

Lacto Japan

Independent trading company handling dairy ingredients: Domestic inventory surplus remains, but recovery in commercial demand likely as pandemic impact

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Business

One of Japan's leading independent trading company focused on dairy products; expanding into meat products and the Asia market

Company with a top share in dairy ingredients, cheese imports: Lacto Japan is the nation's biggest independent specialist trading company of dairy ingredients and cheese (around 35% import share in FY2020). It imports dairy ingredients and cheese from milk-producing nations globally, for wholesale mostly to leading domestic food manufacturers. The company handles about 40 general-purpose ingredients and over 500 customized (primary processed) products. With no corporate affiliations, it has more than 100 suppliers and a diverse range of customers. In 13 years, its dairy ingredient and cheese handling volume grew 2.7x, from 76,868 tons in FY11/06 to 204,105 tons in FY11/19. However, the volume shrank to 184,358 tons (-3.8% YoY) in FY11/21 due to the COVID-19 pandemic. The company's sales and profit come mainly from the fees (commissions) on these imports. Adjusted for forex gains and losses, its operating profit margin is about 3%. The company has 323 employees (as of November 30, 2021).

New business domains: Aside from its Dairy Ingredients and Cheese (69.0% of sales in FY11/21), Lacto Japan has imported Meat Products since FY11/05 (12.9%). It also has the Asian Business centered in Singapore, engaged in dairy ingredient sales (14.2%) and the manufacture and sale of cheese (3.0%). The remaining 0.9% of sales come from the Other business, which was started in FY11/20 and conducts sales of functional food ingredients (including whey protein ingredients and gelatin) mainly in Japan.

Performance trends

FY11/22: Company expects commercial demand to return steadily as pandemic impact subsides

FY11/21 earnings: Sales of JPY110.9bn (+0.0% YoY) and ordinary income of JPY2.7bn (-3.6%). Commercial demand stagnated throughout the year due to the pandemic, and domestic skim milk powder inventory remained high, leading to declines in tenders and in sales to major dairy companies. This was offset by sales of domestically produced dairy ingredients and imported ingredients taking advantage of low tariff quotas, and overall sales remained essentially flat YoY, falling 3.6% short of the company's revised forecast. Although Lacto Japan handled more high-margin products in 1H, gross profit declined in 2H due to a sharp rise in international dairy ingredient prices and higher distribution costs, causing ordinary income to fall 4.6% short of plan, down 3.6% YoY. However, taking into account forex rates, profit increased slightly in real terms.

FY11/22 forecast: Lacto Japan forecasts sales of JPY126.0bn (+13.6% YoY) and ordinary income of JPY2.9bn (+8.1%). It expects ongoing impact of surplus domestic inventory, but gradual recovery in demand as the impact of the pandemic subsides and relatively rapid recovery in the Asia market. The company projects sales volume growth in Dairy Ingredients and Cheese (+11.1%), Meat Products (+5.1%), dairy ingredient sales in the Asian Business (+14.3%), and cheese manufacturing and sales in the Asian Business (+9.8%).

Medium-term strategy

Aiming for sustainable growth by evolving existing businesses, expanding the Asian Business, and building next-generation businesses

Medium-term plan: Under its NEXT-LJ2024 medium-term business plan, Lacto Japan targets FY11/24 sales of JPY150.0bn (+35.3% vs FY11/21), ordinary income of JPY3.9bn (+45.5%), and net income of JPY2.9bn (+45.5%). With the impact of the pandemic, both sales and ordinary income in the first year (FY11/21) of the

previous plan, NEXT-LJ2023, fell slightly short of the upwardly revised forecast, but ordinary income did clear the initial projection. This means the company managed to secure a certain level of ordinary income despite the pandemic's impact throughout the year as it enhanced sales of imported ingredients taking advantage of free trade agreement quotas, developed the business of exporting Japanese dairy products, worked to expand the cheese business in Asia, and accelerated development of the functional food business.

Strengths and weaknesses

Strengths

Wealth of information, ability to offer solutions and respond to customer needs:

Lacto Japan is a leading specialist trading company with a share of some 35% in dairy ingredients and cheese imports. Over the years (including the Toshoku era), it has amassed a wealth of specialist expertise and know-how.

Independence: Being free of capital alliances or complex trading relationships is the key difference vs. rival general trading companies; diversity of suppliers (more than 100) and customers.

Presence in Asia and manufacturing

function: Lacto Japan has been in Singapore for about 20 years. It set up plants and added manufacturer to its trading company identity before general trading companies invested in manufacturing dairy products in Asia.

Weaknesses

Heavy reliance on domestic market

(constraint on growth): Although the import ratio has increased, dairy product consumption in Japan remains flat.

Limits on potential for adding value: Lacto Japan's stable supply of ingredients is a source of value-added, as are the above information resources and ability to offer solutions and respond to customer needs. Still, in comparison with suppliers and customers, potential for adding value is limited.

Profit growth drivers

To Date: Importing dairy ingredients and cheese into Japan (and sales)

Medium term: Above plus expanded product lineup plus cheese manufacturing and sales and dairy ingredient sales in Asia

		Sales (JPYmn)	YoY	Operating profit (JPYmn)	YoY	Ordinary income (JPYmn)	YoY	Net income (JPYmn)	YoY	EPS (JPY)	BPS (JPY)	ROA (OI-based)	ROE
FY11/14	Cons.	96,550	27.1%	1,532	118.8%	1,653	-1.0%	988	-1.9%	127.79	1,165.58	4.5%	12.2%
FY11/15	Cons.	98,001	1.5%	720	-53.0%	1,343	-18.8%	831	-15.9%	98.94	1,062.54	3.3%	8.5%
FY11/16	Cons.	88,679	-9.5%	3,349	365.1%	1,434	6.8%	946	13.8%	96.79	1,167.72	3.7%	8.7%
FY11/17	Cons.	101,335	14.3%	1,924	-42.6%	2,523	75.9%	1,755	85.5%	179.48	1,302.98	6.0%	14.5%
FY11/18	Cons.	115,441	13.9%	3,009	56.4%	2,613	3.6%	1,784	1.7%	182.31	1,462.35	5.5%	13.2%
FY11/19	Cons.	116,794	1.2%	3,144	4.5%	2,747	5.1%	1,963	10.0%	200.11	1,618.31	5.7%	13.0%
FY11/20	Cons.	110,838	-5.1%	2,959	-5.9%	2,781	1.2%	2,062	5.1%	209.47	1,774.58	6.1%	12.3%
FY11/21	Cons.	110,884	0.0%	2,787	-5.8%	2,682	-3.6%	1,959	-5.0%	198.73	1,978.42	5.6%	10.6%
FY11/22	Est. Cons.	126,000	13.6%	-	-	2,900	8.1%	2,100	7.2%	212.95	-	-	-

Note: Figures rounded to the nearest million yen (amounts less than JPY1mn are rounded down in materials released by the company).

Business

One of Japan's leading trading company of dairy products (roughly 35% import share); expanding into meat products and the Asia market

Company overview

Among Japan's leading independent food trading company focused on dairy products

Lacto Japan is the nation's biggest independent specialist trading company of dairy ingredients and cheese (about 35% share of imports in FY2020). The company imports dairy ingredients—which includes customized (primary processed) products and products that are extracted from concentrated raw milk, including whole milk powder, skim milk powder, whey (liquid separated out from milk solids during the manufacture of yogurt and cheese), and sweetened condensed milk—and cheese from milk-producing nations around the world. It then wholesales these imported dairy ingredients to leading domestic food manufacturers, the Agriculture Livestock Industries Corporation (ALIC), and other entities. In all, Lacto Japan handles around 40 general-purpose ingredients and over 500 customized (primary processed) products. With no corporate affiliations, the company has more than 100 suppliers. Fees (commissions) for wholesaling (importing) serve as the main source of sales and profit. In real terms (adjusted for exchange gains and losses), the operating profit margin is about 3%. As of November 30, 2021, the company had 323 employees.

Background to establishment

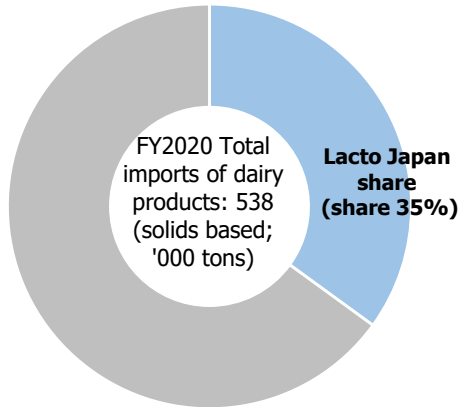
Lacto Japan was founded by a team previously engaged in importing for the dairy product division of Toshoku*, in response to strong pleas from Toshoku suppliers and customers after that company filed for bankruptcy, reportedly because of a subsidiary's excessive investments. President Motohisa Miura was one of Lacto Japan's founding members; over his many years at Toshoku and Lacto Japan, he has acquired a wealth of experience in selling dairy ingredients and cheese. Lacto Japan celebrated the 20th anniversary of its founding in May 2018.

*Toshoku: a leading specialist food trading company, which filed for bankruptcy in 1997. Formerly a part of Mitsui and Co., it was founded in 1946 in line with the dissolution of conglomerates in postwar Japan.

Among Japan's leading independent trading companies of dairy products

- ▶ Leading company with 35% share
- ▶ Imports dairy ingredients and cheese from milk-producing nations around the world (more than 100 suppliers)
- ▶ Handles around 40 general-purpose ingredients and over 500 customized (primary processed) products
- ▶ Customers include leading domestic dairy product, confectionery, oil & fats, beverage, and animal feed manufacturers
- ▶ Employees number 323 (as of November 30, 2021)

Lacto Japan share of dairy product imports to Japan (by volume)

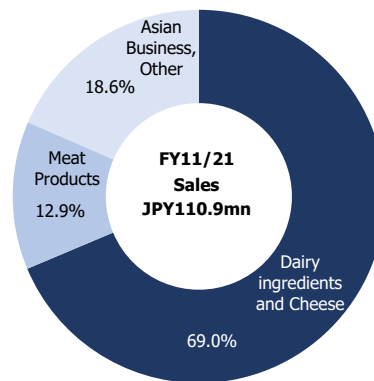


Source: Lacto Japan based on the Ministry of Agriculture, Forestry and Fisheries' "Food Supply and Demand Projections"

Note 1: Share is calculated by converting total imports to a solids basis (coefficient 0.1).

Note 2: Dairy imports include ingredients for animal feed.

Sales by segment



Source: Shared Research based on company data

Lacto Japan's defining characteristics

- Independent specialist trading company:** Aside from the relevant business units of large general trading companies such as Mitsubishi Corporation, Mitsui & Co., and Itochu Corporation, other dairy product trading companies tend to be small or midsized. Lacto Japan is distinguished by its full lineup of dairy ingredients and its lack of capital ties to other companies. According to management, Lacto Japan requires 61 personnel to run its Dairy Ingredients and Cheese business (as of November 30, 2021). Even the large general trading companies devote just five to ten people to this area. Other trading companies specializing in dairy ingredients usually are small in scale and focus on particular product categories.
- Long-standing relationships with suppliers and customers:** Lacto Japan plays the role of business partner both for dairy ingredient manufacturers (its suppliers) and for domestic dairy product, confectionery, oil & fats, beverage, and animal feed manufacturers (its customers). The company conveys information from overseas to customers, whose specific demands it relays to suppliers who then undertake primary processing, with Lacto Japan subsequently delivering the processed products to customers.

