

Lacto Japan

Independent trading company handling dairy ingredients: despite the pandemic, aims to develop functional food ingredient market in Japan and expand Asia market

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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 (39% import share in FY11/19). 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 191,575 tons (-6.1% YoY) in FY11/20 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 305 employees (as of November 30, 2020).

New business domains: Aside from its Dairy Ingredients and Cheese (70.7% of sales in FY11/20), Lacto Japan has imported Meat Products since FY11/05 (10.7%). It also has the Asian Business centered in Singapore, engaged in dairy ingredient sales and the manufacture and sale of cheese (18.0%). The remaining 0.6% of sales come from the company's other business, which was started in FY11/20 and conducts sales of functional food ingredients (including collagen and glucosamine) mainly in Japan.

Performance trends

FY11/21: company forecasts ordinary income decline of 6.5% YoY

FY11/20 earnings: Sales of JPY110.8bn (-5.1% YoY) and ordinary income of JPY2.8bn (+1.2%). Sales came in 14.7% below the company's initial forecast, reflecting stagnant sales of ingredients for commercial foods, including for restaurants. Ordinary income came in just 7.3% below the initial forecast and higher YoY due to cost reductions and increased handling of high-margin goods.

FY11/21 forecast: Lacto Japan forecasts sales of JPY115.0bn (+3.8% YoY) and ordinary income of JPY2.6bn (-6.5%). To deal with the increase in skim milk powder inventory in Japan, the company will actively work to sell domestic skim milk powder to compensate for a decline in sales of imported ingredients. The company projects sales volume growth in Dairy Ingredients and Cheese (+0.4%), Meat Products (+15.0%), and cheese manufacturing and sales in the Asia Business (+9.4%), but a drop in dairy ingredient sales in the Asia Business (-12.0%).

Medium-term strategy

Achieve sustained growth by cultivating new customers, developing new products, and expanding operations in Asia

Medium-term plan: Under its NEXT-LJ2023 medium-term business plan, Lacto Japan is targeting FY11/23 sales of JPY141.0bn (+27.2% vs FY11/20), ordinary income of JPY3.5bn (+25.9%), and net income of JPY2.5bn (+21.2%). Due to the impact of the COVID-19 pandemic, it pushed back by one year the performance targets for the final year (FY11/22) of its previous medium-term business plan, NEXT-LJ2022, and will continue to cultivate existing businesses and develop new customers. The company will develop new products and expand its product lineup in such areas as functional dairy ingredients (including milk proteins and healthcare-related foods) and processed foods. With a view to expanding its business in the fast-growing Asian market, Lacto Japan furthermore seeks to increase handling volume in dairy ingredients, invest in additional manufacturing capacity for cheese, and enlarge sales channels in emerging ASEAN markets, modelled on the approach used in the Philippines.

Strengths and weaknesses

Strengths

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

Lacto Japan is a leading specialist trading company with a share of some 39% 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

Indices	
Market capitalization	JPY25.3 bn
Stock price (2021/3/1)	JPY2,557
Issued shares	9,877,200 shares
Foreign stockholding ratio	6.7 %
BPS (FY11/20)	JPY1,774.58
PBR (FY11/20)	1.44 x
PER (FY11/21 Est.)	13.6 x
Dividend (FY11/21 Est.)	JPY32.00
Dividend yield (FY11/21 Est.)	1.25 %
ROE (FY11/21 Est.)	10.6 %
Net debt / Equity ratio (FY11/20)	51.4 %

*Number of issued shares includes treasury stock

		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	Est. Cons.	115,000	3.8%	-	-	2,600	-6.5%	1,850	-10.3%	187.35	-	-	-

Note: Figures rounded to the nearest million yen (amounts less than JPY1 mn are rounded down in materials released by the company).

Business

One of Japan's leading trading company of dairy products (roughly 39% 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 (39% share of imports in FY11/19). 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 250 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, 2020, the company had 305 employees.

Background to establishment

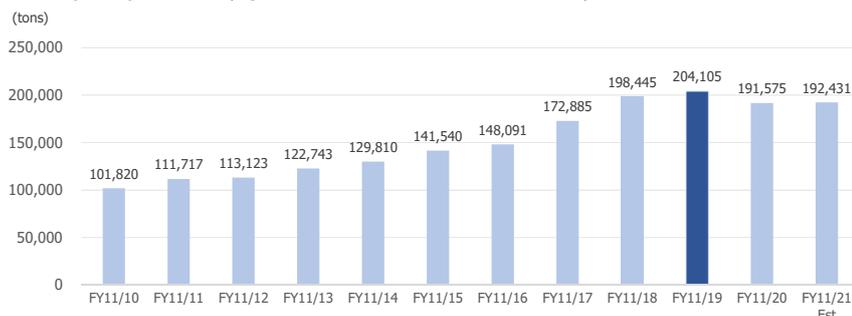
Lacto Japan was founded by a team previously engaged in importing for the dairy product division of Toshoku*, in response to strong pleas from Toshoku suppliers and clients after that company filed for bankruptcy, reportedly because of a subsidiary's excessive investments. President Motohisa Miura was 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

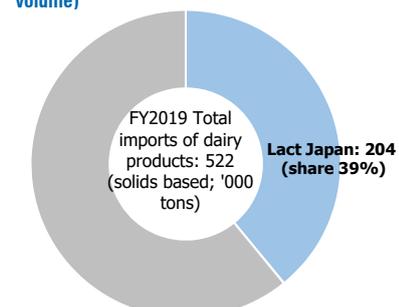
- ▶ Leading company with 39% share
- ▶ Imports dairy ingredients and cheese from milk-producing nations around the world (more than 100 suppliers)
- ▶ Handles around 40 general-purpose ingredients and over 500 customized (primary processed) products
- ▶ Customers include leading domestic dairy product, confectionery, oil & fats, beverage, and animal feed manufacturers
- ▶ Employees number 305 (as of November 30, 2020)

Lacto Japan import volume (ingredients and cheese; solid content based)



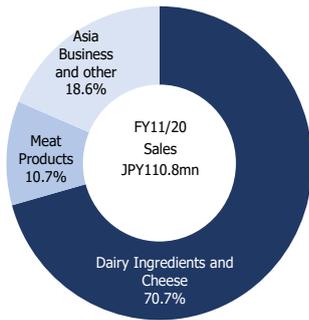
Source: Shared Research based on company data

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



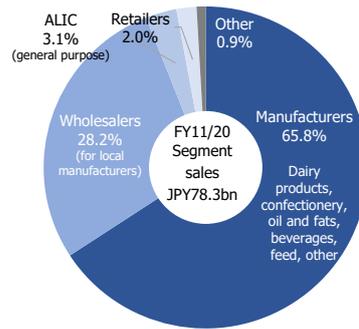
Source: Shared Research based on company data with reference to MAFF Food Balance Sheet
Note: Share calculated on solid content-based total imports (conversion factor: 0.1).

Sales by segment



Source: Shared Research based on company data

Sales by customer type (Dairy Ingredients and Cheese)



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 approximately 62 personnel to run its Dairy Ingredients and Cheese business (as of November 30, 2020). 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 (primary processing is conducted at company plants in Singapore, Thailand, and Indonesia).

Products handled and their respective sales weightings (in FY11/20)

- Dairy Ingredients and Cheese (70.7%):** 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, and with the exception of cheese, these products can be reconstituted as milk and other types of dairy product.

