

## Lacto Japan | 3139 |

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On April 13, 2022, Lacto Japan Co., Ltd. announced earnings results for Q1 FY11/22.

		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	-	-	-

Source: Shared Research based on company data

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

### Q1 FY11/22 (December 2021–February 2022) results

#### Summary

In Q1 FY11/22, the company reported consolidated sales of JPY31.8bn (+32.3% YoY), operating profit of JPY740mn (-9.0% YoY), ordinary income of JPY719mn (-2.5% YoY), and net income attributable to owners of the parent of JPY524n (-0.6% YoY).

Compared with its full-year FY11/22 forecast, sales in Q1 reached 25.2% of the full-year target (Q1 FY11/21 sales were 21.6% of the full-year FY11/21 result), while ordinary income reached 24.8% (27.5%) and net income 24.9% (26.9%).

In Q1 FY11/22, there were signs of recovery in economic activity following a temporary drop in the number of new COVID-19 cases, but a resurgence in infections driven by a variant strain from January 2022 triggered Tokyo and other major cities to implement priority measures to prevent the spread of COVID-19, which dampened demand in the overall food industry. In the dairy industry in particular, while demand was sluggish, domestic raw milk production remained relatively steady, resulting in a continued surplus of domestic skim milk powder and butter inventories. Furthermore, inflation fears heightened as resource and energy prices, as well as various raw material prices rose, and the economic outlook once again became clouded.

In the domestic food industry, demand for food ingredients for commercial use remained weak owing to the slump in the restaurant and leisure industries. As for dairy products, inventories for domestic skim milk powder and butter remained high due to an imbalance between supply and demand. In the overseas food and food ingredients markets, while restaurant demand rebounded as more countries, particularly in Europe and the US, eased movement restrictions with the aim of resuming economic activities, the supply demand balance was strained as supply volumes dropped as a result of soaring energy prices, reduced production due to labor shortages, and disruptions in logistics. In particular, prices for dairy products, the company's core products, rose markedly due to higher feed and energy prices, as well as lower milk production in major production areas due to unfavorable weather conditions.

Against this backdrop, the company worked to stably procure raw materials by fully leveraging its procurement network. For dairy ingredients, the company participated in a project to reduce domestic dairy product inventories and actively marketed domestically produced products as well as imported products. As a result, Q1 sales volumes in all categories rose YoY.

**Sales up 32.3% YoY:** Sales rose 32.3% YoY to JPY31.8bn driven by higher sales volume as well as higher sales prices for both dairy and meat products, which reflected rising international market prices in response to higher feed and energy prices and the weakening yen.

**Operating profit down 9.0% YoY:** Cost of goods sold rose 34.6% YoY, and while the gross profit margin fell 1.6pp YoY to 5.4%, gross profit rose 2.6% YoY. Operating profit fell 9.0% YoY and operating profit margin fell 1.1pp YoY to 2.3%. In addition to higher raw material costs, higher sales volume, higher logistics costs stemming from container shortages and soaring energy prices, and a change in transport method from sea to air due to delays in shipping schedules were the main reasons for the drop in profit margins.

**Ordinary income down 2.5% YoY:** While the company recorded foreign exchange losses of JPY50mn in Q1 FY11/21, it recorded foreign exchange gains of JPY7mn in Q1 FY11/22. Excluding the JPY5mn boost in profit from the shift in foreign exchange rates during Q1, ordinary income would have come in at JPY713mn for a 6.9% decrease over the comparable figure of JPY765mn in Q1 FY11/21.

\* In order to avoid taking on exchange rate risk in the course of regular business transactions, as a rule the company enters into forward exchange contracts to cover the cost of the purchases made in foreign currencies at the time the contract is signed. Meanwhile, regarding the accounting treatment of the purchase transaction, procurement (purchase) is recorded at the time of shipment, which creates a lag from the point in time the purchase contract is signed. If the yen strengthens during that timeframe, the exchange rate will be lower than the forward rate at purchase and the actual cost of the goods will be lower than the cost based on forward exchange rate secured at the time the contract was concluded. Lacto Japan calculates its gross profit using the cost of goods sold based on the forward exchange rate at the time the goods were purchased, and records a forex hedging loss under non-operating expenses as a foreign exchange loss.