Expansion into new business domains

Aside from its dairy ingredients and cheese business, Lacto Japan also has run a business importing meat products since FY11/05. In addition, it has an Asian regional headquarter in Singapore-based subsidiary Lacto Asia Pte. Ltd., with subsidiaries, second-tier subsidiaries, and affiliates in Malaysia, Thailand, Indonesia, the Philippines, and China. These companies are engaged in dairy ingredient wholesaling and in the manufacturing and sale of cheese (company plants in Singapore and Thailand manufacture processed cheese, and the Indonesia plant manufactures shredded cheese).

Products handled and their respective sales weightings (in FY11/21)

- Dairy Ingredients and Cheese (69.0%):** handles around 40 general-purpose ingredients and over 500 customized (primary processed) products

Dairy ingredients: Dairy ingredients are the raw materials for milk products (collective term for products made by processing raw milk). Raw milk can be converted into solids, powders, and so forth,

- Expansion into new business domains
- Dairy Ingredients and Cheese (69.0% of sales in FY11/21)**
 - Meat Products (12.9%)**
 - Asian Business (17.2%)**
 - Other (0.9%)**
- Identifying business opportunities in the westernizing Asia market (sale of dairy ingredients)
 - Constructing new business model through addition of manufacturer function (cheese manufacturing and sale)
 - Manufacture of own-brand cheese in Singapore and Thailand**
 - Establishment of cheese processing company in Indonesia, as joint venture with local manufacturer**
 - Establishment by Philippines subsidiary of a dairy ingredient sales subsidiary (Lacto Japan's second-tier subsidiary)**

and with the exception of cheese, these products can be reconstituted as milk and other types of dairy product.

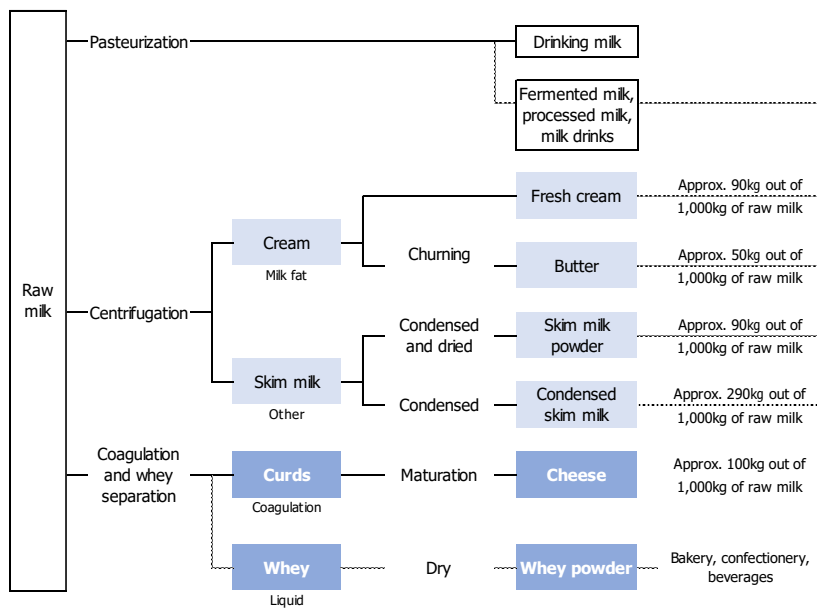
Whole milk powder: Whole milk powder is made by drying raw milk to remove water. In comparison with skim milk powder, whole milk powder has higher fat content. It therefore is not suited to long-term storage, as fat oxidation can cause the taste to deteriorate quickly. Whole milk powder primarily is used as an ingredient in cafe au lait and other canned coffee blends (coffee drinks), and in milk tea-type tea drinks.

Skim milk powder: Skim milk powder is made by removing water from skim milk (raw milk that has had the milk fat removed). It also is widely used in the food industry, as in comparison with whole milk powder it has a longer shelf life.

Curd: Curd is a dairy product obtained by coagulating raw milk through the addition of acids or enzymes such as chymosin. When the curd is molded and then heated, the result is natural cheese.

Whey: Whey is the liquid remaining when raw milk is treated to remove milk fat, casein, and so forth.

Casein: Casein is a family of phosphoproteins found in raw milk and cheese (roughly 80% of all protein in cows' milk is casein, and 20% is whey).



Source: Shared Research based on Ministry of Agriculture, Forestry and Fisheries data

- Meat Products (12.9%): pork (chilled and frozen), beef, chicken, dry-cured ham, salami, bacon, etc.
- Asian Business (17.2%): dairy ingredients and cheese, own-brand cheese (processed cheese* brand Foodtech, natural cheese** brand Choosy)
- Other (0.9%): functional food ingredients (including whey protein ingredients and gelatin)

* Processed cheese: To make processed cheese, one or more varieties of natural cheese are shredded and heated, and then reshaped after addition of an emulsifier and other ingredients.
 ** Natural cheese: Natural cheese is raw milk that has been coagulated to form a solid, before undergoing fermentation.

Global network

- Overseas bases charged mainly with procurement: US, Australia, Netherlands, Italy
- Overseas bases responsible principally for manufacturing and sales: Singapore, Malaysia, Indonesia, Thailand, Philippines, and China

Suppliers

- Dairy Ingredients and Cheese: Suppliers include dairy ingredient manufacturers from the three key milk-producing areas: Europe, Oceania, and North America (over 100 suppliers across 20 countries). Over 13 years, Lacto Japan's dairy ingredients and cheese import volume rose to 2.7x, from 76,868 tons in FY11/06 to 204,105 tons in FY11/19. However, the pandemic caused import volume to fall back to 191,575 tons

(-6.1% YoY) in FY11/20 and 184,358 tons (-3.8% YoY) in FY11/21.

- Meat Products: In pork products, the chief supplier is US-based Seaboard Foods. Lacto Japan also imports from companies that repackage dry-cured ham and salami into different shapes and sizes, primarily Italy’s Fratelli Galloni S.P.A. (Parma prosciutto) and Villani S.P.A. (Milano salami), and Spain’s Esteban Espuna S.A. (Serrano ham).

Customers

- Dairy Ingredients and Cheese: Customers include domestic dairy product, confectionery, oil & fats, beverage, and animal feed manufacturers, among them Meiji, Morinaga Milk Industry, Yotsuba Milk Products, Megmilk Snow Brand, Ezaki Glico, and Lotte, as well as the Agriculture Livestock Industries Corporation (ALIC; see later section on “state trading system”).
- Meat Products: Customers are domestic food manufacturers, particularly ham and sausage manufacturers.

*For dairy product, confectionery, oil & fats, beverage, and animal feed manufacturers, trading companies like Lacto Japan fulfill functions including ensuring a stable supply of ingredients (decentralization of procurement routes) and improving production efficiency (outsourcing the processing of raw materials).

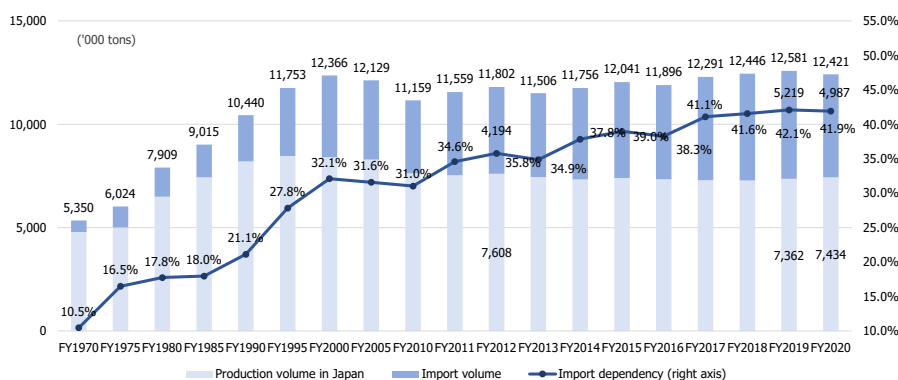
Market environment

Business climate favorable at present

We think Lacto Japan, as a company importing dairy ingredients from milk-producing nations around the world, is experiencing some negative impact from the pandemic in the short term, but generally enjoys a beneficial external (market) environment. That is to say, Japan’s dairy product consumption (milk equivalent basis) has remained stable since FY2000, at about 12 million tons per year. With domestic production (milk equivalent basis) contracting from 7.5 million tons in FY2011 to 7.4 million tons in FY2020, for a CAGR of -0.1%*, Japan has become increasingly reliant on imports (import weighting of 42.7% in FY2020, up from 34.6% in FY2011) in order to meet consistently high demand. Japan’s dairy product import volume (milk equivalent basis) has risen from 4.0 million tons in FY2011 to 5.0 million tons in FY2020, for a CAGR of 3.5%.

* The number of dairy farming households in Japan peaked at 418,000 in 1963, and by 2021 had dropped to only 13,800, largely due to aging dairy farmers exiting the industry without successors. Similarly, the total number of dairy cows in Japan declined from 2,111,000 in 1985 to 1,323,000 in 2017, before logging modest increases to 1,328,000 in 2018, 1,332,000 in 2019, 1,352,000 in 2020, and 1,356,000 in 2021. (Source: *Statistics on Livestock*, Ministry of Agriculture, Forestry and Fisheries.)

Japan's dairy product consumption ('000 tons, milk equivalent basis)



Source: Shared Research based on Ministry of Agriculture, Forestry and Fisheries’ Food Balance Sheet
 Note: For the sake of convenience, consumption is defined as the total of domestic production and import volume. In reality, domestic consumption is this sum less export volume, also taking into account changes in inventory. However, the difference is negligible.

Countries of origin for Japan's dairy product imports

According to the Ministry of Finance's Trade Statistics of Japan, in 2020 the nation's dairy product import volume (solid content basis) rose 1.9% YoY to 413,444 tons (0.09 of milk equivalent), while the value of dairy product imports rose 1.2% to JPY173,528mn (see table below). While whey imports were up 6.7% YoY and cheese and curd imports were up 4.4% on a volume basis, there were declines of 57.1% YoY for fermented dairy products, 19.2% YoY for butter, 16.7% YoY for milk and cream, and 8.8% for powdered milk. The three main countries of origin for dairy imports are Australia (source of the largest volume of cheese), New Zealand (source of the largest volume of butter), and the US (source of the largest volume of whey and powdered milk). Japan also imports dairy products from European nations including the Netherlands, Germany, Denmark, France, and Italy. According to the company, the above list also covers the main countries of origin for Lacto Japan's imports.

Volumes and prices of Japan's dairy product imports (2021)

(tons)	Imports	By category					
		Milk and cream	Powdered milk	Fermented dairy products	Whey	Butter	Cheese and curd
Total	336,821	132	25,812	17	44,428	11,460	254,972
Value (JPYmn)	148,567	63	8,489	24	9,658	6,496	123,836
Unit price (JPY/kg)	441	479	329	1,428	217	567	486
Three main countries	212,101	2	19,184	6	24,604	8,380	159,924
Australia	71,003	-	5,133	-	4,557	76	61,236
New Zealand	80,910	2	7,838	4	4,947	8,171	59,947
US	60,188	-	6,212	2	15,100	133	38,740
Share of the three	63.0%	1.5%	74.3%	38.0%	55.4%	73.1%	62.7%
Europe	114,290	84	6,307	10	11,770	2,994	93,125
Netherlands	12,677	-	1,221	2	2,793	907	33,936
Germany	11,992	61	582	2	5,887	170	25,526
Denmark	38,858	-	54	-	90	5	18,133
France	18,282	5	4,112	0	1,574	1,911	5,075
Italy	32,228	-	110	-	1,425	2	10,455
South America	3,366	34	19	-	1,440	25	1,848
Argentina	3,312	-	-	-	1,440	25	1,848
Brazil	53	34	19	-	-	-	-
Asia, other	7,064	12	302	-	6,614	60	76

Source: Shared Research based on Ministry of Finance's Trade Statistics of Japan (figures rounded to the nearest millions of yen). Figures for January–November 2021 are final, while those for December are preliminary. Note: Figures above show sums for items covered under HS codes 0401 to 0406

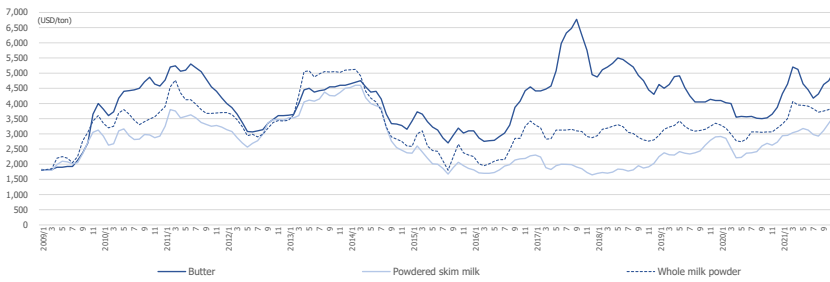
International market

International market prices for dairy products are mostly holding steady after a period of increase that occurred in mid-2016. Market conditions were bearish until the first half of 2016, but prices began trending upward in the latter half of 2016 as an adjustment to global supply and demand came to an end. Prices fell again during the latter half of 2017, but were generally stable at low levels from 2018 to 2020, making for a favorable environment from the perspective of buyers. Prices rose again in 2021 due to lower milk production in major producing nations, a sharp increase in demand as the impact of the pandemic began to subside, and disruption in global logistics.