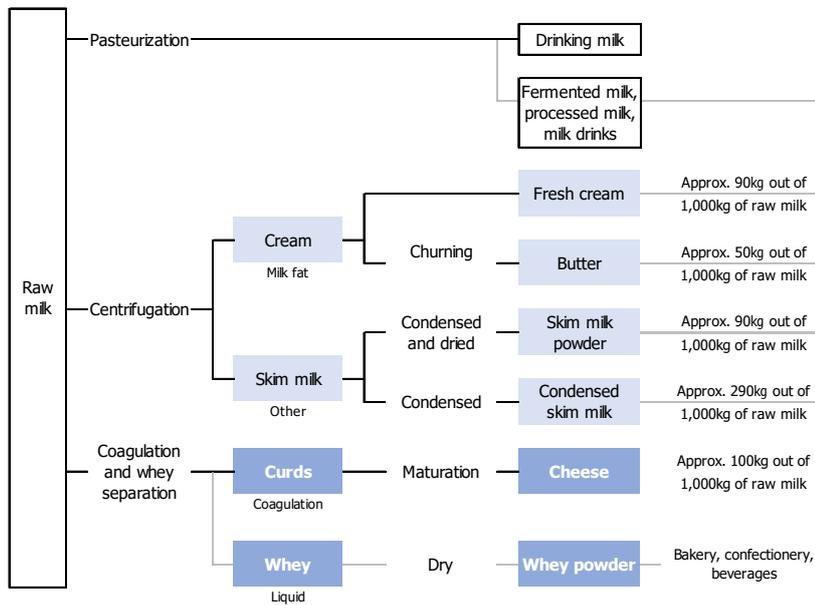
Whole milk powder: Whole milk powder is made by drying raw milk to remove water. In comparison with skim powder, whole milk powder has higher fat content. It therefore is not suited to long-term storage, as fat oxidation can cause the taste to deteriorate quickly. Whole milk powder primarily is used 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.

Expansion into new business domains

- ▶ Dairy Ingredients and Cheese (70.7% of sales in FY11/20)
 - ▶ Meat Products (10.7%)
 - ▶ Asia Business and other (18.6%)
- Identifying business opportunities in the westernizing Asian markets (supplying 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)

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 (10.7%): chilled and frozen pork, dry-cured ham, salami, bacon, etc.
- Asia Business and other (18.6%): dairy ingredients and cheese, own-brand cheese (processed cheese* brand Foodtech, natural cheese** brand Choosy)

* 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 140 suppliers across 20 countries). Over 13 years, Lacto Japan's dairy ingredients and cheese import volume rose 2.7x, from 76,868 tons in FY11/06 to 204,105 tons in FY11/19. However, in FY11/20, the pandemic caused import volume to fall back to 191,575 tons (-6.1% YoY).
- 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 fulfil functions including ensuring a stable supply of ingredients (decentralization of procurement routes) and improving production efficiency (outsourcing the processing of raw materials).

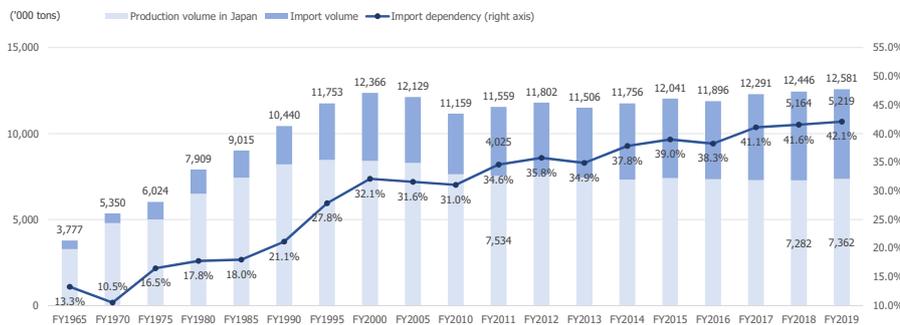
Market environment

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 7.6 million tons in FY2010 to 7.4 million tons in FY2019, for a CAGR of -0.4%,* Japan has become increasingly reliant on imports (import weighting of 42.1% in FY2019, up from 31.0% in FY2010) in order to meet consistently high demand. Japan’s dairy product import volume (milk equivalent basis) has risen from 3.5 million tons in FY2010 to 5.2 million tons in FY2019, for a CAGR of 4.4%.

* The number of dairy farming households in Japan peaked at 418,000 in 1963, and by 2020 had dropped to only 14,400, 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, and 1,352,000 in 2020. (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 (2020)

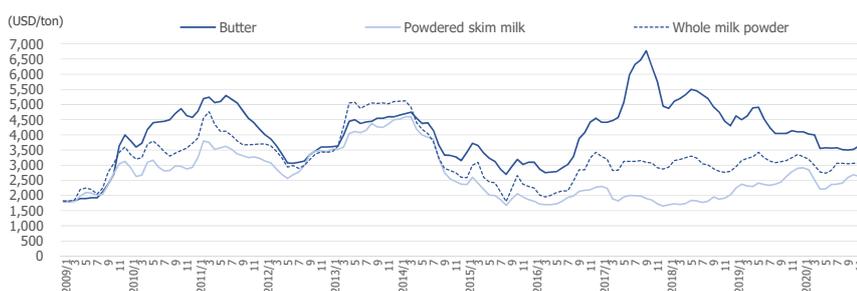
(tons)	Imports	By category					
		Milk and cream	Powdered milk	Fermented dairy products	Whey	Butter	Cheese and curd
Total	413,444	103	42,357	19	61,271	18,184	291,510
Value (JPYmm)	173,528	47	12,815	26	14,667	9,665	136,308
Unit price (JPY/kg)	420	452	303	1,371	239	532	468
Three main countries	234,249	2	26,234	7	29,483	11,112	167,410
Australia	82,470	-	5,670	-	4,636	199	71,965
New Zealand	80,872	2	8,275	5	3,039	10,482	59,069
US	70,907	-	12,289	2	21,808	432	36,376
Share of the three	56.7%	2.2%	61.9%	37.1%	48.1%	61.1%	57.4%
Europe	162,349	77	13,827	12	21,566	6,904	119,963
Netherlands	18,025	3	3,562	0	2,407	2,511	11,447
Germany	34,429	-	88	-	1,408	2	9,729
Denmark	19,930	-	1,739	1	4,000	2,237	32,157
France	40,134	-	300	-	1,018	8	16,699
Italy	11,227	61	1,385	5	5,604	1,052	26,322
South America	5,475	12	1,021	-	903	109	3,431
Argentina	4,032	-	-	-	624	-	3,408
Brazil	34	12	22	-	-	-	-
Asia, other	11,370	12	1,275	0	9,319	59	705

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 2020 are final, while those for December are preliminary. Note: Figures above show sums for items covered under HS codes 0401 to 0406

International market

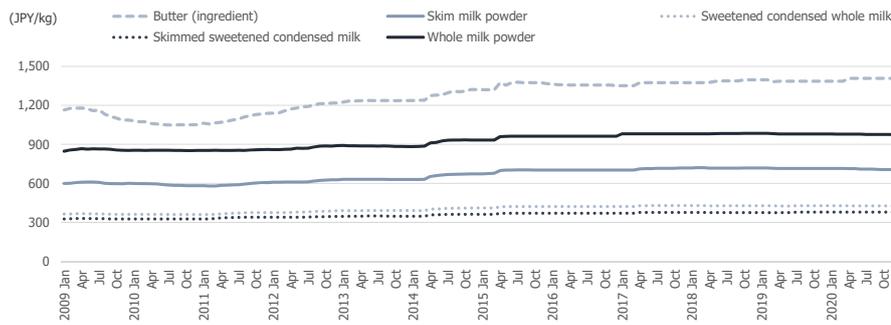
International market prices for dairy products are mostly holding steady after a period of increase that occurred in mid-2016. Market conditions were bearish until the first half of 2016, but prices began trending upward in the latter half of 2016 as an adjustment to global supply and demand came to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

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)