## Breakdown by business category

### Dairy Ingredients and Cheese

In Q1 FY11/22, sales were JPY22.0bn (+28.9% YoY) and total sales volumes were 46,731 tons (+8.3% YoY).

In the Dairy Ingredients business, recovery in the restaurant and leisure industries were slower than initially expected owing to the resurgence of COVID-19 cases driven by a variant strain. On the other hand, raw milk production was solid, and the surplus of domestic dairy ingredient inventories, such as skim milk powder and butter, remained high. Sales volume rose YoY as the company focused on selling dairy ingredients that are relatively unaffected by domestic inventories, as well as actively marketing domestically-produced skim milk powder.

In the Cheese business, both sales and sales volume were solid. Unlike skim milk powder and butter, cheese was less affected by the surplus inventory of domestically produced dairy products, and many customers rushed to procure cheese amid fears of a sharp rise in international market prices and delays in shipping schedules. The company actively proposed products that meet the needs of its customers, based on its assessment of price trends and logistics conditions in the main production areas in Europe, Oceania, and the US, which proved successful.

### Meat Product Ingredients

In Q1 FY11/22, sales were JPY3.5bn (+13.3% YoY) and total sales volumes were 6,004 tons (+4.7% YoY).

In the Meat Product Ingredients business, sales were affected by the shipping schedule delays that have persisted since last year, but sales of all products remained steady. While commercial demand was sluggish due to the spread of COVID-

19, demand for home cooking and consumption was firm, and sales of chilled pork, one of the company's core products, were solid, especially to mass retailers. As for processed food ingredients used to make frozen pork, ham, sausage, and other products, there were some delays in procurement owing to the continuing shortage of workers at production plants in the US, a major production area, because of the pandemic. However, the company was able to secure supply by collaborating with its long-time suppliers in the US, and sales volume rose YoY. Sales of beef—for which the company began full-fledged marketing last year—were sluggish due in part to a sharp rise in import prices.

### Asia Business and other

In Q1 FY11/22, sales were JPY6.2bn (+63.7% YoY).

#### Dairy ingredient sales (wholesaling)

Sales were JPY4.8bn (+69.1% YoY) and sales volumes were 11,397 tons (+14.9% YoY).

Sales of prepared dairy mixtures for the Japanese market remained weak, owing to the continued elevated inventory levels of domestic dairy ingredients. However, sales to Asian countries were steady, especially to local customers (local food manufacturers and Japanese companies operating in Asia). Amid a highly volatile procurement environment for dairy products, including sharp rises in international market prices, the company promoted products that meet the needs of its customers in terms of both price and quality, which resulted in YoY increases in both sales and volume.

#### Cheese manufacturing and sales

Sales were JPY935mn (+16.6% YoY) and sales volumes were 1,253 tons (+11.8% YoY).

In Q1, Southeast Asia and China showed signs of easing restrictions on restaurant operations and accepting travelers, although there were differences from country to country, and food demand for both home cooking and restaurants was on a recovery track. Sales of processed cheese produced by the company remained firm for home cooking and consumption, while sales to restaurants began to show signs of recovery, and sales to local manufacturers in Singapore, Thailand, Malaysia, Taiwan, and other countries were strong. Utilization rates remained high at the company's Singapore plant, which expanded capacity in June 2021.

#### Other businesses

Sales in the functional food ingredients business, which Lacto Japan started in FY11/20 and has categorized as a new growth business, made steady progress. It sells mainly milk-derived protective protein ingredients to the sports nutrition industry and is attracting an increasing number of inquiries. The company expects the market for protein-related products to continue to grow as demand for these products increases not only for use in training, but also as health food products.