Butter prices rose sharply between 2016 and the middle of 2017 in response to growing worldwide demand for natural foods, but then fell after that, remaining on a downtrend through early spring 2020 with the exception of short upswings that extended into early summer in 2018 and 2019. Prices have been relatively flat since. Skim milk powder prices have been on an uptrend since the second half of 2018 and especially in 2019 following the elimination of Europe's skim milk powder inventory. In 2021, prices fell going into summer due to the pandemic, but rose sharply from October through the end of the year due to a rapid increase in demand as people became inured to COVID-19, which seemed

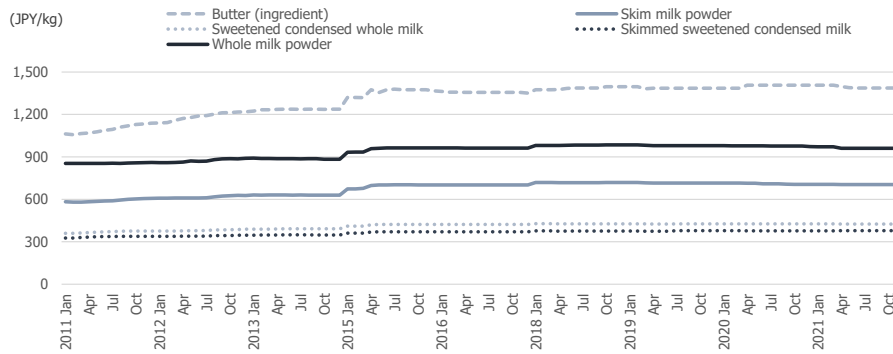
to be moving into an endemic stage.

International dairy product prices (USD/ton)



Source: Shared Research based on Japan Dairy Association (J-Milk) data (referencing original data from ALIC)
 Note: Prices are simple averages of highs and lows (FOB, Western European ports)

Domestic selling prices of designated dairy products for big users (JPY/kg)

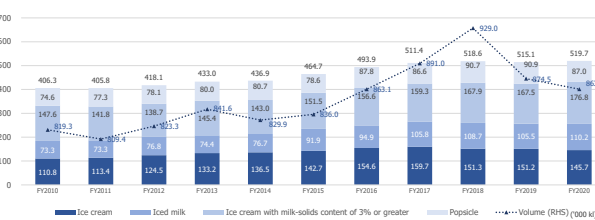


Source: Ministry of Agriculture, Forestry and Fisheries' data on Price Survey on Major Foods

Demand for main users' products

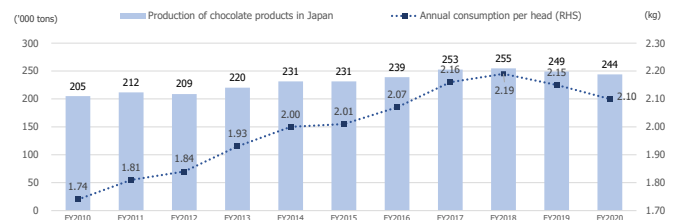
Through late 2019 before COVID-19 first reared its head, domestic demand for dairy ingredients continued to rise thanks to generally steady growth in sales of major products made by dairy product and confectionery manufacturers. Domestic consumption of cheese continued to grow, rising from 204,535 tons in 1995 to 360,744 tons in 2020 for average annual growth of 2.3%. Imported cheese accounted for roughly 80% of that, rising from 159,345 tons in 1995 to 291,741 tons in 2020 for a CAGR of 2.4%.

Sales of ice cream and popsicles (JPYbn)



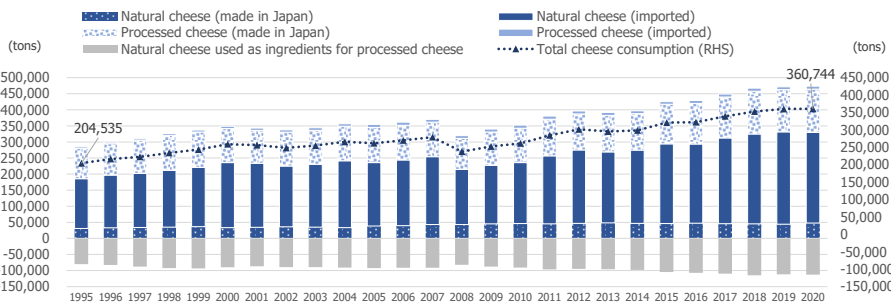
Source: Shared Research based on Japan Ice Cream Association

Domestic production of chocolate products ('000 tons)



Source: Shared Research based on Chocolate & Cocoa Association of Japan

Cheese consumption in Japan (Unit: tons)



Source: Shared Research, based on statistics from the Japan Dairy Association (J-Milk), as compiled in the Survey of Cow Milk and Dairy Product Production conducted by the Livestock Industry Department of the Agricultural Production Bureau of the Ministry of Agriculture, Forestry and Fisheries

State trading system and tariff rate quota for dairy products

State trading system

In Japan, designated dairy products,* such as skim milk powder, butter, and whey, are subject to a state trading system and tariff rate quota, with the Agriculture and Livestock Industries Corporation (ALIC) controlling imports. The difference between the import price and the wholesale price is retained by ALIC to fund subsidies for domestic dairy farmers. Butter and skim milk powder can be easily reconstituted to manufacture virtually all milk and dairy products. The government took the big-picture view that unregulated imports of butter and skim milk powder could adversely affect domestic supply-demand for all dairy products, including drinking milk, and accordingly opted for a state trading system. In conducting its state trading activities, ALIC uses two systems of tendering: general tender** and SBS (simultaneous buy and sell) tender.***

*In the Uruguay Round of the General Agreement on Tariffs and Trade (GATT), Japan committed to import purchases for designated dairy products of up to 137,000 tons annually (in milk equivalent calculation).

** The state (ALIC) buys products in an import tender, then temporarily holds these products as stockpile before offering them to users via sell tender.

***Under this system, shortlisted import agents (sellers) and domestic users (buyers) can pair up and make a joint bid. The state (ALIC) chooses the bids that have the biggest difference between the purchase price (from the import agent) and the sales price (to internal markets), retaining the difference between the prices as a mark-up (e.g., JPY949/kg for butter as of April 1, 2018). The state (ALIC) enters into a contract of sale with the seller and the buyer, simultaneously buying from the former and selling to the latter.

* While there is some variation between fiscal years, Lacto Japan more often participates in SBS tenders (in roughly 60% of cases). In FY11/19, wholesaling to ALIC accounted for 7.3% of total sales in the dairy ingredients and cheese business.

Tariff rate quota system

Under the tariff rate quota system, no tariff or a reduced tariff (the primary tariff rate) is applied to imports of below a certain quantity, to ensure that imported products are available to users at lower prices. Imports above that quota limit are subject to a higher tariff (the secondary tariff rate),* in order to protect domestic producers.

The in-quota tariff rate (primary tariff rate) is 25% for skim milk powder, 35% for butter, 25% for whey (35% for whey containing added sugar), and 25% for unsweetened condensed milk. The out-of-quota tariff (secondary tariff rate) is 21.3% + JPY396/kg for skim milk powder, 29.8% + JPY985/kg for butter, 29.8% + JPY425/kg (or JPY687/kg) for whey, and 21.3% + JPY254/kg (or 25.5% + JPY509/kg) for unsweetened condensed milk. Tariffs of zero within the quota apply for whey and skim milk powder for use in animal feed. There are no quotas for imported cheese, where the tariff rate is 29.8% for natural cheese (in some cases 26.3% or 22.4%), and 40% for processed cheese.

Impact of new trade agreements

As new trade agreements (including TPP-11 and Japan-EU EPA) go into effect with countries other than the US, Japan's import tariffs on cheese, whey, and other dairy products will come down year by year (dairy product categories under the Japan-U.S. trade agreement are the same as those for the TPP, and there is no ceiling on U.S. imports). In the case of hard cheeses like cheddar and gouda that account for much of Lacto Japan's cheese sales, the import tariff will come down from the current rate of 29.8% by 1.9pp each year until it reaches zero in 16 years. Under the Japan-EU EPA, Japan's import tariff on fresh cheese will come down by a fixed rate every year and will reach zero in 11 years; likewise, under both TPP and the Japan-EU EPA, Japan's tariff on whey will also be reduced by a fixed rate every year and will reach zero after 11 years. Imports of goods such as skim milk powder and whey will remain under the bidding system run by ALIC (Agriculture and Livestock Industries Corporation), but new import ceilings will be established for countries

participating in these trade agreements, and import tariffs will be gradually reduced to zero in 16 years. Between the new import ceilings and the steady reduction in import tariffs, Lacto Japan believes that the resulting decline in prices, coupled with promotions conducted by retailer distributors, will generate additional domestic demand for dairy products.

Japan-foreign price gap for dairy products

Whereas in the main milk-producing nations a kilogram of butter retails for approximately USD8, in Japan the price is about USD19. In large part, this is because the producer's price for a kilogram of raw milk is around USD35–40 in the main milk-producing nations, but in Japan it is a much higher USD93 or so (Source: Japan Dairy Industry Association, "Japan Dairy Yearbook 2020 Edition").

Impact of exchange rates

To understand how forex affects revenue and profit at Lacto Japan, it is necessary first to gain an understanding of accounting standards for foreign currency transactions and accounting standards for financial instruments (hedge accounting rules). We use the following hypothetical transaction to illustrate the effects of forex.

Hypothetical transaction: On October 31, 20XX, Lacto Japan inks a USD10,400 sales contract (sales: USD10,400 x USD/JPY98 = JPY1,019,200) with Japanese dairy company A. At the same time, it enters into a USD10,000 forward exchange contract (settlement date: February 28, 20X1) with a bank to hedge the forex risk associated with the USD-denominated import transaction (scheduled for December 31, 20XX), for which the settlement of accounts payable is slated for February 28, 20X1. Lacto Japan applies separate accounting treatment* for the foreign currency-denominated transaction. The forward exchange contract satisfies the accounting standards for financial instruments (hedge accounting). The effective tax rate is 40%.

*Separate accounting treatment of the foreign currency-denominated transaction that is being hedged, and the forward exchange contract used as a hedging device. Hedge accounting is an exceptional accounting treatment to recognize the gains or losses on a hedging instrument in the same period as the gains or losses on the hedged exposure.