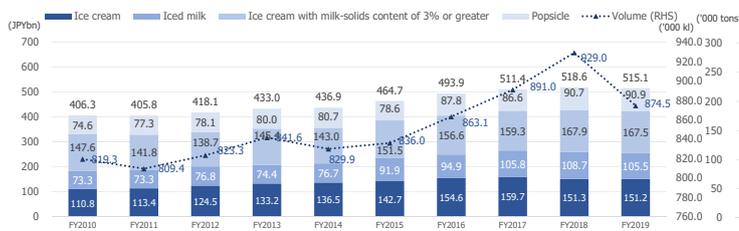


Source: Ministry of Agriculture, Forestry and Fisheries' data on Price Survey on Major Foods

Demand for main users' products

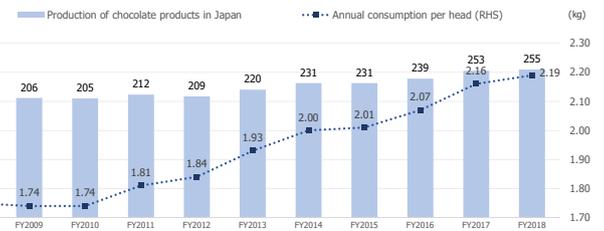
Through late 2019 before COVID-19 first reared its head, domestic demand for dairy ingredients continued to rise thanks to generally steady growth in sales of major products made by dairy product and confectionery manufacturers. Domestic consumption of cheese continued to grow, rising from 204,535 tons in 1995 to 358,229 tons in 2019 for average annual growth of 2.4%. Imported cheese accounted for roughly 80% of that, rising from 159,345 tons in 1995 to 295,655 tons in 2019 for average annual growth of 2.6%.

Sales of ice cream and popsicles (JPYbn)



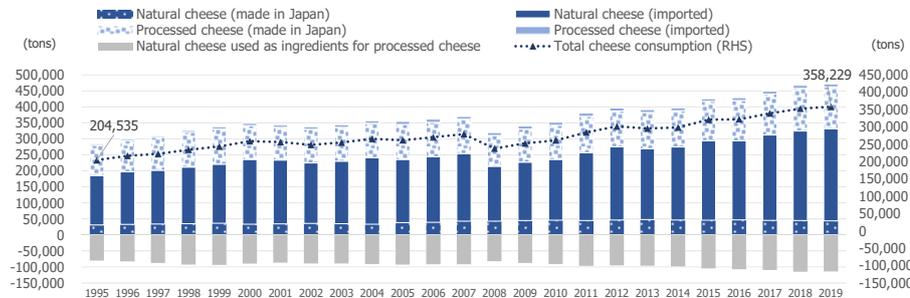
Source: Shared Research based on Japan Ice Cream Association

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-11 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 USD91 or so (Source: Japan Dairy Industry Association, "Japan Dairy Yearbook 2019 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	(Oct. 31, 20xx)	98	95
= at foreign exchange forward contract			
As of settlement	(Nov. 30, 20xx)	99	96
As of shipping	(Dec. 31, 20xx)	100	97
= at booking of purchase			
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
			Deferred hedge gain (loss)
			4,000 (*2)
			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
			Deferred hedge gain (loss)
			4,000
			6,000
Purchase (Dec. 31, 20xx)	① Debit: Purchase	1,000,000	Credit: Accounts payable
	② Debit: Forward exchange contract	10,000 (*4)	Credit: Deferred tax liability
			Deferred hedge gain (loss)
			4,000
	③ Debit: Deferred tax liability	8,000	Credit: Forward exchange contract
	Deferred hedge gain (loss)	12,000	
			20,000
	*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
	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 mid-sized (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: Shoei Foods (TSE2: 8079)

Comparison with competitors (listed companies)

Ticker	Company	Fiscal year		Sales (revenue)	Ordinary income (pre-tax profit)	% of sales (revenue)	ROA (based on OI or pre- tax profit)	ROE	Equity ratio
				(JPYmn)	(JPYmn)				
8058	Mitsubishi Corp.	FY03/20	IFRS	14,779,734	648,864	4.4%	3.8%	9.8%	29.0%
8001	Itochu Corp.	FY03/20	IFRS	10,982,968	701,430	6.4%	4.5%	17.0%	27.4%
8031	Mitsui & Co.	FY03/20	IFRS	6,885,033	534,320	7.8%	4.5%	9.7%	32.3%
3139	Lacto Japan	FY11/20	Cons.	110,838	2,781	2.5%	6.1%	12.3%	40.4%
8079	Shoei Foods	FY10/20	Cons.	100,572	4,308	4.3%	5.6%	7.0%	52.7%
Average				6,571,829	378,341	5.1%	4.9%	11.2%	36.4%

Source: Shared Research based on company data

Earnings

For FY11/21, company forecasts 6.5% YoY decrease in ordinary income due to COVID-19 pandemic

FY11/20 results

Summary

For FY11/20, Lacto Japan reported sales of JPY110.8bn (-5.1% YoY), operating profit of JPY3.0bn (-5.9% YoY), ordinary income of JPY2.8bn (+1.2% YoY), and net income attributable to parent company shareholders of JPY2.1bn (+5.1% YoY). The YoY declines in sales and sales volume were caused largely by stagnant sales for commercial foods, such as for restaurants, due to the COVID-19 pandemic. At the same time, handling of high-margin products increased, boosting ordinary income slightly despite the pandemic.

Sales

Sales declined 5.1% YoY.

- ▶ In Dairy Ingredients and Cheese, there was increased demand for dairy products for home consumption as more people stayed home due to the pandemic, but demand for dairy products for commercial use declined because of voluntary restraint on outings,

FY11/20 results: Sales down 5.1% YoY, ordinary income up 1.2%

and sales volume for imported ingredients fell with the rapid increase in domestic dairy product inventory. In addition, falling procurement prices translated to lower sales prices, also causing sales to decline YoY.

- ▶ In the Asia Business, sales and sales volume both rose YoY, with robust sales of products for retail customers reflecting expansion of at-home consumption, despite declines in sales of ingredients for prepared foods for the Japanese market and the food service industry.
- ▶ Factors in the JPY6.0bn YoY decrease in sales included lower sales volume (-JPY5.4bn), lower sales prices (-JPY378mn; stemming from low prices in global markets and tariff reductions), and foreign exchange impacts (-JPY194mn)

Ordinary income

Ordinary income rose 1.2% YoY. Although sales volume declined on stagnant domestic demand, there was an increase in the handling of high-margin products, and the company says it was able to prevent a downswing despite the pandemic by expanding the range of customer industries.

- ▶ An improved gross profit margin helped to compensate for the negative impact of the decline in sales volume.
- ▶ Contributions to the JPY34mn YoY increase in ordinary income included improvement in the product mix and, by extension, the gross profit margin (+JPY234mn), foreign exchange impact (+JPY62mn), and other factors (+JPY103mn), which together offset the negative impact of lower sales volume (-JPY354mn) and higher SG&A expenses (-JPY11mn).
- ▶ 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 JPY78.3bn were down 8.1% YoY. Sales volume fell 6.1% YoY to 191,575 tons.

The pandemic has had both positive and negative effects, but the impact of stagnant commercial demand hit particularly hard, causing sales volume to decline 6.1% YoY. This, along with soft international raw material markets and the impact of foreign exchange rates (as the yen appreciated), caused an 8.1% YoY drop in sales.

Negative impacts also included reduced bidding volume by the government and the replacement of some imported ingredients with domestic ones in light of excess domestic dairy ingredient inventory. However, sales and sales volume were underpinned by the use of free trade agreement quotas, including those under TPP-11 and Japan-EU EPA, along with sales of domestic ingredients.

