Japanese)

3. Conclusions

Impact of Pursuing These Various Strategies on Our PBR (Currently Under 1)

- We will achieve a ROE of 10% by using our business strategy to increase our ROIC and adjusting our financial leverage.
- We will aim for the industry-average PER* of 15–20 (or more) through a business strategy that increases our potential growth rate and by implementing our policy on dialogue.
- By achieving these targets, we will aim for a PBR of 1.5–2.0 or more (= ROE of 10% × PER of 15–20).

	FY2023	Target figures going forward (medium- to long-term)
ROIC	6.4%	7% or more
ROE	7.5%	10% or more
	×	×
PER	12.1	15–20 or more
	‖	‖
PBR	0.91	1.5–2.0 or more

*The industry average PER is taken from the average figures from the end of the most recent accounting period in the sub-sector, covering department stores, GMS, SM, convenience stores, and drug stores (outliers were omitted).

Quantitative Targets in Our Second Medium-Term Management Plan

- We set an EBITDA target facilitating an increased likelihood of achieving our performance and ROE targets through acquisition of Seiyu's Kyushu stores and other purchases and boosting our growth by stepping up our M&A and related activities.
- We will aim for a ROE of 10% or more by launching structural reforms in response to the short-term decrease in ROIC expected due to our increased M&A activity and by improving our financial leverage.
- We will implement our policy on dialogue and commit to achieving our KPIs in the aim of improving our expected growth rate, lowering cost of capital, and increasing our PER.
- Through these measures, we aim to address the issue of our PBR by bringing it up to 1, then further increase it.

		Second Medium-Term Management Plan	Current prospects & other remarks
Performance	Operating revenue	590.0 billion yen	Increased likelihood of achieving these targets due to purchase of Seiyu's Kyushu stores (A)
	Operating profit	41.0 billion yen	
	EBITDA	59.0 billion yen	
Capital efficiency	ROE	8.7%	Aiming for 10% or more over the medium- to long-term
	ROIC	6.9%	Short-term decrease due to A, but aiming for improvement with launch of structural reforms
Shareholder returns	Dividend payout ratio	30% or more (progressive dividend policy)	Change
	Repurchases of treasury stock	Carry out repurchases in the aim of achieving optimal capital structure & implementing flexible capital strategies	
Maintaining financial stability	Net D/E ratio	Goal of 0.5–1.0	Change
	Equity ratio	50% (for the present)	

Notes: ROIC = net operating profit after tax ÷ (interest-bearing liabilities + shareholders' equity + non-controlling interests); EBITDA = operating profit + depreciation + goodwill amortization