[Forward exchange contract]

Buy USD10,000 (contract date October 31, 20XX; settlement date February 28, 20X1)

[Forex assumptions] (yen depreciation)

JPY per USD		Spot rate (SR)	Forward rate (FR)
As of transaction contract = at foreign exchange forward contract	(Oct. 31, 20xx)	98	95
As of settlement	(Nov. 30, 20xx)	99	96
As of shipping = at booking of purchase	(Dec. 31, 20xx)	100	97
As of payment for the purchase	(Feb. 28, 20x1)	104	-

Note: Difference between SR and FR set at JPY3/USD for the sake of convenience (not on the basis of detailed calculations)

[Transaction in foreign currency (deferred hedging): rundown of accounting process]

Transaction in foreign currency (deferred hedging): accounting process			
Forward exchange contract date (Oct. 31, 20xx)	No journal entry		
Settlement (Nov. 30, 20xx)	< Market-value evaluation of forward exchange contract >		
	Debit: Forward exchange contract	10,000 (*1)	Credit: Deferred tax liability
			4,000 (*2)
			Deferred hedge gain (loss)
			6,000
	*1 (FR on settlement date [96] - FR on contract date [95]) x USD10,000		
	*2 USD10,000 x effective tax rate [40%]		
	Trial balance after settlement		
	Forward exchange contract	10,000	Deferred tax liability
			4,000
			Deferred hedge gain (loss)
			6,000
Purchase (Dec. 31, 20xx)	① Debit: Purchase	1,000,000	Credit: Accounts payable
			1,000,000 (*3)
	② Debit: Forward exchange contract	10,000 (*4)	Credit: Deferred tax liability
			4,000
			Deferred hedge gain (loss)
			6,000
	③ Debit: Deferred tax liability	8,000	Credit: Forward exchange contract
			20,000
			Deferred hedge gain (loss)
			12,000
	*3 SR on purchase date [100] x USD10,000		
	*4 (FR on purchase date [97] - FR on settlement date [96]) x USD10,000		
Payment for the purchase (Feb. 28, 20x1)	① Debit: Accounts payable	1,000,000	Credit: Cash and deposits
			104,000 (*5)
			Gain (loss) on forex
			40,000
	② Debit: Cash and deposits	90,000 (*6)	Credit: Gain (loss) on forex
			90,000
	*5 SR on date of payment for the purchase [104] x USD10,000		
	*6 (SR on forward contract settlement date [104] - FR on contract date [95]) x USD10,000		
Sales (Mar. 15, 20x1)	Debit: Accounts receivable	1,019,200	Credit: Sales
			1,019,200
Summary of a series of transaction (Income statement assuming the whole process took place within the same fiscal year)	Sales	1,019,200	
	CoGS	1,000,000	
	Gross profit	19,200	
	Gain (loss) on forex	50,000	
	Profit	69,200	
* SG&A expenses are ignored in this example	* CoGS [950,000] is excluded from sales (based on contract date FR)		
	The profit above equals the actual profit of JPY69,200		
Summary of a series of transaction (Cash out from the purchase)	Settlement of accounts payable	-1,040,000	
	Net settlement on foreign exchange	90,000	
	Balance	-950,000	

Source: Shared Research

Note: Journal entry ③ at time of transaction (account item on credit side) is based on Lacto Japan's actual practice.

[Main point]

In the simulation above, the forward exchange contract ensures that actual profit (gross profit adjusted for forex gains/losses) remains fixed at JPY69,200, regardless of exchange rate movements. In short, the actual cost of sales remains fixed at JPY950,000 (based on the forward rate agreed upon for the settlement date).

By thus entering into a forward exchange contract with a financial institution* whenever it signs a sales contract, Lacto Japan determines the actual profit (gross profit adjusted for forex gains/losses) at the time of the sales contract. In other words, foreign exchange movements have no impact on an actual profit basis once the sales contract is signed. That said, yen depreciation is preferable from the standpoint of the sales amount determined at the time the sales contract is signed, and the commission on that amount (while this is disadvantageous from the perspective of price competition with domestically produced ingredients, the reality is that customers are being forced to import because domestic production is insufficient to meet their needs). There is usually a four- to six-month lag between the signing of the sales contract and the booking of sales.

* Lacto Japan's policy is not to bet on currency markets. Even when the yen is expected to strengthen it enters into forward exchange contracts to buy US dollars, etc. (in short, every sales contract is accompanied by a forward exchange contract, without exception).

Competitive landscape

Aside from the relevant business units of large general trading companies, other dairy product trading companies tend to be small or midsized (see the earlier section on "Lacto Japan's defining characteristics" for a discussion of how the company differs from its competition).

- Large general trading companies (relevant business units): Mitsubishi Corporation (TSE1: 8058), Mitsui & Co. (TSE1: 8031), and Itochu Corporation (TSE1: 8001)
- Specialist food trading company: Shoen Foods (TSE2: 8079)

Comparison with competitors (listed companies)

Ticker	Company	Fiscal year		Sales (revenue) (JPYmn)	Ordinary income (pre-tax profit) (JPYmn)	% of sales (revenue)	ROA (based on OI or pre-tax profit)	ROE	Equity ratio
8058	Mitsubishi Corp.	FY03/21	IFRS	12,884,521	253,527	2.0%	0.9%	3.2%	30.1%
8001	Itochu Corp.	FY03/21	IFRS	10,362,628	512,475	4.9%	3.6%	12.7%	29.7%
8031	Mitsui & Co.	FY03/21	IFRS	8,010,235	450,202	5.6%	2.8%	8.0%	36.5%
3139	Lacto Japan	FY11/21	Cons.	110,884	2,682	2.4%	5.6%	10.6%	36.9%
8079	Shoei Foods	FY10/21	Cons.	96,631	4,279	4.4%	3.6%	6.7%	55.5%
	Average			6,292,980	244,633	3.9%	3.3%	8.2%	37.7%

Source: Shared Research based on company data

Earnings

FY11/22: Company expects commercial demand to return steadily as pandemic impact subsides, boosting ordinary income 8.1% YoY

FY11/21 results

Summary

For FY11/21, Lacto Japan reported sales of JPY110.9bn (+0.0% YoY), operating profit of JPY2.8bn (-5.8% YoY), ordinary income of JPY2.7bn (-3.6% YoY), and net income attributable to parent company shareholders of JPY2.0bn (-5.0% YoY). Commercial demand stagnated throughout the year due to the pandemic, and domestic skim milk powder inventory remained high, leading to declines in tenders and in sales to major dairy companies. This was offset by sales of domestically produced dairy ingredients and imported ingredients taking advantage of low tariff quotas, and overall sales remained essentially flat YoY, falling 3.6% short of the company's revised forecast. Although Lacto Japan handled more high-margin products in 1H, gross profit declined in 2H due to a sharp rise in international dairy ingredient prices and higher distribution costs, causing ordinary income to fall 4.6% short of plan, down 3.6% YoY. However, taking into account foreign exchange rates, profit increased slightly in real terms.

Sales

Although sales volume was weak, sales were essentially flat YoY due mainly to higher international market prices for dairy products.

- ▶ In Dairy Ingredients and Cheese, demand for commercial dairy products stagnated as people refrained from going out because of the pandemic, and domestic dairy product inventory remained high, leading to declines in tenders and in sales to major dairy companies. Sales of domestically produced dairy ingredients and imported ingredients taking advantage of low tariff quotas helped to compensate, and sales for the business fell just 2.4% YoY.
- ▶ In Meat Products, sales rose 20% YoY with robust pork sales and growth in sales of new products such as beef.
- ▶ In the Asian Business, sales of dairy ingredients declined 7.5% YoY due to lower sales in Japan, but the cheese manufacturing and sales business set records for both sales and sales volume on enhancements to production and sales systems, with sales rising 14.8% YoY.

Ordinary income

Ordinary income fell 3.6% YoY. Although GPM improved in 1H due to solid performance in the high-margin cheese manufacturing and sales business in Asia, international market prices for dairy ingredients rose sharply in 2H, and logistics costs increased due to container shortages, rising fuel costs, and a shift to air transport in response to shipping delays. In addition, the company incurred one-time expenses related to quality complaints

FY11/21 results:

Sales flat YoY, ordinary income down 3.6%

and other factors, which weighed on profit.

- ▶ Forex fluctuations had a negative impact of JPY77mn on ordinary income during FY11/21. Factoring in this impact, ordinary income would have been JPY2.8bn, a slight increase of 0.3% YoY versus similarly adjusted ordinary income in FY11/20.
- ▶ Some of Lacto Japan's income is proportional to sales prices and some is proportional to volume. A decade or so ago, most of the company's income fit the first description, but now there is a fairly equal division between the two. In short, the actual value of sales now has less impact on income than was the case 10 years ago. Note that Lacto Japan considers sales volume an important KPI.

Earnings by business

- ▶ **Dairy Ingredients and Cheese:** Sales of JPY76.5bn were down 2.4% YoY. Sales volume fell 3.8% YoY to 184,358 tons.

Both sales and sales volume were sluggish throughout the year due to the pandemic. In the global market, demand began to return as restaurants and other businesses resumed operations in areas where the number of COVID-19 cases declined. Logistics disruption and sluggish milk production caused an imbalance in supply and demand. As a result, international market prices continued trending upward. In Japan, demand for dairy products, especially for commercial use, remained sluggish due to inclement weather during the summer, when demand typically increases. At the same time, the government's tender volume decreased due to the ongoing surplus of dairy ingredient inventory in light of strong domestic raw milk production, which also led to some imported ingredients being replaced with domestic ones. However, sales and sales volume were supported by taking advantage of free trade agreement quotas, including those under TPP and Japan-EU EPA, and by increasing handling of domestically produced ingredients through active participation in government and industry measures to deal with surplus inventory, developing new domestic customers, and conducting export business to Asia.

By customer category, Lacto Japan logged robust sales to feed manufacturers, which increased their sales of domestically produced ingredients, and to beverage manufacturers.

- ▶ **Meat Products:** Sales of JPY14.3bn were up 20.0% YoY. Sales volume rose 17.2% YoY to 25,699 tons.

In the imported pork business, both sales and sales volume increased YoY on strong sales of mainstay chilled pork and processed ingredients for ham and sausage manufacturers, backed by stable demand for home consumption. On the other hand, profit was soft due to delays in the supply of some products arising from labor shortages at the production plants of major suppliers in the US, and to rising procurement-related costs such as logistics expenses.

Sales of meat products including dry-cured ham and salami were sluggish due to weak demand from restaurants amid the pandemic. Meanwhile, strong sales of beef and honey, which began in earnest in FY11/20, contributed to overall sales.

- ▶ **Asian Business and Other:** Sales were JPY20.1bn, down 2.4% YoY.
 - Sales of dairy ingredients were JPY15.8bn, down 7.5% YoY. Sales volume declined 20.5% YoY to 47,817 tons. Despite the acquisition of new business and expanded transactions with existing customers, sales of ingredients for dairy products destined for Japan declined because inventory of domestically produced dairy ingredients remained high in Japan. Part of the declines in sales and sales volume

included the impact of postponed delivery due to shipping delays.

- Sales in cheese manufacturing were JPY3.3bn, up 14.8% YoY. Sales volume increased 10.4% YoY to 4,635 tons. Sales to the restaurant industry were sluggish due to lockdowns in Thailand and Malaysia in July and August. However, despite the impact of lockdowns during the summer, sales increased for the year because the company won new business from manufacturers seeking ingredients for products for home consumption and export. In 2H, while cheese was in short supply in Asian countries due to shipping delays caused by the global shipping container shortage, the company increased sales by expanding production capacity at its Singapore plant. Despite the impact of the pandemic, the cheese manufacturing and sales business achieved record highs for both sales and sales volume.
- In the Other business, the company conducted sales activities in earnest for functional food ingredients, and sales of whey protein ingredients grew especially in the sports nutrition field. The market for plant-derived ingredients is also gradually expanding, and Lacto Japan is focusing on new product development.