Sales to animal feed manufacturers and beverage manufacturers were robust with sales growth due to the start of business with new customers.

- ▶ **Meat Products:** Sales of JPY11.9bn were down 3.1% YoY. Sales volume rose 1.8% YoY to 21,925 tons.

In pork imports, the steady expansion of business with new customers offset a decline in sales volume caused by a change in the import policy of a major customer. Sales of ingredients for ham and sausage for home consumption were solid.

Sales of meat products including dry-cured ham and salami decreased YoY in terms of both sales and sales volume due to soft demand from restaurants because of the pandemic.

In 1H, the pandemic caused major US suppliers to reduce their production volume, but this impact largely disappeared toward end-FY11/20.

- ▼ **Asia Business and other:** Sales were JPY20.6bn, up 6.8% YoY, as detailed below:
 - Dairy ingredients sales: Sales were JPY17.0bn, up 6.2% YoY. Sales volume increased 0.4% YoY to 60,159 tons. The ratio of supply to the food service industry is low, so the impact of the pandemic was limited. An increase in product varieties sold to key customers in the Philippines contributed to improved performance. Lacto Japan has made progress in developing new customers even though most sales activities have been conducted remotely. In 2H, sales of ingredients for dairy products in Japan declined due to the presence of excess domestic dairy ingredient inventory.
 - Cheese manufacturing: Sales were JPY2.9bn, up 9.2% YoY. Sales volume increased 12.3% YoY to 4,197 tons. Demand from the food service industry, including restaurants and bakeries, was temporarily sluggish due to the pandemic, but this was offset by robust home consumption demand. Sales grew in Thailand and were robust in China, where recovery from the impact of the pandemic was fairly rapid.

Company forecast for FY11/21

Summary

For FY11/21, Lacto Japan forecasts sales of JPY115.0bn (+3.8% YoY), ordinary income of JPY2.6bn (-6.5% YoY), and net income attributable to parent company shareholders of JPY1.9bn (-10.3% YoY). By business, the company assumes sales volumes will rise 0.4% for Dairy Ingredients and Cheese (see below for details, same hereafter), 15.0% for Meat Products, and 9.4% for cheese manufacturing and sales in the Asia Business, but fall 12.0% for dairy ingredient sales in the Asia Business.

Company forecasts for FY11/21: sales up 3.8%, ordinary income down 6.5%

Business environment

- ▼ Lacto Japan expects ongoing impact from the pandemic on its domestic operations, especially in 1H FY11/21.
 - It projects sluggish demand for dairy ingredients due to weak commercial demand.
 - The government will reduce its import quotas due to the high level of domestic dairy ingredient inventory. However, international minimum access commitments and TPP-11 and Japan-EU EPA quotas mean that a certain degree of imports will continue.
 - The company expects during FY11/21 to see the effects of measures to balance supply and demand for domestic dairy ingredients realized.
- In the Asian market, Lacto Japan expects relatively rapid economic recovery, despite lingering concerns regarding the COVID-19 pandemic.
 - It anticipates robust demand centered on home consumption to support dairy ingredient sales in China and ASEAN member nations.
 - It also expects continued interest in dairy ingredients and cheese for use in frozen foods and convenience store foods in Japan.

Company response to excess domestic inventory of skim milk powder

- ▶ In the past, when there was excess 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.
- ▶ According to research by the company, the estimated domestic skim milk powder inventory had expanded to about 80,700 tons as of end-November 2020, due in part to the COVID-19 pandemic. It therefore believes that measures to balance supply and demand will proceed. Current measures differ in some respects from those conducted in the past. In the past there was just an issue of adjusting supply versus demand for raw milk, but this time the excess inventory was due to the extraordinary situation caused by the pandemic. In addition, past response has been led by the National Federation of Agricultural Cooperative Associations with the participation of the government, so measures were mainly conducted with producer contributions. However, this time the government itself is leading the response. The government has gone through two rounds of budgetary measures totaling JPY6.7bn to reduce skim milk powder inventory by 2,400 tons. Furthermore, with the third supplementary budget, the government aims to cut the inventory by another 7,000 tons or so by end-2021. The Hokuren Federation of Agricultural Cooperatives has also announced that it will shoulder some JPY1.0–1.2bn worth of ingredients on behalf of dairy product manufacturers as an emergency measure to ensure all raw milk is sold.
- ▶ Lacto Japan also aggressively sells domestic skim milk powder when there is excess 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 excess 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 excess inventory quickly.
- ▶ Such response can lead to the development of new customers in the medium and long term and, once the excess 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 excess 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 YoY increase in sales of 4.0% to JPY81.5bn, assuming a 0.4% rise in sales volume to 192,431 tons, and a 3.5% increase in the average unit price to JPY423,373 per ton.
- ✔ **Meat Products:** Lacto Japan forecasts a YoY increase in sales of 9.2% to JPY13.0bn, assuming a 15.0% increase in sales volume to 25,210 tons, and a 5.0% decrease in the average unit price, to JPY515,272 per ton.
- ✔ **Asia Business and other:** Lacto Japan projects a YoY decrease in sales of 0.3% to JPY20.5bn, assuming a 12.0% decrease to 52,920 tons in sales volume for dairy ingredients and a 9.4% increase to 4,593 tons in sales volume for cheese manufacturing.

Business plan

Dairy Ingredients and Cheese

- ▶ Lacto Japan aims to increase sales by taking advantage of free trade agreement quotas and 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 excess domestically produced inventory. In addition, it will begin building an export business for domestically produced dairy products using the group's sales network.
- ▶ The company forecasts that domestic companies will continue shifting to imported dairy products in the medium term 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, causing prices of imported dairy ingredients to increase as well. When milk prices go up, companies in the dairy industry are able to pass along some of the cost increases by raising the prices of their end-products, but this leads to lower demand for domestic dairy products, creating a self-perpetuating downward spiral.
- ▶ Once the aforementioned new trade agreements go into effect (TPP-11, Japan-EU EPA, and Japan-US trade agreement), 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 January 29, 2020, that prices for all types of milk would be left unchanged for FY2020.

Meat Products

- ▶ In pork imports, Lacto Japan aims to increase sales by promoting product branding in collaboration with suppliers. It will enhance efforts to develop suppliers beyond the US (North America), Canada, and Europe, and will also continue working to expand its customer base. In addition, it aims to expand sales by actively proposing new products to new customers developed in recent years.
- ▶ In the domestic meat market, pork imports are on the rise thanks to higher quality and increased consumer recognition. Of an estimated 1,811,600 tons of pork (-0.9% YoY; CAGR of 1.0% over the past 10 years) on the Japanese market in FY2019, imports accounted for 913,300 tons (-1.9% YoY; CAGR of 2.5%) and domestically produced pork 898,200 tons (+0.2% 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 12.8kg in 2019. OECD statistics for meat consumption put per capita pork consumption in Japan at 16.2kg in 2018. Either way, per capita consumption of pork is much higher in the US and the European Union (35.5kg) than it is in Japan, while neighboring China and South Korea consume roughly twice as much pork as Japan, with per capital consumption of 30.4kg and 30.1kg, respectively. 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.
- ▶ 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). The gate price system*2 and current gate price of JPY524/kg will be maintained, though. Under the gate price system, importers can minimize their tariff bill by combining pork cuts with differing customs duties to ensure that the value per kilogram of the imported pork is in the vicinity of JPY524/kg (the price at which the per-kilogram duty is at its smallest, at JPY23/kg before USJTA implementation, to be reduced to zero in the final year of tariff reductions), and Lacto Japan has the expertise and suppliers/sales routes needed to practice combination imports.

