IR Presentation, Session 1
Growth Strategy of Core Businesses
Questions and Answers (Summary)

August 26, 2020
Nippon Express Co., Ltd.

<u>Pharmaceuticals/Medical Business</u>

Q1. During last year's presentation, you stated that pharmaceuticals would be one of the five priority industries you would emphasize in particular. Has the spread of COVID-19 caused any changes?

A1. There have been some changes. We have started receiving inquiries regarding transportation and storage for COVID-19 vaccines. Vaccine development is advancing in many countries around the world. We have been receiving inquiries about shipping from customers in the U.S., Europe, and Japan. We have been preparing to transport investigational drugs and biopharmaceuticals for some time, so we are ready to transport vaccines as well. Vaccines require transport and storage at -20°C, and we are readying ourselves for this type of operation.

Q2. I had understood that operations for pharmaceutical warehouses would begin in January 2021. Has the spread of COVID-19 caused any delays? Also, are there any scheduling delays?

A2. We were forced to interrupt the construction of a pharmaceutical warehouse, which caused a delay of about one month in our original schedule. This is something our customers understand and we have already adjusted the schedule. For customers with whom we already have signed contracts, we are preparing to bring in goods at our pharmaceutical warehouse at the end of February and begin shipping in early March.

Q3. I understand that in addition to approximately ¥50 billion yen in investment for pharmaceutical warehouse construction, you expect another ¥10 billion or so in separate investments as well. Can you tell us the entire amount of investment you plan to make? Also, can you provide more information about the time required to see a return of investment and investment recovery strategies?

A3. As of right now, we have invested ¥15 billion in addition to the ¥50 billion for pharmaceutical warehouse construction, for a total of ¥65 billion. Including future investments overseas, we expect to make about ¥100 billion in construction investments. The ¥15 billion in question includes pharmaceutical transportation vehicles and systems development for a logistics platform, etc., as well as materials handling and other equipment to be installed in the pharmaceutical warehouse.

Of the four warehouses, we plan to leverage three for liquidity. Investment in the Toyama warehouse, which will become as an asset, has been smaller compared to the other three. The payout period for warehouses is between 15 and 18 years. About 12 years is required for warehouses that provide particularly good profit margins. Vehicles require seven or eight years, while systems typically require four or five. As these investments run across a broader range, we expect that the payback period might take slightly longer.

Priority Industries Other than Pharmaceuticals/Medical

Q4. Can you tell us about any new measures forced by the spread of COVID-19, COVID-19-related initiatives, and results related to priority industries other than the pharmaceuticals/medical industry?

A4. Other priority industries have been affected by the spread of COVID-19.

The automotive industry has been most affected; however, sales rebounded from a low point in February for China, April for the U.S., and May for Japan. The industry has since been recovering, and reached more than 90% of pre-COVID-19 levels in Japan in the second half of August. Depending on a second wave of infection, we expect production in every region to return to pre-COVID-19 levels toward the end of the year.

Our air cargo transportation will be the main driver of our response to transportation demand stemming from this recovery.

Air cargo transportation for both the semiconductor and apparel industries has been affected by the still-low number of international passenger flights. We cannot keep up with demand using only freighters. Some regions are not even offering freighter operations. In response, we are using passenger flights for cargo. Since May, airlines have been operating passenger flights as cargo flights on a regular basis. While freight rates remain high, a certain amount of demand is required to maintain supply chains, and volumes are beginning to rise in conjunction with the recovery.

We have seen quite a bit of capital investment in semiconductors from last year to this. And while there has been a temporary slowdown due to the impact of COVID-19, manufacturing equipment and other transport is recovering, albeit gradually.

The apparel industry in Italy has been badly damaged. However, we have seen an increase in the shift of money from the purchase of travel and leisure, prevented by COVID-19, to the purchase of goods. The purchase of luxury brand items is recovering slowly. Imports are increasing in Japan as well, and we expect to see more e-commerce activity in the future.

Q5. Major manufacturers in the automotive industry have announced policies for reducing production capacity. What is your company doing in response? Also, what factors did you anticipate in your target for fiscal 2023 revenues and what is the current status of your target?

A5: Among Japanese finished component manufacturers, some will be returning production from overseas to Japan, while others will be building new factories overseas to expand production. For the latter, we are building warehouses in regions close to these factories for JIT deliveries and plan to begin operations between this fall and next year. Our target figures reflect our anticipation of these factors. In addition, some companies are pushing toward global procurement. We plan to respond in accordance with the policies of each company. The same is true for European automakers and big suppliers. The automotive industry experienced severe conditions last year, but we believe after the end of COVID-19, the industry will begin starting up factories.

Q6. What price range does the apparel industry define as luxury apparel? Are you concerned about the risk of customer insolvencies stemming from excess inventories and other factors due to COVID-19?

A6. Our luxury apparel target customers are the high-end brands in Italy, France, and Spain, and consumer appetite for these brands have not weakened. There was a period of time when our warehouses in Italy were not in operation due to lockdowns. Once the lockdowns were lifted, supply recommenced without the inventory becoming dead stock. All of our warehouses are now operating and we do not believe we need to worry too much about the risk of customer insolvencies due to excess inventory. However, we are seeing a second wave of COVID-19 in Europe. Depending on governmental response, there could be similar conditions as the earlier lockdowns. However, that is not the case at this stage.

Operating Income Margin

Q7. Has the spread of COVID-19 changed the 5% target you set for operating income margin?

A7. Conditions are becoming more challenging. Our ocean transportation business, in particular, remains in a difficult situation with operating income margin of less than 5%, while the mixed loading efficiency in our air transportation business is rising. At this point we want to maintain our 5% target.

Expanding Sales to Non-Japanese Customers

Q8. Regarding the expansion of sales to non-Japanese companies. What kind of jobs are you targeting and how are you going about securing these jobs?
How do you win jobs away from your competitors? What is the difference in profit margins compared to Japanese companies? Will profit margins weaken if ocean transportation volume increases or competition intensifies? When you bid for jobs, do you bid based on return on investment or profitability? Do you sacrifice immediate profits to win customers?

A8. Our sales approach is based on responding to calls for bids. We have been increasing our market share every year by responding to calls for bids. Our basic strategy is to increase our market share in areas and lanes by first building a record of success in jobs for which we can provide service and secure profits, rather than simply responding to every RFQ. The European global mega-forwarders are our main competition. Global companies call for bids every year, so a company could start at a loss and increase profits gradually once the job has been won, but this is becoming an outdated strategy. With COVID-19 this year, air transportation fees are two to three times higher. Ocean transportation fees from China to the U.S. are about two times higher than the first of the year. The issue is how to respond to these fluctuations in freight rates. We analyze transportation methods, creating multiple plans, rather that limiting our service to a single route. Then we negotiate with carriers at the execution stage. This is our main approach, and we do not pursue an approach that calls for an up-front loss.

Q9. You have narrowed your list of Global Target Accounts (GTAs) to 29 companies. What is your selection criteria? Are you targeting too few companies?

A9. We narrow GTAs in most industries from among customers for which we expect to grow our business in the future. We believe that there are 40 companies at most that meet this condition. In addition to Japan, we are playing a role in approaching four overseas areas More recently, we have captured share of Europe-to-Japan/Korea ocean and air forwarding for major automotive suppliers from European forwarders. Our proposals regarding global supply chains were well received by a certain semiconductor manufacturer, which switched to our company from another provider.

End