Company forecast for FY11/22

Summary

For FY11/22, Lacto Japan forecasts sales of JPY126.0bn (+13.6% YoY), ordinary income of JPY2.9bn (+8.1% YoY), and net income attributable to parent company shareholders of JPY2.1bn (+7.2% YoY). By business, the company assumes sales volumes will rise 3.1% for Dairy Ingredients and Cheese (see below for details, same hereafter), 10.1% for Meat Products, 4.6% for dairy ingredient sales in the Asian Business, and 7.9% for cheese manufacturing and sales in the Asian Business.

Company forecasts for FY11/22:
sales up 13.6%, ordinary income up 8.1%

Business environment

- ▶ Lacto Japan expects the surplus of domestically produced inventory to continue affecting its domestic operations, but believes that demand for imported ingredients will begin to recover as commercial demand recovers.
 - As the impact of the pandemic subsides, commercial demand is likely to see gradual recovery.
 - Of domestic dairy ingredients, while adjustment to skim milk powder inventory will take time, the company expects butter inventory to achieve appropriate levels.
 - The company expects measures to alleviate domestic dairy ingredient supply and demand discrepancy to continue, accompanied by a new measure initiated in FY2022 by dairy farmers, the dairy industry, and the government to reduce skim milk powder inventory by 25,000 tons.
 - The company expects international market prices for dairy products to remain high for the time being due to a rapid increase in demand as the impact of the pandemic subsides, along with logistics disruption and rising costs for dairy farmers, such as feed and energy prices.
- ▶ In the Asia market, Lacto Japan expects relatively rapid economic recovery, despite lingering concerns regarding the COVID-19 pandemic.
 - In China and ASEAN member nations, it expects recovery in commercial demand on top of demand for home consumption.

Company response to surplus domestic inventory of skim milk powder

- ▶ In the past, when there was surplus domestic skim milk powder inventory, industry groups have taken measures to balance supply and demand, with the effects of such measures steadily appearing from the next fiscal year. For example, according to research by the company, when it was estimated that there was domestic skim milk powder inventory of about 93,200 tons in FY2003, measures to balance supply and demand reduced the inventory by some 22,100 tons in FY2004, so that by end-FY2004 inventory was estimated to be 88,000 tons (-5.6% YoY). Thereafter, ongoing measures caused estimated domestic skim milk powder inventory to fall by 14.4% YoY as of end-FY2005 and 9.3% YoY as of end-FY2006. When the estimated inventory grew again as of end-FY2009, relief measures were implemented again, lowering estimated inventory by 15.8% as of end-FY2010.
- ▶ As a measure to improve the supply and demand balance for domestic skim milk powder inventory against the backdrop of the pandemic, the government budgeted approximately JPY6.7bn in FY2020 to promote sales for animal feed, and in FY2021 the Hokuren Federation of Agricultural Cooperatives announced a JPY10.0bn budget to promote sales of domestically produced dairy products.
- ▶ Lacto Japan also aggressively sells domestic skim milk powder when there is surplus inventory in Japan. Ordinarily, except for ingredients supplied to some dairy product manufacturers, it would not handle domestically produced skim milk powder, which is more expensive, because users are more interested in competitively priced imports. However, domestic skim milk powder becomes more competitive when subsidies are applied, so in response to surplus inventory the company actively sells domestic skim milk powder as an industry leader. It promotes the sale of surplus domestic skim milk powder held by customers through its existing sales channels or newly developed channels.
 - Short-term benefit to Lacto Japan: The aforementioned efforts can help the company offset a decline in imported ingredient sales and contribute to resolving surplus inventory quickly.
- ▶ Such response can lead to the development of new customers in the medium and long term and, once the surplus inventory of domestic skim milk powder is cleared, to sales of imported ingredients, which can be procured at stable, low prices. The company cooperates with dairy product manufacturers holding domestic skim milk powder inventory to resolve their surplus inventory. Once that is achieved, many of those manufacturers will consult with the company about new ingredients and businesses.
 - Medium- to long-term benefit to Lacto Japan: The aforementioned efforts can help the company develop new customers and strengthen relationships with dairy product manufacturers.

Forecasts by business

- ✔ **Dairy Ingredients and Cheese:** Lacto Japan projects a 11.1% YoY increase in sales to JPY85.0bn, assuming a 3.1% rise in sales volume to 190,000 tons.
- ✔ **Meat Products:** Lacto Japan forecasts a 5.1% YoY increase in sales to JPY15.0bn, assuming a 10.1% increase in sales volume to 28,300 tons.
- ✔ **Asian Business:** Lacto Japan projects a 14.3% YoY increase in sales of dairy

ingredients to JPY18.0bn and a 9.8% increase in sales from the manufacture and sale of cheese to JPY3.7bn, assuming a 4.6% increase to 50,000 tons in sales volume for dairy ingredients and a 7.9% increase to 5,000 tons in sales volume for cheese manufacturing.

- **Other:** Lacto Japan expects a 316.7% YoY increase in sales to JPY4.4bn.

Business plan

Dairy Ingredients and Cheese

- ▶ Lacto Japan aims to increase sales by taking advantage of free trade agreement quotas, including those under TPP and Japan-EU EPA, for the products it handles and by expanding sales of newly developed products. It will also actively sell domestic ingredients to maintain sales and sales volume levels and contribute to the disposition of surplus domestically produced inventory. It will promote the export business launched in FY11/21 for domestically produced dairy products using its sales network for the Asian region. In Hong Kong and Taiwan, Japanese dairy products are valued for their quality, and the company aims to develop the ASEAN and China markets, where the number of health-conscious middle-class and wealthy individuals is rapidly growing.
- ▶ In the medium term, the company forecasts that domestic companies will continue shifting to imported dairy products in response to the ongoing decline in domestic milk production. Milk prices in Japan are already much higher than in other developed countries*¹ but continue to rise*², while imported dairy ingredients are quite competitive in terms of pricing.
- ▶ As the aforementioned new trade agreements (including TPP, Japan-EU EPA, and the Japan-US trade agreement) go into effect, however, there is a good chance that growth in imports of low-cost dairy products will pick up markedly.

*¹ Average 2018 milk prices per 100kg in major milk-producing countries were JPY4,423 in New Zealand, JPY4,215 in the 28 countries that comprise the European Union, and JPY3,930 in the US, compared with JPY10,310 in Japan. (Source: Japan Dairy Association (J-Milk) based on data from the Japanese National Committee of International Dairy Federation)

*² According to the Hokuren Federation of Agricultural Cooperatives, which sets the price for the roughly 80% of milk produced in Hokkaido that is used in food processing, in FY2019, the price of milk was to increase by JPY4 per kilogram (not including tax). There would also be an increase in prices for specific types of milk: in the case of milk used for drinking, prices would go up 3.4%; in the case of milk used in yogurt, prices would go up 4.6%; and in the case of milk suitable for other uses, prices would go up 4.2%. This represented the first increase in the price of milk used for drinking in four years. Hokkaido milk producers had also set their sights on raising prices for milk used to produce butter, powdered skim milk, and other dairy products, but encountered strong pushback from dairy product manufacturers and ended up leaving these prices where they were. It was announced on March 23, 2021, that prices for all types of milk would be left unchanged for FY2020 and FY2021.

Meat Products

- ▶ In pork imports, Lacto Japan aims to increase sales by promoting product branding in collaboration with suppliers. In addition, it will promote efforts to develop new suppliers beyond the US (North America), Canada, and Europe, while keeping a close watch on the external environment (shipping schedules and trends in other countries).
- ▶ In the domestic meat market, pork imports are on the rise thanks to higher quality and increased consumer recognition. Of an estimated 1,827,000 tons of pork (+0.9% YoY; CAGR of 1.0% over the past 10 years) on the Japanese market in FY2020, imports

accounted for 884,000 tons (-7.3% YoY; CAGR of 2.5%) and domestically produced pork 917,000 tons (+1.5% YoY; CAGR of -0.2%). (FY2017 was the first year that the volume of pork imports exceeded the volume of domestically produced pork on the Japanese market.)

- ▶ According to supply and demand statistics from Japan's Ministry of Agriculture, Forestry and Fisheries, annual per capita consumption of pork in Japan rose from 10.6kg in 2000 to 12.9kg in 2020. OECD statistics for meat consumption put per capita pork consumption in Japan at 16.1kg in 2020. Either way, per capita consumption of pork is much higher in the US and the European Union (34.3kg), China (22.7kg), and South Korea (31.6kg) than it is in Japan. As these international comparisons suggest that pork consumption in Japan is likely to continue rising in the years ahead, the company intends to focus on cultivating and securing new sources of supply in pursuit of growth.
- ▶ It will steadily expand sales of products other than its mainstay pork (to include beef, beef products, and honey), diversifying its product lineup.
- ▶ Lacto Japan procures much of its chilled and frozen pork from the US, and it believes the 2020 start of the US-Japan Trade Agreement (USJTA) will enhance its price competitiveness. With respect to pork tariffs*1, under the USJTA the ad valorem tariff ((3) in the box below) is to be eliminated progressively (reduced from 4.3% before the USJTA was enacted to 1.9% in the first year and zero in the ninth year), while the specific duty ((1) in the box below) is to be reduced progressively from JPY482/kg before (JPY361/kg for carcass meat) to JPY50/kg (JPY37.5/kg) in the ninth year (as in the TPP).

*1 Tariff structure for pork: Pork imports are subject to one of three tariff rates depending on dutiable value, as indicated below. The tariff bill is lowest for pork valued at the gate price of JPY524/kg (at JPY23/kg before USJTA implementation, to be reduced to zero in the final year of tariff reductions).

Before enactment of USJTA

1. When the value per kilogram of the imported pork is below the administratively set minimum price of JPY64.53/kg: specific duty of JPY482/kg applied
2. When the value per kilogram of the imported pork is below the gate price of JPY524/kg but above the minimum price of JPY64.53/kg: tariff applied is equal to gap between JPY524/kg (the standard import price) and the import value per kilogram
3. When the value per kilogram of the imported pork equals or exceeds the gate price: ad valorem duty of 4.3% applied

In final year of tariff reductions

- When the value per kilogram of the imported pork is below the administratively set minimum price of JPY474/kg: specific duty of JPY50/kg applied
- When the value per kilogram of the imported pork is below the gate price of JPY524/kg but above the administratively set minimum price of JPY474/kg: tariff applied is equal to gap between JPY524/kg (the standard import price) and the import value per kilogram
- When the value per kilogram of the imported pork equals or exceeds the gate price of JPY524/kg: no duty is applied

Asian Business and Other

- ▶ Dairy ingredient sales: Lacto Japan believes domestic skim milk powder inventory will remain high in FY11/22, and is concerned about the impact on the sale of ingredients for dairy products for the Japan market. It also expects international market prices for dairy products to remain high, suggesting there may be a temporary impact on dairy product consumption in the Asia market, which is particularly sensitive to pricing. The company aims to maintain or even expand its market share by maximizing the use of

its global network to procure from price-competitive regions, and by proposing alternative products that can help reduce costs. It will further strengthen the sales structure of local subsidiaries in the various countries where it does business to increase sales by meeting the specific needs of each region.