*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 JPY64.53/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

*2 Gate price system for pork imports. A system designed to balance the needs of consumers and domestic pork producers. As outlined above, if the import price is below the gate price, then the importer must pay a differential duty equal to the gap between the standard import price and import value per kilogram, thereby protecting domestic pork producers. If the import price is at the gate price level or above, then only the ad valorem tariff is paid, thereby benefiting consumers.

Asia Business

- ▶ Dairy ingredient sales: Although the impact of the pandemic on sales of dairy ingredients in Japan is likely to continue for some time, the company aims to increase sales to China, where the market recovered from the impact of the pandemic fairly quickly and has been expanding, and to local companies in Southeast Asia, where sales have been robust. It will collaborate with suppliers to develop competitive dairy ingredients. In cooperation with the head office's dairy ingredients sales division, it will begin building a system for selling domestically produced dairy products in the ASEAN region.
- ▶ Cheese manufacturing and sales: Lacto Japan aims to increase sales in markets it expects to recover faster than in Japan. In particular, the company plans to further enhance sales efforts in China, where business is steadily expanding. In light of an increasingly fierce competitive environment, it will focus on developing and quickly launching products that can help it stand out, such as its high-temperature cheese. The company plans to leverage the group's procurement capabilities to reduce costs by reviewing its cheese ingredients, and enhance measures to improve productivity.

Earnings by business category

Earnings by business category													
(JPYmn)	FY11/10	FY11/11	FY11/12	FY11/13	FY11/14	FY11/15	FY11/16	FY11/17	FY11/18	FY11/19	FY11/20	FY11/21 Est.	FY11/23 Est.
	Parent	Parent	Parent	Cons.	Cons.								
Sales	46,411	56,089	55,201	75,943	96,550	98,001	88,679	101,335	115,441	116,794	110,838	115,000	141,000
YoY	-	20.9%	-1.6%	37.6%	27.1%	1.5%	-9.5%	14.3%	13.9%	1.2%	-5.1%	3.8%	8.4%*
< Sales by category >													
Dairy Ingredients and Cheese	-	-	-	47,899	63,978	69,047	60,543	70,019	85,290	85,206	78,330	81,470	97,100
YoY	-	-	-	-	33.6%	7.9%	-12.3%	15.7%	21.8%	-0.1%	-8.1%	4.0%	7.4%*
% of sales	-	-	-	63.1%	66.3%	70.5%	68.3%	69.1%	73.9%	73.0%	70.7%	70.8%	68.9%
Meat Products	-	-	-	14,971	15,673	15,449	16,338	15,253	12,576	12,280	11,895	12,990	17,200
YoY	-	-	-	-	4.7%	-1.4%	5.8%	-6.6%	-17.6%	-2.4%	-3.1%	9.2%	13.1%*
% of sales	-	-	-	19.7%	16.2%	15.8%	18.4%	15.1%	10.9%	10.5%	10.7%	11.3%	12.2%
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	15,640	20,600
YoY	-	-	-	-	-	-	-	-	9.2%	9.9%	6.2%	-8.1%	6.6%*
% of sales	-	-	-	-	-	-	-	13.2%	12.6%	13.7%	15.4%	13.6%	14.6%
Asia Business (cheese)	-	-	-	-	-	-	-	1,919	2,116	2,651	2,895	3,120	3,600
YoY	-	-	-	-	-	-	-	-	10.3%	25.3%	9.2%	7.8%	7.5%*
% of sales	-	-	-	-	-	-	-	1.9%	1.8%	2.3%	2.6%	2.7%	2.6%
Other	-	-	-	-	-	-	-	793	878	630	690	1,780	2,500
YoY	-	-	-	-	-	-	-	-	10.7%	-28.2%	9.5%	158.0%	53.6%*
% of sales	-	-	-	-	-	-	-	0.8%	0.8%	0.5%	0.6%	1.5%	1.8%
< Sales by region >													
Japan	-	-	-	62,387	79,693	84,879	77,395	85,418	98,483	97,879	-	-	-
YoY	-	-	-	-	27.7%	-	-8.8%	10.4%	15.3%	-0.6%	-	-	-
% of sales	-	-	-	82.1%	82.5%	86.6%	87.3%	84.3%	85.3%	83.8%	-	-	-
Asia	-	-	-	13,142	16,824	13,083	11,270	15,911	16,945	18,866	-	-	-
YoY	-	-	-	-	28.0%	-	-13.9%	41.2%	6.5%	11.3%	-	-	-
% of sales	-	-	-	17.3%	17.4%	13.4%	12.7%	15.7%	14.7%	16.2%	-	-	-
Other	-	-	-	414	33	39	14	6	12	49	-	-	-
YoY	-	-	-	-	-92.1%	-	-63.9%	-54.8%	92.9%	300.9%	-	-	-
% of sales	-	-	-	0.5%	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	275,154	342,900	
YoY	-	-	-	-	5.4%	6.3%	14.5%	11.7%	5.0%	-4.0%	-1.0%	7.3%*	
Dairy Ingredients and Cheese	101,820	111,717	113,123	122,148	129,810	141,540	148,091	172,885	198,445	204,105	191,575	192,431	232,700
YoY	5.4%	9.7%	1.3%	8.0%	6.3%	9.0%	4.6%	16.7%	14.8%	2.9%	-6.1%	0.4%	6.7%*
Price per ton (JPY)	-	-	-	392,136	492,861	487,827	408,823	405,003	429,792	417,462	408,874	423,373	417,275
YoY	-	-	-	-	25.7%	-1.0%	-16.2%	-0.9%	6.1%	-2.9%	-2.1%	3.5%	0.7%*
Meat Products	-	-	-	25,809	25,010	28,029	26,349	21,595	21,532	21,925	21,925	25,210	32,000
YoY	-	-	-	-	-3.1%	12.1%	-6.0%	-18.0%	-0.3%	1.8%	15.0%	13.4%*	
Price per ton (JPY)	-	-	-	607,257	617,713	582,896	578,883	582,357	570,314	542,531	515,272	537,500	
YoY	-	-	-	-	1.7%	-5.6%	-0.7%	0.6%	-2.1%	-4.9%	-5.0%	-0.3%*	
Asia Business: dairy ingredients	-	-	-	34,914	34,223	37,472	45,014	52,822	59,925	60,159	52,920	72,600	
YoY	-	-	-	-	-2.0%	9.5%	20.1%	17.3%	13.4%	0.4%	-12.0%	6.5%*	
Price per ton (JPY)	-	-	-	-	-	-	296,530	275,983	267,434	283,000	295,540	283,747	
YoY	-	-	-	-	-	-	-	-6.9%	-3.1%	5.8%	4.4%	0.1%*	
Asia Business: cheese	-	-	-	1,730	1,959	1,912	2,509	2,668	3,737	4,197	4,593	5,600	
YoY	-	-	-	-	13.2%	-2.4%	31.2%	6.3%	40.1%	12.3%	9.4%	10.1%*	
Price per ton (JPY)	-	-	-	-	-	-	764,847	793,103	709,393	689,778	679,295	642,857	
YoY	-	-	-	-	-	-	-	3.7%	-10.6%	-2.8%	-1.5%	-2.3%*	

Source: Shared Research based on company data

* Note: Represents compound average annual growth rate from FY11/19 through FY11/22 (company forecast)

** Figures rounded to the nearest million yen (amounts less than JPY1mn are rounded down in materials

released by the company).