### Company outlook for near-term business environment

- ▶ Dairy Ingredients and Cheese: The company expects measures to ease the supply and demand imbalance to continue in FY11/22 and plans to keep focusing on sales of domestically produced skim milk powder to help reduce inventories. It also noted that milk production in major overseas production areas is sluggish, and that rising material and energy prices are driving up dairy farming costs, making a significant recovery in production unlikely. On the other hand, international market prices for dairy products are expected to remain high in the near term, as demand in Western countries is recovering due to policies aimed at living with COVID-19. The company believes that although it will take some time for import volumes to fully recover, the company is in an environment where it can better leverage its diverse supply chain and full lineup of dairy products amid soaring dairy market prices and ongoing logistics delays.
- ▶ Meat Product Ingredients: The company noted that a decline in supply capacity at meat processing plants for both pork and beef, and the resulting increase in international prices, is a cause for concern. In addition, the company

expects shipping schedule delays to continue for the foreseeable future and is closely monitoring labor negotiations with port officials, which are scheduled to take place by July 1, 2022, on the West Coast of the US. Although the company is making good progress in cultivating new customers for new products such as beef and honey, it is concerned that rising import prices, the weak yen, and its potential inability to secure products may become bottlenecks.

- ▶ Asia Business (dairy ingredient sales): In Japan, the company expects weak sales of dairy products in the near term. However, the company is looking to expand its export business as a way to reduce Japan's skim milk powder inventories. It also expects demand for dairy products in China to grow.
- ▶ Asia Business (cheese manufacturing and sales): The company expects to see further increases in sales of cheese products to food product manufacturers in Asia, especially those making products for the Chinese market. It will also continue negotiating prices with suppliers as it expects raw material and energy prices to continue rising. The company is also developing new products to meet market needs. It plans to introduce vegan cheese made from plant-derived ingredients in FY11/22.

### Financial position

- ▶ Current assets totaled JPY51.8bn, up JPY1.7bn versus end-FY11/21. The increase is mainly attributable to a JPY294mn rise in notes and accounts receivable and a JPY903mn increase in merchandise and finished goods.
- ▶ Fixed assets of JPY2.9bn were down JPY29mn versus end-FY11/21, stemming largely from a JPY26mn decrease in investments and other assets.
- ▶ Current liabilities stood at JPY29.6bn, up JPY2.0bn versus end-FY11/21, with most of this increase coming as a result of a JPY1.0bn increase in accounts payable as well as a JPY1.0bn increase in commercial papers and a JPY217mn increase in short-term borrowings due to an increase in working capital. Fixed liabilities of JPY5.1bn were down JPY681mn versus end-FY11/21, primarily reflecting a JPY665mn decrease in long-term borrowings.
- ▶ Net assets totaled JPY19.9bn, up JPY357mn versus end-FY11/21. The increase is mainly attributable to a JPY108mn increase in foreign currency translation adjustments and a JPY208mn increase in retained earnings.

### Impact of the Russia-Ukraine situation on business operations and earnings

Lacto Japan does not expect the Russia-Ukraine situation to have a material impact on its consolidated FY11/22 earnings. The company imports dairy products and meat and meat products from major dairy farming countries around the world and sells them in Japan and other Asian countries. Europe is one of the main producers of dairy products, accounting for approximately 40% of the company's dairy product imports. According to the company, it does not have any direct transactions with Russian or Ukrainian suppliers, and there has been no impact on its product procurement at this point in time.

However, Russia and Ukraine are major exporters of agricultural products such as wheat and corn, as well as energy, and the company is concerned that the conflict will reduce exports from both countries, which will further increase feed and energy prices and impact global dairy farming costs. This may further raise international market prices for dairy products, which are already high, and this may in turn affect demand patterns in Japan and Asia. Regarding meat and processed meat products, the company's main suppliers in Europe are located in Italy and Spain, and although the situation in Russia and Ukraine has not directly affected them, the company believes that, as with dairy products, market prices may

rise due to surging feed and energy prices. As for logistics, the shortage of workers caused by the spread of COVID-19 has led to continued disruptions on the West Coast of the US and in China, and developments in the Russia-Ukraine conflict may affect logistics in Europe going forward.