- ▶ Cheese manufacturing and sales: Prices have been rising for natural cheese as the main ingredient and for secondary ingredients and packaging. To avoid any decline in competitiveness that might come from raising its selling prices, Lacto Japan will strive to reduce ingredient prices by developing new suppliers and its own products. It also plans to develop diced cheese that is cheaper than conventional products and propose it as a cost-cutting measure with the aim of expanding sales volume through ongoing use. In addition, it plans to develop its own brand of vegan cheese for launch in Asia, along with several other new products in the second half of FY11/22 and in FY11/23.
- ▶ Functional food ingredients: Lacto Japan intends to enhance sales to the sports nutrition industry in particular, developing new customers and expanding sales through cross-selling to existing customers in coordination with the business development and dairy ingredients divisions. As the price of whey protein ingredients continues to rise with increased global demand, the company will work to ensure a stable supply of its price-competitive products. It also intends to expand its lineup of new products made from plant- and insect-derived ingredients, which are attracting attention as alternatives to dairy-derived proteins, through collaboration with domestic food product manufacturers. It will look into eventually exporting to the Asia market.

Earnings by business category

Earnings by business category												
(JPYmn)	FY11/12	FY11/13	FY11/14	FY11/15	FY11/16	FY11/17	FY11/18	FY11/19	FY11/20	FY11/21	FY11/22	FY11/24
	Parent	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons. Est.	Cons. Est.
Sales	55,201	75,943	96,550	98,001	88,679	101,335	115,441	116,794	110,838	110,884	126,000	150,000
YoY	-1.6%	37.6%	27.1%	1.5%	-9.5%	14.3%	13.9%	1.2%	-5.1%	0.0%	13.6%	10.6%*
< Sales by category >												
Dairy Ingredients and Cheese	-	47,899	63,978	69,047	60,543	70,019	85,290	85,206	78,330	76,481	85,000	96,000
YoY	-	-	33.6%	7.9%	-12.3%	15.7%	21.8%	-0.1%	-8.1%	-2.4%	11.1%	7.9%*
% of sales	-	63.1%	66.3%	70.5%	68.3%	69.1%	73.9%	73.0%	70.7%	69.0%	67.5%	64.0%
Meat Products	-	14,971	15,673	15,449	16,338	15,253	12,576	12,280	11,895	14,278	15,000	17,000
YoY	-	-	4.7%	-1.4%	5.8%	-6.6%	-17.6%	-2.4%	-3.1%	20.0%	5.1%	6.0%*
% of sales	-	19.7%	16.2%	15.8%	18.4%	15.1%	10.9%	10.5%	10.7%	12.9%	11.9%	11.3%
Asia Business and Other	-	13,073	16,899	13,503	11,797	-	-	-	-	-	-	-
YoY	-	-	29.3%	-20.1%	-12.6%	-	-	-	-	-	-	-
% of sales	-	17.2%	17.5%	13.8%	13.3%	-	-	-	-	-	-	-
Asia Business (dairy ingredients)	-	-	-	-	-	13,348	14,578	16,026	17,025	15,754	18,000	24,000
YoY	-	-	-	-	-	-	9.2%	9.9%	6.2%	-7.5%	14.3%	15.1%*
% of sales	-	-	-	-	-	13.2%	12.6%	13.7%	15.4%	14.2%	14.3%	16.0%
Asia Business (cheese)	-	-	-	-	-	1,919	2,116	2,651	2,895	3,324	3,650	4,500
YoY	-	-	-	-	-	-	10.3%	25.3%	9.2%	14.8%	9.8%	10.6%*
% of sales	-	-	-	-	-	1.9%	1.8%	2.3%	2.6%	3.0%	2.9%	3.0%
Other	-	-	-	-	-	793	878	630	690	1,044	4,350	10,000
YoY	-	-	-	-	-	-	10.7%	-28.2%	9.5%	51.3%	316.7%	112.4%*
% of sales	-	-	-	-	-	0.8%	0.8%	0.5%	0.6%	0.9%	3.5%	6.7%
< Sales by region >												
Japan	-	62,387	79,693	84,879	77,395	85,418	98,483	97,879	90,912	-	-	-
YoY	-	-	27.7%	-	-8.8%	10.4%	15.3%	-0.6%	-7.1%	-	-	-
% of sales	-	82.1%	82.5%	86.6%	87.3%	84.3%	85.3%	83.8%	82.0%	-	-	-
Asia	-	13,142	16,824	13,083	11,270	15,911	16,945	18,866	19,879	-	-	-
YoY	-	-	28.0%	-	-13.9%	41.2%	6.5%	11.3%	5.4%	-	-	-
% of sales	-	17.3%	17.4%	13.4%	12.7%	15.7%	14.7%	16.2%	17.9%	-	-	-
Other	-	414	33	39	14	6	12	49	46	-	-	-
YoY	-	-	-92.1%	-	-63.9%	-54.8%	92.9%	300.9%	-5.8%	-	-	-
% of sales	-	0.5%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	-	-	-
Customers (over 10% of total sales)												
Yonekyu Corporation	-	10,530	10,170	-	10,235	8,823	-	-	-	-	-	-
% of sales	-	13.9%	10.5%	-	11.5%	8.7%	-	-	-	-	-	-
< Sales volume by category >												
Total sales volume (tons)	-	-	192,263	202,732	215,504	246,757	275,530	289,299	277,856	262,509	273,300	-
YoY	-	-	-	5.4%	6.3%	14.5%	11.7%	5.0%	-4.0%	-5.5%	4.1%	-
Dairy Ingredients and Cheese	113,123	122,148	129,810	141,540	148,091	172,885	198,445	204,105	191,575	184,358	190,000	-
YoY	1.3%	8.0%	6.3%	9.0%	4.6%	16.7%	14.8%	2.9%	-6.1%	-3.8%	3.1%	-
Price per ton (JPY)	-	392,136	492,861	487,827	408,823	405,003	429,792	417,462	408,874	414,850	447,368	-
YoY	-	-	25.7%	-1.0%	-16.2%	-0.9%	6.1%	-2.9%	-2.1%	1.5%	7.8%	-
Meat Products	-	-	25,809	25,010	28,029	26,349	21,595	21,532	21,925	25,699	28,300	-
YoY	-	-	-	-3.1%	12.1%	-6.0%	-18.0%	-0.3%	1.8%	17.2%	10.1%	-
Price per ton (JPY)	-	-	607,257	617,713	582,896	578,883	582,357	570,314	542,531	555,586	530,035	-
YoY	-	-	1.7%	-5.6%	-0.7%	0.6%	-2.1%	-4.9%	2.4%	-4.6%	-	-
Asia Business: dairy ingredien	-	-	34,914	34,223	37,472	45,014	52,822	59,925	60,159	47,817	50,000	-
YoY	-	-	-	-2.0%	9.5%	20.1%	17.3%	13.4%	0.4%	-20.5%	4.6%	-
Price per ton (JPY)	-	-	-	-	-	296,530	275,983	267,434	283,000	329,464	360,000	-
YoY	-	-	-	-	-	-	-6.9%	-3.1%	5.8%	16.4%	9.3%	-
Asia Business: cheese	-	-	1,730	1,959	1,912	2,509	2,668	3,737	4,197	4,635	5,000	-
YoY	-	-	-	13.2%	-2.4%	31.2%	6.3%	40.1%	12.3%	10.4%	7.9%	-
Price per ton (JPY)	-	-	-	-	-	764,847	793,103	709,393	689,778	717,152	730,000	-
YoY	-	-	-	-	-	-	3.7%	-10.6%	-2.8%	4.0%	1.8%	-

Source: Shared Research based on company data

* Note: Represents compound average annual growth rate from FY11/21 through FY11/24 (company forecast)

** Figures rounded to the nearest million yen (amounts less than JPY1mn are rounded down in materials released by the company).

Medium-term strategy

Aiming for sustainable growth by evolving existing businesses, expanding the Asian Business, and building next-generation businesses

Medium-term strategy

Rolling approach

The company says it will revise targets annually, producing a rolling medium-term plan in order to respond flexibly to changes in the operating environment. On January 14, 2022, it rolled over the targets of its NEXT-LJ2023 (covering FY11/21–FY11/23) and announced NEXT-LJ2024 (covering FY11/22–FY11/24).

Summary

Under its NEXT-LJ2024 medium-term business plan, the company is targeting FY11/24 sales of JPY150.0bn (+35.3% vs FY11/21), ordinary income of JPY3.9bn (+45.4%), and net income attributable to parent company shareholders of JPY2.9bn (+45.5%). The target figures assume increased sales via increased handling volume, rising contributions to earnings from overseas businesses, and expansion of new businesses to support the group in the future.

Numerical targets of current medium-term business plan, NEXT-LJ2024

(JPYmn)	FY11/19	FY11/20	FY11/21	FY11/22	FY11/24
	Act.	Act.	Act.	Est.	Est.
Sales	116,794	110,838	110,884	126,000	150,000
Ordinary income	2,747	2,781	2,682	2,900	3,900
Profit margin	2.4%	2.5%	2.4%	2.3%	2.6%
Net income	1,963	2,062	1,959	2,100	2,850
Net margin	1.7%	1.9%	1.8%	1.7%	1.9%

Source: Shared Research based on company data

Business climate

Taking into account the impact of the pandemic, the company's sense of the business climate and its earnings forecast assumptions are as follows. As needed, it intends to review the order of priority and implementation methods for its various initiatives for the Japan and Asia markets.

- ▶ View of overall climate
 - Lacto Japan expects rapid growth in demand as the impact of the pandemic subsides, accompanied by a sharp rise in ingredient prices.
 - It anticipates rising transport costs due to soaring energy prices.
 - It projects increasing demand for functional ingredients with "health" as a keyword.
- ▶ Japan market
 - Lacto Japan expects recovery in demand for imported dairy products due to recovery in commercial demand.
 - In terms of domestic dairy production, while it expects Hokkaido to remain firm, it believes the number of dairy cows will decline nationwide.
- ▶ Asia market
 - Lacto Japan expects demand for dairy products to grow in China.
 - It expects demand for commercial dairy products to expand as tourism recovers.
 - It anticipates ongoing westernization of food culture.

Medium-term strategy

- ▶ Targeting sales of JPY150.0bn in FY11/24 (+35.3% vs. FY11/21 result)
- ▶ Ordinary income target of JPY3.9bn (+45.4%)
- ▶ Premised on sales growth driven by increased handling volume, and higher profit contribution from overseas business (Asia)
- ▶ Building next-generation businesses
- ▶ Key initiatives: (1) Grow business with existing customers and secure new customers; (2) expand business in Asia; (3) build next generation businesses; and (4) build sound foundation for sustained growth

Basic course of action: Lacto Japan intends to grow by evolving its existing customer businesses and expanding the Asian Business, and to lay a foundation for building next-generation businesses.

Its plan comprises the following three initiatives.

- Evolve existing businesses (Base)
- Expand the Asian Business (Growth)
- Build next-generation businesses (Challenge)

Key initiatives

- Evolve existing businesses

Enhance sales of imported ingredients by taking advantage of free trade agreements

Based on the company's expertise in importing dairy products, meat, and meat products that it has cultivated over many years, Lacto Japan will take advantage of trading systems enabled by TPP and Japan-EU EPA to actively propose and supply those ingredients that best meet the needs of its customers in terms of origin, cost, quality, and delivery timing.

Develop export business for Japanese dairy products

Due to the imbalance in supply and demand caused by the pandemic, surplus inventory of domestically produced dairy products, especially skim milk powder, have become a problem in Japan. In response, Lacto Japan has been actively marketing domestically produced dairy ingredients it had not handled much in the past. In FY11/21, in addition to expanding its domestic sales channels, it began export operations in earnest.

Industry associations and others are implementing measures to eliminate surplus domestic skim milk powder inventory, but it is expected to take some time for inventory to reach an appropriate level. Lacto Japan will promote the export of Japanese dairy products by developing new transactions favoring domestically produced ingredients and utilizing the sale network it has established in Southeast Asia markets.