Quarterly (cumulative) earnings

Cumulative (JPYmn)	FY11/18				FY11/19				FY11/20				FY11/20	
	Q1 Cons.	Q2 Cons.	Q3 Cons.	Q4 Cons.	Q1 Cons.	Q2 Cons.	Q3 Cons.	Q4 Cons.	Q1 Cons.	Q2 Cons.	Q3 Cons.	Q4 Cons.	% of Est.	Est.
Sales	29,462	59,165	87,943	115,441	27,886	57,712	87,536	116,794	28,222	57,912	85,065	110,838	99.9%	111,000
YoY	35.3%	27.3%	20.7%	13.9%	-5.3%	-2.5%	-0.5%	1.2%	1.2%	0.3%	-2.8%	-5.1%		0.1%
Dairy Ingredients and Cheese	21,972	43,812	65,668	85,290	21,109	42,675	64,795	85,206	20,061	39,927	59,925	78,330		
YoY	61.9%	46.4%	33.5%	21.8%	-3.9%	-2.6%	-1.3%	-0.1%	-5.0%	-6.4%	-7.5%	-8.1%		
% of sales	74.6%	74.1%	74.7%	73.9%	75.7%	73.9%	74.0%	73.0%	71.1%	68.9%	70.4%	70.7%		
Meat Products	3,337	6,616	9,607	12,576	2,941	6,104	9,291	12,280	2,900	6,107	8,781	11,895		
YoY	-22.4%	-21.1%	-19.3%	-17.6%	-11.8%	-7.7%	-3.3%	-2.4%	-1.4%	0.0%	-5.5%	-3.1%		
% of sales	11.3%	11.2%	10.9%	10.9%	10.5%	10.6%	10.6%	10.5%	10.3%	10.5%	10.3%	10.7%		
Asia Business and other	4,151	8,735	12,667	17,572	3,834	8,932	13,449	19,307	5,259	11,876	16,358	20,611		
YoY	6.4%	6.9%	7.9%	9.4%	-7.6%	2.3%	6.2%	9.9%	37.2%	33.0%	21.6%	6.8%		
% of sales	14.1%	14.8%	14.4%	15.2%	13.7%	15.5%	15.4%	16.5%	18.6%	20.5%	19.2%	18.6%		
Dairy ingredients	3,436	7,302	10,431	14,578	2,992	7,303	11,013	16,026	4,411	10,138	13,752	17,025		
YoY	5.6%	6.1%	6.7%	9.2%	-12.9%	0.0%	5.6%	9.9%	47.4%	38.8%	24.9%	6.2%		
% of sales	11.7%	12.3%	11.9%	12.6%	10.7%	12.7%	12.6%	13.7%	15.6%	17.5%	16.2%	15.4%		
Cheese	499	997	1,552	2,116	658	1,284	1,963	2,651	680	1,352	2,036	2,895		
YoY	10.0%	12.1%	13.1%	10.3%	31.9%	28.8%	26.5%	25.3%	3.3%	5.3%	3.7%	9.2%		
% of sales	1.7%	1.7%	1.8%	1.8%	2.4%	2.2%	2.2%	2.3%	2.4%	2.3%	2.4%	2.6%		
Other	216	436	684	878	184	345	473	630	168	386	570	691		
YoY	9.6%	9.5%	15.5%	10.7%	-14.8%	-20.9%	-30.8%	-28.2%	-8.7%	11.9%	20.5%	9.7%		
% of sales	0.7%	0.7%	0.8%	0.8%	0.7%	0.6%	0.5%	0.5%	0.6%	0.7%	0.7%	0.6%		
< Sales volume (tons)>														
Dairy Ingredients and Cheese	53,509	104,168	154,317	198,445	49,784	100,139	152,953	204,105	49,413	98,294	145,534	191,575		
YoY	49.6%	37.9%	25.2%	14.8%	-7.0%	-3.9%	-0.9%	2.9%	-0.7%	-1.8%	-4.9%	-6.1%		
Meat Products	5,789	11,366	16,505	21,595	4,985	10,511	16,317	21,532	5,220	11,453	16,143	21,925		
YoY	-22.7%	-22.0%	-19.9%	-18.0%	-13.9%	-7.5%	-1.1%	-0.3%	4.7%	9.0%	-1.1%	1.8%		
Asia Business: dairy ingredients	11,977	26,431	38,409	52,822	11,298	27,892	41,746	59,925	14,676	34,921	48,281	60,159		
YoY	10.4%	14.4%	15.8%	17.3%	-5.7%	5.5%	8.7%	13.4%	29.9%	25.2%	15.7%	0.4%		
Asia Business: cheese	643	1,289	1,950	2,668	874	1,804	2,732	3,737	1,014	1,983	2,949	4,197		
YoY	4.6%	9.8%	8.0%	6.3%	35.8%	40.0%	40.1%	40.1%	16.0%	9.9%	7.9%	12.3%		
< Average price (JPY/kg) >														
Dairy Ingredients and Cheese	411	421	426	430	424	426	424	417	406	406	412	409		
YoY	8.2%	6.2%	6.6%	6.1%	3.3%	1.3%	-0.4%	-2.9%	-4.3%	-4.7%	-2.8%	-2.1%		
Meat products	576	582	582	582	590	581	569	570	556	533	544	543		
YoY	0.4%	1.2%	0.7%	0.6%	2.3%	-0.2%	-2.2%	-2.1%	-5.8%	-8.2%	-4.5%	-4.9%		
Asia Business: dairy ingredients	287	276	272	276	265	262	264	267	301	290	285	283		
YoY	-4.3%	-7.2%	-7.8%	-6.9%	-7.7%	-5.2%	-2.9%	-3.1%	13.5%	10.9%	8.0%	5.8%		
Asia Business: cheese	776	773	796	793	753	712	719	709	671	682	690	690		
YoY	5.4%	2.1%	4.8%	3.7%	-3.0%	-8.0%	-9.7%	-10.6%	-10.9%	-4.2%	-3.9%	-2.8%		
CoGS	27,942	56,028	83,001	108,930	26,319	54,347	82,387	109,994	26,535	54,505	79,981	104,211		
YoY	38.1%	28.4%	20.7%	13.5%	-5.8%	-3.0%	-0.7%	1.0%	0.8%	0.3%	-2.9%	-5.3%		
CoGS ratio	94.8%	94.7%	94.4%	94.4%	94.4%	94.2%	94.1%	94.2%	94.0%	94.1%	94.0%	94.0%		
Gross profit	1,519	3,137	4,942	6,511	1,567	3,365	5,149	6,801	1,686	3,407	5,084	6,626		
YoY	-1.3%	9.7%	21.9%	20.9%	3.1%	7.3%	4.2%	4.4%	7.6%	1.2%	-1.3%	-2.6%		
GPM	5.2%	5.3%	5.6%	5.6%	5.6%	5.8%	5.9%	5.8%	6.0%	5.9%	6.0%	6.0%		
SG&A expenses	752	1,657	2,568	3,502	831	1,757	2,660	3,656	922	1,826	2,709	3,667		
YoY	-1.3%	3.7%	6.7%	1.1%	10.4%	6.0%	3.6%	4.4%	10.9%	3.9%	1.8%	0.3%		
SG&A ratio	2.6%	2.8%	2.9%	3.0%	3.0%	3.0%	3.0%	3.1%	3.3%	3.2%	3.2%	3.3%		
Operating profit	767	1,480	2,374	3,009	736	1,608	2,490	3,144	764	1,581	2,375	2,959		
YoY	-1.4%	17.2%	44.0%	56.4%	-4.0%	8.7%	4.9%	4.5%	3.8%	-1.7%	-4.6%	-5.9%		
OPM	2.6%	2.5%	2.7%	2.6%	2.6%	2.8%	2.8%	2.7%	2.7%	2.7%	2.8%	2.7%		
Gains (losses) on foreign exchange	38	-219	-256	-135	-116	-185	-186	-114	15	-39	-21	3		
YoY	-93.8%	-	-	-	-	-	-	-	-	-	-	-		
% of sales	0.1%	-0.4%	-0.3%	-0.1%	-0.4%	-0.3%	-0.2%	-0.1%	0.1%	-0.1%	0.0%	0.0%		
OP + Gains (losses) on forex	805	1,261	2,118	2,874	620	1,423	2,303	3,030	780	1,542	2,354	2,962		
YoY	-42.1%	-35.9%	-17.7%	-6.8%	-22.9%	12.8%	8.8%	5.4%	25.7%	8.4%	2.2%	-2.2%		
% of sales	2.7%	2.1%	2.4%	2.5%	2.2%	2.5%	2.6%	2.6%	2.8%	2.7%	2.8%	2.7%		
Ordinary income	746	1,133	1,924	2,613	536	1,253	2,087	2,747	753	1,434	2,209	2,781	95.9%	2,900
YoY	-41.4%	-36.1%	-17.1%	3.6%	-28.2%	10.5%	8.4%	5.1%	40.6%	14.5%	5.8%	1.2%		4.3%
Profit margin	2.5%	1.9%	2.2%	2.3%	1.9%	2.2%	2.4%	2.4%	2.7%	2.5%	2.6%	2.5%		2.6%
Net income	493	736	1,291	1,784	376	888	1,490	1,963	546	1,040	1,608	2,062	101.6%	2,030
YoY	-42.5%	-38.7%	-17.9%	1.7%	-23.8%	20.5%	15.4%	10.0%	45.3%	17.2%	7.9%	5.1%		-1.6%
Net margin	1.7%	1.2%	1.5%	1.5%	1.3%	1.5%	1.7%	1.7%	1.9%	1.8%	1.9%	1.9%		1.8%
Foreign exchange														
USD/JPY	110.61	109.18	109.73	110.47	110.62	110.78	109.71	109.33	109.53	108.55	107.97	107.27		
EUR/JPY	134.17	132.52	131.34	130.91	125.89	125.30	123.73	122.63	120.87	119.33	120.52	121.40		