Quarterly (cumulative) earnings

Cumulative (JPYmn)	FY11/20				FY11/21				FY11/22	FY11/22	
	Q1 Cons.	Q2 Cons.	Q3 Cons.	Q4 Cons.	Q1 Cons.	Q2 Cons.	Q3 Cons.	Q4 Cons.	Q1 Cons.	% of Est.	Est.
Sales	28,222	57,912	85,065	110,838	23,994	52,648	79,630	110,884	31,755	25.2%	126,000
YoY	1.2%	0.3%	-2.8%	-5.1%	-15.0%	-9.1%	-6.4%	0.0%	32.3%	-	13.6%
Dairy Ingredients and Cheese	20,061	39,927	59,925	78,330	17,090	36,952	54,996	76,481	22,024	25.9%	85,000
YoY	-5.0%	-6.4%	-7.5%	-8.1%	-14.8%	-7.5%	-8.2%	-2.4%	28.9%	-	11.1%
% of sales	71.1%	68.9%	70.4%	70.7%	71.2%	70.2%	69.1%	69.0%	69.4%	-	-
Meat Product Ingredients	2,900	6,107	8,781	11,895	3,116	6,769	10,380	14,278	3,530	23.5%	15,000
YoY	-1.4%	0.0%	-5.5%	-3.1%	7.4%	10.8%	18.2%	20.0%	13.3%	-	5.1%
% of sales	10.3%	10.5%	10.3%	10.7%	13.0%	12.9%	13.0%	12.9%	11.1%	-	11.9%
Dairy ingredients	4,411	10,138	13,752	17,025	2,829	6,809	11,111	15,754	4,783	26.6%	18,000
YoY	47.4%	38.8%	24.9%	6.2%	-35.9%	-32.8%	-19.2%	-7.5%	69.1%	-	14.3%
% of sales	15.6%	17.5%	16.2%	15.4%	11.8%	12.9%	14.0%	14.2%	15.1%	-	14.3%
Cheese	680	1,352	2,036	2,895	801	1,689	2,428	3,324	935	25.6%	3,650
YoY	3.3%	5.3%	3.7%	9.2%	17.9%	24.9%	19.3%	14.8%	16.7%	-	9.8%
% of sales	2.4%	2.3%	2.4%	2.6%	3.3%	3.2%	3.0%	3.0%	2.9%	-	2.9%
Other	168	386	570	691	156	428	712	1,044	481	0	4,350
YoY	-8.7%	11.9%	20.5%	9.7%	-7.1%	10.9%	24.9%	51.1%	208.3%	-	316.7%
% of sales	0.6%	0.7%	0.7%	0.6%	0.7%	0.8%	0.9%	0.9%	1.5%	-	3.5%
Sales volume (tons)											
Dairy Ingredients and Cheese	49,413	98,294	145,534	191,575	43,141	91,993	135,032	184,358	46,731	24.6%	190,000
YoY	-0.7%	-1.8%	-4.9%	-6.1%	-12.7%	-6.4%	-7.2%	-3.8%	8.3%	-	3.1%
Meat Product Ingredients	5,220	11,453	16,143	21,925	5,736	12,567	19,013	25,699	6,004	21.2%	28,300
YoY	4.7%	9.0%	-1.1%	1.8%	9.9%	9.7%	17.8%	17.2%	4.7%	-	10.1%
Asia Business: dairy ingredients	14,676	34,921	48,281	60,159	9,918	22,690	34,546	47,817	11,397	22.8%	50,000
YoY	29.9%	25.2%	15.7%	0.4%	-32.4%	-35.0%	-28.4%	-20.5%	14.9%	-	4.6%
Asia Business: cheese	1,014	1,983	2,949	4,197	1,120	2,334	3,355	4,635	1,253	25.1%	5,000
YoY	16.0%	9.9%	7.9%	12.3%	10.5%	17.6%	13.8%	10.4%	11.9%	-	7.9%
Average price (JPY/kg)											