With advances in dairy technology, Lacto Japan says there are dairy ingredients that are not produced domestically. The only dairy ingredients produced in Japan are cream, butter, skim and whole milk powder, cheese, and whey. On a global basis, though, more than 100 types of dairy ingredient are manufactured. Lacto Japan plans to introduce customers (including dairy product manufacturers and beverage manufacturers) to dairy ingredients that are not manufactured in Japan, and then source these items. The key with infant formula, for example, is to ensure that the proteins are as close as possible to those in breast milk. The protein mix is the single greatest difference between breast milk and cow's milk, and Lacto Japan can supply infant formula manufacturers with milk powder mixtures that have had the protein mix suitably adjusted. High tariffs are applied under the current system. As discussed earlier, though, Japan's reliance on imports is increasing year by year, as the volume of domestically produced dairy ingredients is insufficient to support domestic consumption. Domestic manufacturers (Lacto Japan's customers) are very demanding when it comes to dairy ingredients, and moreover they have a strong tendency to be specific in their requirements. Long-standing relationships with suppliers are critical in meeting these customers' needs in a timely manner (a difficult task for new market entrants with no such channels in place). Furthermore, Lacto Japan can offer customers value-added. For example, in order to attract a lower secondary tariff rate, it can import blended preparations containing non-dairy constituents such as sugar and vegetable oil.

- Expand the Asian Business

Expand cheese manufacturing and sales business

Lacto Japan aims to further develop its own products, establish its brand as a B2B

processed cheese manufacturer, and become the top commercial cheese brand in Asia. During the period covered by its NEXT-LJ2024 plan, it plans to develop the market by launching new products using plant-derived ingredients and processed cheese with better price appeal than conventional products.

Strengthen sales structure of local subsidiaries

The company has designated regions where the westernization of food is particularly pronounced as priority regions, and will develop sales activities with the aim of initiating new transactions with local distributors and companies. In the Asia market, each country or region has different needs, and sales activities must be tailored to those specific needs. For this reason, Lacto Japan will establish sales offices in each region and assign professionals with expertise in the sale of dairy products and ingredients in order to differentiate itself from the competition by providing meticulous customer service. The company's list of priority markets includes China, the Philippines, Malaysia, Thailand, Indonesia, and Vietnam.

According to Lacto Japan, the company has more than 10 expatriate staff in Asia, which reportedly is more than would be seen at the local food business units of Japan's major general trading companies. Moreover, Lacto Japan's practice of specializing in dairy products affords it a competitive advantage in Asia. In the immediate aftermath of capital expenditure in cheese manufacturing facilities in Asia, the company was burdened by losses. Now, however, those losses have been eradicated, and the company can begin recouping its investments. As was the case in Japan, Lacto Japan believes that demand for dairy products and food containing large amounts of dairy (such as ice cream, chocolate, and pizza) will increase in Asia as food cultures become more westernized. The company chose Asia as the site of its overseas business for the opportunity to (1) supply "Japanese-quality" dairy ingredients and cheese to Japanese manufacturers with operations in Asia; and (2) leverage its familiarity with information on local economy, etc. in introducing Japan's unique dairy ingredients and cheese culture to Asia (the company sees limited potential for competing in Western markets, where dairy products are well entrenched). By building a greater brand presence in Asia, Lacto Japan aims to broaden the application of its businesses fostered in Japan.

▀ Build next-generation businesses

Accelerate development of functional food business

Lacto Japan will expand its handling of functional food ingredients* and build next-generation businesses that will become new pillars of growth. As consumers become more health-conscious, it believes demand for functional food ingredients will grow among food manufacturers and others. In addition to the dairy ingredients that have been the company's strength, it aims to expand sales by increasing the number of products it handles, with a focus on health and functionality. Beyond the food and beverage industries, it will also accelerate efforts to expand sales to new industries, including sports, healthcare, and beauty.

* This includes secondary ingredients other than those for dairy products, and products in peripheral areas, to which Lacto Japan will apply the same approach it uses for existing products.

Creation of new businesses to contribute to the realization of a sustainable society

The company will continue seeking to enter new businesses to support medium- to long-term growth. It will specifically consider new businesses that leverage the group's strengths in procurement and sales, are likely to generate synergies with its existing businesses, and contribute to the realization of a sustainable society on the road to long-term business growth.

▀ Build sound foundation for sustained growth:

Transition to a company with an Audit & Supervisory Committee

In February 2021, Lacto Japan changed its management structure from a company with an Audit & Supervisory Board to a company with an Audit & Supervisory Committee to further enhance its governance structure and decision-making speed. It will continue to promote highly transparent governance.

Implement initiatives for sustainable growth

In FY11/21, the company began environmental, social, and governance (ESG) initiatives in earnest. It actively discloses details and information on progress of these initiatives via its website and other means. In December 2021, it released material describing its thinking regarding the value creation process.

Outlook for longer-term use of funds

- ▶ Lacto Japan plans to use funds in the Asian Business, a pillar of the company's growth strategy, to establish sales bases in promising markets.
- ▶ It will strengthen investment for expansion of cheese manufacturing and sales in the Asian Business (for automation and expansion of production lines, construction of new plants, and so on).
- ▶ It will further increase financial soundness by increasing equity to build a sound base for the diversification of business operations (transition from a trading company model to a combination of trading and manufacturing), targeting an equity ratio of 40%.
- ▶ It will use funds to start new businesses related to food (including upstream, downstream, and horizontal development) and that contribute to the realization of a sustainable society.

Review of previous medium-term plan, NEXT-LJ2023 (Reference)

- ▶ In FY11/21, as in FY11/20, Lacto Japan's main products—dairy ingredients, cheese, meat, and meat products—were affected by falling demand for commercial dairy products triggered by the COVID-19 pandemic. On the supply side, mainly overseas suppliers had reduced ingredient production capacity due to labor shortages triggered by the pandemic, and there were disruptions and delays in logistics and price hikes in international markets. Such factors caused the company to fall short of its upwardly revised plan (revised in July 2021) for the first year of NEXT-LJ2023.
- ▶ Expand business in fast-growing markets in Asia: The cheese manufacturing and sales business set records for both sales and sales volume by capturing home consumption demand. In Indonesia, a local subsidiary began operations in November 2021 selling dairy ingredients.
- ▶ Grow business with existing customers and secure new customers: The business development, dairy ingredients, and cheese divisions began collaborating on sales activities (proposing new products to existing customers). The company also began dealing with the healthcare and beauty industries (starting with sales of high-protein dairy ingredients).
- ▶ Enhance management base for sustainable growth: The company transitioned to a Company with an Audit & Supervisory Committee format to enhance governance.

Strengths and weaknesses

Strengths

- ✔ **Wealth of information, ability to offer solutions, respond to customer needs:**

As a trading company specializing in dairy ingredients and cheese, Lacto Japan is a leading company with a share of some 35% in imports of these products. The company was founded in May 1998 by long-standing employees of Toshoku (dairy product division), in response to pleas from the latter's suppliers and customers following Toshoku's collapse. Since then, Lacto Japan has amassed a wealth of specialist expertise and know-how, with around 60 employees involved in the dairy ingredients and cheese fields (even more than the five to ten employed at competing business units of general trading companies). The company is able to provide customers with specialist knowledge of overseas markets, including information on dairy ingredients not manufactured in Japan, international markets, forex, trade, and tax systems. At the same time, it boasts a full lineup comprising around 40 general-purpose dairy ingredients as well as over 500 primary processed products tailored to customers' detailed specifications. Lacto Japan has built favorable relationships with leading dairy companies in key milk-producing countries, and now boasts more than 100 suppliers in 20 countries around the world (including almost all major suppliers in the main milk-producing countries). As a consequence, the company is now able to source products worldwide, and therefore is able to ensure Japanese customers of a reliable flow of imports (supplies).

- ▶ **Independence** (not bound by capital alliances or complex trading relationships): Lacto Japan operates independently, with no ties to any particular corporate group. Not only does this permit it to cultivate new suppliers and customers with no constraints from capital relationships or complicated dealings within business groups, but the company is also able to put itself always in the customer's shoes in order to devise optimal solutions, and can act nimbly, starting with swift decision-making. Although there are other trading companies specializing in food, they tend to be small in scale, and none have a sufficiently broad lineup of dairy ingredients and cheese products to compete with Lacto Japan.
- ▶ **Presence in Asia and addition of manufacturing capability:** Since establishing a subsidiary in Singapore in 1999, Lacto Japan has accumulated nearly 20 years of experience in Asia, importing and selling "Japanese-quality" dairy ingredients (surpassing international standards on aspects such as bacteria count) to Japanese manufacturers operating in the region. Back in 2005—before Mitsui & Co, Itochu, and Mitsubishi Corp respectively invested in dairy product manufacturing in Asia in August 2007, August 2009, and June 2012—Lacto Japan started up its own processed cheese plant in Singapore, thus adding manufacturer to its trading company persona. In 2015, the company built another plant in Thailand.

Weaknesses

- ▶ **Heavy reliance on domestic market (constraint on growth):** Some 70% of Lacto Japan's sales come from importing dairy ingredients and cheese for sale to Japanese customers (69.0% in FY11/21). The company has benefited from the fact that dairy product imports grew at a CAGR of 2.4% over the ten years from FY2011 to FY2020, while Japan's dairy product output declined at a CAGR of 0.1% over the same period. Since FY2011, however, domestic consumption of dairy products has only grown at a CAGR of 0.8% on a raw milk equivalent basis. This has acted as a constraint on growth.
- ▶ **Limits on potential for adding value:** Lacto Japan imports the dairy ingredients required by customers from appropriate suppliers, earning a commission for doing so. The company's ability to stably supply ingredients is a source of added value, as are the aforementioned information resources and ability to offer solutions and respond to customer needs. Potential for adding value is limited, however, in

comparison with the scope for suppliers (dairy ingredient manufacturers) and customers (dairy product, confectionery, oils & fat, and beverage manufacturers) to add value through manufacturing and sales. In real terms (adjusted for exchange gains and losses), the company's operating profit margin is only about 3%.