Source: Shared Research based on company data

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

Quarterly earnings

Quarterly (JPYmn)	FY11/18				FY11/19				FY11/20			
	Q1 Cons.	Q2 Cons.	Q3 Cons.	Q4 Cons.	Q1 Cons.	Q2 Cons.	Q3 Cons.	Q4 Cons.	Q1 Cons.	Q2 Cons.	Q3 Cons.	Q4 Cons.
Sales	29,462	29,703	28,778	27,498	27,886	29,826	29,824	29,258	28,222	29,690	27,153	25,773
YoY	35.3%	20.3%	9.1%	-3.5%	-5.3%	0.4%	3.6%	6.4%	1.2%	-0.5%	-9.0%	-11.9%
CoGS	27,942	28,085	26,974	25,929	26,319	28,028	28,040	27,607	26,535	27,969	25,476	24,231
YoY	38.1%	20.1%	7.2%	-4.5%	-5.8%	-0.2%	4.0%	6.5%	0.8%	-0.2%	-9.1%	-12.2%
CoGS ratio	94.8%	94.6%	93.7%	94.3%	94.4%	94.0%	94.0%	94.4%	94.0%	94.2%	93.8%	94.0%
Gross profit	1,519	1,618	1,805	1,569	1,567	1,798	1,784	1,651	1,686	1,721	1,677	1,542
YoY	-1.3%	22.6%	51.0%	17.8%	3.1%	11.1%	-1.1%	5.2%	7.6%	-4.3%	-6.0%	-6.6%
GPM	5.2%	5.4%	6.3%	5.7%	5.6%	6.0%	6.0%	5.6%	6.0%	5.8%	6.2%	6.0%
SG&A expenses	752	905	910	934	831	926	903	997	922	904	883	958
YoY	-1.3%	8.4%	12.7%	-11.7%	10.4%	2.3%	-0.9%	6.7%	10.9%	-2.4%	-2.2%	-3.8%
SG&A ratio	2.6%	3.0%	3.2%	3.4%	3.0%	3.1%	3.0%	3.4%	3.3%	3.0%	3.3%	3.7%
Operating profit	767	713	894	635	736	872	882	655	764	817	794	584
YoY	-1.4%	47.1%	131.1%	131.2%	-4.0%	22.3%	-1.4%	3.1%	3.8%	-6.3%	-10.0%	-10.8%
OPM	2.6%	2.4%	3.1%	2.3%	2.6%	2.9%	3.0%	2.2%	2.7%	2.8%	2.9%	2.3%
Gains (losses) on foreign exchange	38	-257	-37	121	-116	-69	-1	72	15	-54	18	24
YoY	-93.8%	-	-	-48.3%	-	-	-	-40.3%	-	-	-	-66.5%
% of sales	0.1%	-0.9%	-0.1%	0.4%	-0.4%	-0.2%	0.0%	0.2%	0.1%	-0.2%	0.1%	0.1%
OP + Gains (losses) on forex	805	456	857	756	620	802	881	727	780	762	812	608
YoY	-42.1%	-21.2%	41.3%	48.7%	-22.9%	75.9%	2.7%	-3.9%	25.7%	-5.0%	-7.8%	-16.3%
% of sales	2.7%	1.5%	3.0%	2.7%	2.2%	2.7%	3.0%	2.5%	2.8%	2.6%	3.0%	2.4%
Ordinary income	746	388	791	688	536	717	834	660	753	680	775	572
YoY	-41.4%	-22.6%	44.5%	240.7%	-28.2%	84.9%	5.5%	-4.1%	40.6%	-5.1%	-7.1%	-13.3%
Profit margin	2.5%	1.3%	2.7%	2.5%	1.9%	2.4%	2.8%	2.3%	2.7%	2.3%	2.9%	2.2%
Net income	493	243	555	493	376	512	602	473	546	495	567	455
YoY	-42.5%	-29.2%	48.9%	170.8%	-23.8%	110.6%	8.6%	-4.0%	45.3%	-3.4%	-5.9%	-3.9%
Net margin	1.7%	0.8%	1.9%	1.8%	1.3%	1.7%	2.0%	1.6%	1.9%	1.7%	2.1%	1.8%

Source: Shared Research based on company data

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

Medium-term strategy

Achieve sustained growth by growing business with existing customers and building new 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, 2021, it rolled over the targets of its NEXT-LJ2022 (covering FY11/20–FY11/22) and announced NEXT-LJ2023 (covering FY11/21–FY11/23).

Summary

Under its NEXT-LJ2023 medium-term business plan, the company is targeting FY11/23 sales of JPY141.0bn (+27.2% vs FY11/20), ordinary income of JPY3.5bn (+25.9%), and net income attributable to parent company shareholders of JPY2.5bn (+21.2%). Lacto Japan has rolled over the various performance targets for the final year (FY11/22) of its previous NEXT-LJ2022 plan for use as the targets of the final year (FY11/23) of its current NEXT-LJ2023 plan. This move was the result of a review of the business environment and assumptions, which was conducted in response to the COVID-19 pandemic. 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-LJ2023

(JPYmn)	FY11/19 Act.	FY11/20 Act.	FY11/21 Est.	FY11/23 Est.
Sales	116,794	110,838	115,000	141,000
Ordinary income	2,747	2,781	2,600	3,500
Profit margin	2.4%	2.5%	2.3%	2.5%
Net income	1,963	2,062	1,850	2,500
Net margin	1.7%	1.9%	1.6%	1.8%

Source: Shared Research based on company data

Medium-term strategy

- ▶ Targeting sales of JPY141.0bn in FY11/23 (+27.2% vs. FY11/20 result)
- ▶ Ordinary income target of JPY3.5bn (+25.9%)
- ▶ 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

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.