Dairy Ingredients and Cheese	406	406	412	409	396	402	407	415	471		
YoY	-4.3%	-4.7%	-2.8%	-2.1%	-2.4%	-1.1%	-1.1%	1.5%	19.0%		
Meat Product Ingredients	556	533	544	543	543	539	546	556	588		
YoY	-5.8%	-8.2%	-4.5%	-4.9%	-2.2%	1.0%	0.4%	2.4%	8.2%		
Asia Business: dairy ingredients	301	290	285	283	285	300	322	329	420		
YoY	13.5%	10.9%	8.0%	5.8%	-5.1%	3.4%	12.9%	16.4%	47.1%		
Asia Business: cheese	671	682	690	690	715	724	724	717	746		
YoY	-10.9%	-4.2%	-3.9%	-2.8%	6.6%	6.1%	4.8%	4.0%	4.3%		
CoGS	26,535	54,505	79,981	104,211	22,316	49,274	74,599	104,243	30,033		
YoY	0.8%	0.3%	-2.9%	-5.3%	-15.9%	-9.6%	-6.7%	0.0%	34.6%		
CoGS ratio	94.0%	94.1%	94.0%	94.0%	93.0%	93.6%	93.7%	94.0%	94.6%		
Gross profit	1,686	3,407	5,084	6,626	1,678	3,375	5,032	6,641	1,722		
YoY	7.6%	1.2%	-1.3%	-2.6%	-0.5%	-1.0%	-1.0%	0.2%	2.6%		
GPM	6.0%	5.9%	6.0%	6.0%	7.0%	6.4%	6.3%	6.0%	5.4%		
SG&A expenses	922	1,826	2,709	3,667	865	1,844	2,786	3,854	982		
YoY	10.9%	3.9%	1.8%	0.3%	-6.2%	1.0%	2.9%	5.1%	13.5%		
SG&A ratio	3.3%	3.2%	3.2%	3.3%	3.6%	3.5%	3.5%	3.5%	3.1%		
Operating profit	764	1,581	2,375	2,959	813	1,530	2,245	2,787	740		
YoY	3.8%	-1.7%	-4.6%	-5.9%	6.4%	-3.2%	-5.5%	-5.8%	-9.0%		
OPM	2.7%	2.7%	2.8%	2.7%	3.4%	2.9%	2.8%	2.5%	2.3%		
Gains (losses) on foreign exchange	15	-39	-21	3	50	0	123	81	7		
YoY	-	-	-	-	224.7%	-	-	2325.6%	-86.2%		
% of sales	0.1%	-0.1%	0.0%	0.0%	0.2%	0.0%	0.2%	0.1%	0.0%		
OP + Gains (losses) on forex	780	1,542	2,354	2,962	863	1,531	2,369	2,868	747		
YoY	25.7%	8.4%	2.2%	-2.2%	10.7%	-0.8%	0.6%	-3.2%	-13.5%		
% of sales	2.8%	2.7%	2.8%	2.7%	3.6%	2.9%	3.0%	2.6%	2.4%		
Ordinary income	753	1,434	2,209	2,781	737	1,412	2,213	2,682	719	24.8%	2,900
YoY	40.6%	14.5%	5.8%	1.2%	-2.1%	-1.5%	0.2%	-3.6%	-2.5%		8.1%
Profit margin	2.7%	2.5%	2.6%	2.5%	3.1%	2.7%	2.8%	2.4%	2.3%		2.3%
Net income	546	1,040	1,608	2,062	527	1,011	1,601	1,959	524	24.9%	2,100
YoY	45.3%	17.2%	7.9%	5.1%	-3.4%	-2.8%	-0.4%	-5.0%	-0.6%		7.2%
Net margin	1.9%	1.8%	1.9%	1.9%	2.2%	1.9%	2.0%	1.8%	1.6%		1.7%
Foreign exchange											
USD/JPY	109.53	108.55	107.97	107.27	104.30	106.65	107.80	108.97	114.65		
EUR/JPY	120.87	119.33	120.52	121.40	126.62	128.73	129.43	129.68	129.77		