Income statement

Income statement										
	FY11/12	FY11/13	FY11/14	FY11/15	FY11/16	FY11/17	FY11/18	FY11/19	FY11/20	FY11/21
(JPYmn)	Parent	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.
Sales	55,201	75,943	96,550	98,001	88,679	101,335	115,441	116,794	110,838	110,884
YoY	-1.6%	37.6%	27.1%	1.5%	-9.5%	14.3%	13.9%	1.2%	-5.1%	0.0%
CoGS		72,684	92,291	94,352	82,333	95,948	108,930	109,994	104,211	104,243
YoY	-	-	27.0%	2.2%	-12.7%	16.5%	13.5%	1.0%	-5.3%	0.0%
CoGS ratio	-	95.7%	95.6%	96.3%	92.8%	94.7%	94.4%	94.2%	94.0%	94.0%
Gross profit		3,259	4,259	3,648	6,346	5,387	6,511	6,801	6,626	6,641
YoY	-	-	30.7%	-14.3%	73.9%	-15.1%	20.9%	4.4%	-2.6%	0.2%
GPM	-	4.3%	4.4%	3.7%	7.2%	5.3%	5.6%	5.8%	6.0%	6.0%
SG&A expenses		2,559	2,727	2,928	2,996	3,463	3,502	3,656	3,667	3,854
YoY	-	-	6.6%	7.4%	2.3%	15.6%	1.1%	4.4%	0.3%	5.1%
SG&A ratio	-	3.4%	2.8%	3.0%	3.4%	3.4%	3.0%	3.1%	3.3%	3.5%
Operating profit		700	1,532	720	3,349	1,924	3,009	3,144	2,959	2,787
YoY	-	-	118.8%	-53.0%	365.1%	-42.6%	56.4%	4.5%	-5.9%	-5.8%
OPM	-	0.9%	1.6%	0.7%	3.8%	1.9%	2.6%	2.7%	2.7%	2.5%
Forex gains (losses)		1,189	638	1,053	-1,537	1,159	-135	-114	3	81
YoY	-	-	-46.3%	65.0%	-	-	-	-	-	-
% of sales	-	1.6%	0.7%	1.1%	-1.7%	1.1%	-0.1%	-0.1%	0.0%	0.1%
OP + Gains (losses) on forex		1,889	2,170	1,773	1,812	3,082	2,874	3,030	2,962	2,868
YoY	-	-	14.9%	-18.3%	2.2%	70.1%	-6.8%	5.4%	-2.2%	-3.2%
% of sales	-	2.5%	2.2%	1.8%	2.0%	3.0%	2.5%	2.6%	2.7%	2.6%
Other non-operating income (expenses)		-219	-516	-430	-378	-560	-261	-284	-178	-106
YoY	-	-	-	-	-	-	-	-	-	-
% of sales	-	-0.3%	-0.5%	-0.4%	-0.4%	-0.6%	-0.2%	-0.2%	-0.2%	-0.1%
Ordinary income		787	1,670	1,653	1,343	1,434	2,523	2,613	2,747	2,781
YoY	-47.4%	112.2%	-1.0%	-18.8%	6.8%	75.9%	3.6%	5.1%	1.2%	-3.6%
Profit margin	1.4%	2.2%	1.7%	1.4%	1.6%	2.5%	2.3%	2.4%	2.5%	2.4%
Net income attrib. to parent company shareholders		422	1,007	988	831	946	1,755	1,784	1,963	2,062
YoY	-50.0%	138.6%	-1.9%	-15.9%	13.8%	85.5%	1.7%	10.0%	5.1%	-5.0%
Net margin	0.8%	1.3%	1.0%	0.8%	1.1%	1.7%	1.5%	1.7%	1.9%	1.8%
Depreciation and amortization of goodwill		-	96	100	179	174	226	212	220	291
EBITDA		-	796	1,632	900	3,524	2,149	3,221	3,365	3,250

Source: Shared Research based on company data
Figures rounded to the nearest million yen

Balance sheet

Balance sheet										
	FY11/12	FY11/13	FY11/14	FY11/15	FY11/16	FY11/17	FY11/18	FY11/19	FY11/20	FY11/21
(JPYmn)	Parent	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.
Cash and deposits	-	3,305	4,300	5,132	6,724	4,006	4,930	4,475	5,005	5,511
Notes and accounts receivable	-	11,908	14,941	12,695	14,278	17,199	15,873	17,852	13,849	19,277
Inventories	-	13,180	19,193	18,496	13,101	21,446	25,216	22,946	21,383	24,335
Merchandise and finished goods	-	13,053	19,040	18,331	12,910	21,178	24,873	22,618	21,008	24,335
Raw materials and supplies	-	126	153	165	191	268	343	328	375	504
Deferred tax asset	-	8	11	124	28	139	101	0	-	-
Other	-	708	1,694	316	1,001	700	318	501	386	391
Total current assets	-	29,109	40,139	36,764	35,133	43,491	46,337	45,775	40,623	50,018
Tangible fixed assets	-	344	715	698	663	560	597	569	691	709
Buildings and structures	-	117	142	268	262	205	250	191	175	199
Machinery, equipment, and vehicles	-	133	226	281	287	263	221	229	192	245
Lease assets	-	-	3	135	96	73	42	121	256	241
Other	-	12	12	14	11	11	33	28	28	24
Land	-	28	-	-	-	-	-	-	-	-
Construction in progress	-	53	332	-	7	7	52	0	41	0
Intangible assets	-	150	125	95	56	21	39	30	20	45
Software	-	150	124	93	54	20	39	29	20	44
Other	-	1	1	2	2	1	1	1	1	0
Investments and other assets	-	1,407	1,543	1,765	1,711	1,833	1,917	1,762	2,035	2,128
Investment securities	-	658	735	900	790	998	889	738	784	838
Deferred tax asset	-	181	149	45	82	102	117	160	273	260
Other	-	568	661	822	839	735	915	863	996	1,047
Allowance for doubtful accounts	-	-	-1	-1	-1	-1	-3	-	-17	-17
Total fixed assets	-	1,901	2,382	2,558	2,429	2,414	2,631	2,360	2,746	2,882
Total assets	21,894	31,010	42,522	39,322	37,562	45,905	48,968	48,135	43,370	52,900
Accounts payable	-	6,559	10,189	8,620	6,890	11,411	11,174	12,649	9,740	12,202
Short-term borrowings	-	7,031	10,476	1,560	209	4,796	8,686	6,100	5,500	10,669
Current portion of bonds	-	688	300	355	620	690	660	450	270	
Current portion of long-term debts	-	2,625	3,308	3,687	3,474	2,893	2,333	6,643	3,220	2,610
Income taxes payable	-	587	300	175	298	657	397	410	491	365
Deferred tax liability	-	-	378	-	130	-	-	18	40	44
Other	-	418	602	703	878	460	730	946	719	679
Total current liabilities	-	17,908	25,553	15,099	12,500	20,908	23,979	27,198	19,939	27,525
Corporate bonds	-	485	385	860	1,590	1,380	720	270	0	0
Long-term borrowings	-	4,839	6,708	12,202	11,209	9,926	8,493	4,050	5,060	5,010
Deferred tax liability	-	48	65	73	61	91	72	18	40	44
Net defined benefit liability	-	264	269	263	297	264	279	311	350	362
Provision for directors' retirement benefits	-	265	313	225	269	-	-	-	-	-
Asset retirement obligations	-	11	37	37	36	36	36	36	38	38
Other	-	60	60	171	181	515	982	287	351	342
Total fixed liabilities	-	5,973	7,837	13,832	13,643	12,212	10,557	4,972	5,839	5,796
Total liabilities	-	23,880	33,390	28,931	26,142	33,120	34,561	32,171	25,778	33,321
Shareholder's equity	5,664	6,698	7,673	9,646	10,446	12,050	13,655	15,416	17,328	18,907
(Treasury stock)	-	(11)	-	-	-	-0	-0	-53	-11	-112
Accumulated other comprehensive income	-	401	1,459	744	973	700	666	480	195	604
Non-controlling interests	-	30	-	-	-	-	-	-	-	-
Share subscription rights	-	-	-	-	-	36	111	69	69	69
Total net assets	-	7,130	9,132	10,391	11,419	12,785	14,432	15,964	17,592	19,579
Net debt	-	12,362	16,877	13,531	10,378	15,679	15,962	13,038	9,045	12,778
Working capital	-	18,528	23,946	22,571	20,489	27,234	29,916	28,150	25,493	31,411

Source: Shared Research based on company data
Figures rounded to the nearest million yen

Per-share data (JPY)

Per-share data (JPY)										
	FY11/12	FY11/13	FY11/14	FY11/15	FY11/16	FY11/17	FY11/18	FY11/19	FY11/20	FY11/21
	Parent	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.
Shares issued (year-end)	3,918,200	3,918,200	3,917,400	4,889,500	4,889,500	4,892,500	4,896,500	9,835,200	9,877,200	9,899,200
EPS	109.80	261.49	255.57	197.87	193.57	358.96	364.62	200.11	209.47	198.73
EPS (fully diluted)	-	-	-	-	-	354.31	356.97	195.98	205.73	195.90
Dividend per share	16.00	30.00	30.00	30.00	32.00	38.00	40.00	22.00	30.00	32.00
Book value per share	1,472.20	1,841.88	2,331.16	2,125.08	2,335.43	2,605.95	2,924.69	1,618.31	1,774.58	1,978.42

Source: Shared Research based on company data

Cash flow statement

Cash flow statement										
	FY11/12	FY11/13	FY11/14	FY11/15	FY11/16	FY11/17	FY11/18	FY11/19	FY11/20	FY11/21
(JPYmn)	Parent	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.
Cash flows from operating activities	-	-3,229	-4,062	2,535	3,560	-5,048	356	3,365	4,534	-4,037
Cash flows from investing activities	-	-130	-541	-242	5	-137	-864	849	-137	-292
Cash flows from financing activities	-	3,802	5,412	-1,476	-1,655	2,385	990	-3,695	-3,764	4,659

Source: Shared Research based on company data

Figures rounded to the nearest million yen

Financial indicators

Financial indicators										
	FY11/12	FY11/13	FY11/14	FY11/15	FY11/16	FY11/17	FY11/18	FY11/19	FY11/20	FY11/21
	Parent	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.
ROA (OI-based)	3.5%	6.3%	4.5%	3.3%	3.7%	6.0%	5.5%	5.7%	6.1%	5.6%
ROE	7.8%	15.6%	12.2%	8.5%	8.7%	14.5%	13.2%	13.0%	12.3%	10.6%
Inventory turnover	-	-	4.8	5.0	5.2	5.6	4.7	4.6	4.7	4.6
Fixed assets turnover	-	-	135.0	138.7	130.4	165.8	199.6	200.3	176.0	158.4
Current ratio	-	162.6%	157.1%	243.5%	281.1%	208.0%	193.2%	168.3%	203.7%	181.7%
Net assets ratio	25.9%	22.9%	21.5%	26.4%	30.4%	27.8%	29.2%	33.0%	40.4%	36.9%

Source: Shared Research based on company data

Note: Figures rounded to the nearest million yen

Policy on shareholder returns

Lacto Japan believes in prioritizing profit returns to shareholders, and has a basic policy of maintaining a stable and steady dividend stream. The company paid a dividend of JPY30.0 per share in FY11/20 (+JPY8 YoY) and JPY32.0 per share in FY11/21 (+JPY2 YoY), and plans to pay a dividend of JPY37.0 per share in FY11/22 (+JPY5 YoY). Lacto Japan aims to realize a 20% payout ratio in FY11/23 on the occasion of the 25th anniversary of its founding (versus 14.3% in FY11/20, 16.1% in FY11/21, and a projected 17.4% in FY11/22). To realize growth over the medium to long term and enhance enterprise value, the company will invest in the expansion of facilities for cheese manufacturing and sales under the Asian Business and will work to strengthen its financial position to achieve this.

Shareholders

Shareholders	Shares	Shareholding ratio
Custody Bank of Japan, Ltd. (Trust account)	1,411,900	14.31%
The Master Trust Bank of Japan, Ltd. (Trust account)	1,013,600	10.27%
Custody Bank of Japan, Ltd. (Trust account 9)	382,600	3.87%
Shigeru Yasumi	311,400	3.15%
Motohisa Miura	251,262	2.54%
Kichiro Kamakura	243,000	2.46%
The Nomura Trust and Banking Co., Ltd. (Trust account)	222,300	2.25%
STATE STREET BANK AND TRUST COMPANY 505019	203,200	2.06%
Meiji Co., Ltd.	200,000	2.02%
Morinaga Milk Co., Ltd.	200,000	2.02%
Yotsuba Milk Products Co., Ltd.	200,000	2.02%
Shares issued	4,639,262	46.97%

Source: Shared Research based on company data (as of November 30, 2021)

Corporate governance

Organization type, capital structure etc.	
Controlling shareholder	None
Parent company code	-
Director	
Number of directors under Articles of Association	12
Directors' terms under Articles of Association	1 year
Number of external (independent) directors	4
Other	
Participation in electronic voting platform	None
Other initiatives to enhance voting rights of investors	In place
Providing convocation notice in English	In place
Disclosure of directors' compensation	None
Disclosure of executive officers' compensation	-
Policy on determining amount of compensation and calculation methodology	In place
Takeover defenses	None

Source: Shared Research based on company data

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