Source: Shared Research based on company data

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

Quarterly earnings (three months)

Quarterly (JPYmn)	FY11/20				FY11/21				FY11/22
	Q1 Cons.	Q2 Cons.	Q3 Cons.	Q4 Cons.	Q1 Cons.	Q2 Cons.	Q3 Cons.	Q4 Cons.	Q1 Cons.
Sales	28,222	29,690	27,153	25,773	23,994	28,654	26,982	31,253	31,755
YoY	1.2%	-0.5%	-9.0%	-11.9%	-15.0%	-3.5%	-0.6%	21.3%	32.3%
CoGS	26,535	27,969	25,476	24,231	22,316	26,957	25,325	29,644	30,033
YoY	0.8%	-0.2%	-9.1%	-12.2%	-15.9%	-3.6%	-0.6%	22.3%	34.6%
CoGS ratio	94.0%	94.2%	93.8%	94.0%	93.0%	94.1%	93.9%	94.9%	94.6%
Gross profit	1,686	1,721	1,677	1,542	1,678	1,697	1,657	1,609	1,722
YoY	7.6%	-4.3%	-6.0%	-6.6%	-0.5%	-1.4%	-1.2%	4.3%	2.6%
GPM	6.0%	5.8%	6.2%	6.0%	7.0%	5.9%	6.1%	5.1%	5.4%
SG&A expenses	922	904	883	958	865	979	942	1,067	982
YoY	10.9%	-2.4%	-2.2%	-3.8%	-6.2%	8.3%	6.7%	11.4%	13.5%
SG&A ratio	3.3%	3.0%	3.3%	3.7%	3.6%	3.4%	3.5%	3.4%	3.1%
Operating profit	764	817	794	584	813	717	715	542	740
YoY	3.8%	-6.3%	-10.0%	-10.8%	6.4%	-12.2%	-9.9%	-7.2%	-9.0%
OPM	2.7%	2.8%	2.9%	2.3%	3.4%	2.5%	2.6%	1.7%	2.3%
Gains (losses) on foreign exchange	15	-54	18	24	50	-50	123	-43	7
YoY	-	-	-	-66.5%	224.7%	-	580.0%	-	-86.2%
% of sales	0.1%	-0.2%	0.1%	0.1%	0.2%	-0.2%	0.5%	-0.1%	0.0%
OP + Gains (losses) on forex	780	762	812	608	863	667	838	499	747
YoY	25.7%	-5.0%	-7.8%	-16.3%	10.7%	-12.5%	3.3%	-18.0%	-13.5%
% of sales	2.8%	2.6%	3.0%	2.4%	3.6%	2.3%	3.1%	1.6%	2.4%
Ordinary income	753	680	775	572	737	675	801	469	719
YoY	40.6%	-5.1%	-7.1%	-13.3%	-2.1%	-0.8%	3.3%	-18.1%	-2.5%
Profit margin	2.7%	2.3%	2.9%	2.2%	3.1%	2.4%	3.0%	1.5%	2.3%
Net income	546	495	567	455	527	484	590	358	524
YoY	45.3%	-3.4%	-5.9%	-3.9%	-3.4%	-2.2%	4.0%	-21.2%	-0.6%
Net margin	1.9%	1.7%	2.1%	1.8%	2.2%	1.7%	2.2%	1.1%	1.6%

Source: Shared Research based on company data

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

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## About Shared Research Inc.

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We offer corporate clients comprehensive report coverage, a service that allows them to better inform investors and other stakeholders by presenting a continuously updated third-party view of business fundamentals, independent of investment biases. Shared Research can be found on the web at <https://sharedresearch.jp>.

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