- ▶ Japan market
 - Demand for dairy products for home consumption will solidify as consumers become more health-conscious.
 - Interest in health will propel the need for functional foods development.
 - Demand for commercial dairy products will decline due to the pandemic.
 - Bidding volume for state-controlled trade items (including skim milk powder and butter) will decline due to excess domestic dairy ingredient inventory.
 - Activity restrictions to prevent transmission of COVID-19 will continue to have a negative impact on sales efforts.
- ▶ Asia market
 - Asian economies will recover from the impact of the pandemic more quickly than the economies of Europe, the US, and Japan.
 - The westernization of diets will continue in Asia.
 - The Lacto Approach* to sales will take hold throughout the company’s sales areas.
 - Demand for Japan-branded foods will become more prominent.

* Lacto Approach: A sales method aimed at precisely targeting the needs of customers that Lacto Japan has served for many years in the Japanese market. Accomplishing this involves the use of global networks to provide information and reliable supply of quality ingredients. Meeting customers’ needs also entails the provision of knowledge and expertise by a team of professionals.

Basic policy: Grow business with existing customers, and create next-generation businesses

The plan consists of three key initiatives.

- ✔ Grow business with existing customers* and secure new customers
- ✔ Expand business in fast-growing markets in Asia
- ✔ Build next-generation businesses

Medium-term business plan NEXT-LJ2023



Source: Shared Research based on company data

Key initiatives

- ✔ Grow business with existing customers and secure new customers:

Grow business with existing customers

In terms of business with existing customers, the company aims to implement measures on the theme of evolution, by which it means it will use the expertise it has cultivated over many years as a trading company specializing in food ingredients, together with trade systems such as those established by TPP-11, Japan-EU EPA, and the Japan-US trade agreement, to actively propose and supply optimal ingredients meeting customer needs in terms of origin, cost, quality, and delivery timing.

Secure new customers

Lacto Japan will take a more proactive approach to broaden its customer base in industries that have need of dairy ingredients but have not yet done business with the company, and in industries that have need of new products such as functional food ingredients.

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 cannot be 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 business in Asia:

Expand sales area

The company has designated regions where diets and food cultures are being increasingly westernized as priority regions and aims to develop sales operations using its Lacto Approach to initiate business with local distributors and companies. It currently considers the Philippines, China, Malaysia, Thailand, Indonesia, and Vietnam as priority markets. The aim is to further build on the approach used in the Philippines (taking business from leading dairy ingredients suppliers with large market shares), and use these proven models to open up new sales routes in emerging markets within Southeast Asia.

Enhance sales network

In existing sales areas, the company aims to continue and improve on its Lacto Approach to advance its position from being just one of several suppliers used by each customer to being their main supplier.

According to Lacto Japan, the company has more than eight 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.

Enhance manufacturing business

Lacto Japan aims to further develop proprietary products, establish itself as a B2B processed cheese manufacturer, and become the top brand of cheese for commercial use in Asia.

Expand product lineup

The company aims to expand sales of ingredients in response to changes and growth in the market by expanding its lineup of products for customers in Asia. It will also work to increase sales by exporting Japanese dairy products, which are regarded in Singapore and other countries as high value-added products.

Build next-generation businesses:

Develop and launch new products

Lacto Japan will expand its handling of functional food ingredients* and 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.

Enter new businesses displaying strong synergies with existing businesses

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 and that it can expect to generate synergies with its existing businesses.

Build sound foundation for sustained growth:

Transition to a company with an Audit & Supervisory Committee

Following a resolution at the general meeting of shareholders held on February 25, 2021, Lacto Japan will change 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.

Establish sustainable management

The company is stepping up its environmental, social, and governance (ESG) initiatives. It actively discloses details and information on progress of these initiatives via its website and other means.

Specific initiatives

- (1) Enhance product development and proposal-based sales (Dairy Ingredients and Cheese): Lacto Japan aims to develop value-added products based on imported ingredients and enhance its proposal-based sales. Specifically, it plans to do the following.
 - Develop products in response to free trade agreements: TPP-11, Japan-EU EPA, and other free trade agreements will lower tariffs on ingredients and provide opportunities for product development due to different tariff treatment for new ingredient combinations. The company will therefore work with suppliers to

develop new ingredients and propose them to customers (some proposals have already been made).

- Develop ingredients that help users lower their operating costs: Even considering a post-pandemic world, the company believes the difficulty of securing labor in Japan will lead to the need for more efficient manufacturing processes. For example, skim milk powder is bagged for shipping, so the customer's manufacturing process requires cutting open the bags and feeding the powder into its machines. If the company were to deliver ingredients in liquid form, the customer could save time and effort in their manufacturing process.
- Enhance efforts with recipe development companies responsible for product development for convenience stores, beverage manufacturers, and others: Lacto Japan conducts sales activities targeting convenience stores and supermarkets, but it is the recipe development companies (vendors) that actually select ingredients, so it plans to make proposals directly to those vendors. For example, the company can use its specialized knowledge to propose dairy ingredients to vendors that can help improve the quality of desserts they manufacture.
- Develop products in line with ESG themes: The company will develop and propose eco-conscious ingredients, as well as traceable and plant-based raw materials.

(2) Actively develop functional food ingredient business (Dairy Ingredients and Cheese, other business)

Sales activities:

- Lacto Japan will prioritize proposals to existing customers through collaboration between its business development and dairy ingredient divisions.
- Approach new fields, starting with sports nutrition: Demand for milk proteins has increased as there are more people seeking to increase their protein intake while exercising at home during the pandemic. Lacto Japan supplies ingredients to OEM manufacturers of protein products for sports gyms and others. Previously, OEM manufacturers were procuring their ingredients from supplement companies, but prices were high and types of milk protein limited. However, because Lacto Japan is a milk protein expert and can procure a variety of ingredients at relatively low cost, it has been seeing an increase in the volume it supplies to OEM manufacturers.

Product development:

- Lacto Japan will coordinate with overseas bases to enhance the development of new products and of relationships with suppliers of milk protein ingredients.
- Expand lineup of new products such as plant-based foods (PBFs): Lacto Japan has started handling oats and nuts. Nuts are commoditized, but the company primarily imports almonds from South America. From the point of view of ESG, there is concern over the possible use of child labor and agrochemicals, but Lacto Japan selects ethically sourced items, which it imports as special ingredients for supply to the market.

(3) Start export sales of Japanese dairy products (Dairy Ingredients and Cheese, Asia Business [dairy ingredient sales]): Lacto Japan aims to leverage its superior position to establish an export and sales business for Japanese dairy products.

Exporting to Asia:

- The company aims to develop the ASEAN and China markets.
- The Japanese government is working to step up exports of foods and of agricultural, forestry, and fishery products*.

Leveraging Lacto Japan's strengths:

- The company will leverage its established sales network in Asia.
- It will leverage its good relationships with Japanese dairy product manufacturers to procure competitive products.

* The export value of Japan's agricultural, forestry, and fishery products has grown from JPY449.7bn in 2012 to JPY912.1bn in 2019. The Japanese government has set goals for further expansion, to JPY2tn in 2025 and JPY5tn in 2030. Milk and dairy products are included among 27 product categories (described as government priorities) with room for expanding exports thanks to their good reputation overseas. Of the JPY587.8bn in agricultural product exports in 2019, milk and dairy products accounted for JPY18.4bn. The government is targeting agricultural product exports of JPY1.3tn in 2025 and JPY3.3tn in 2030. (Source: Ministry of Agriculture, Forestry and Fisheries, "Trends in Agriculture, Forestry and Fisheries Administration and Agriculture and Food Industry Countermeasures in the COVID-19 and Post-COVID-19 Eras")

Lacto Japan has been looking for ways to export Japanese products to Asian markets for several years, and has already been exporting milk from a certain manufacturers for sale in Singapore. Despite a relatively high price because of it being an export product, the milk has been selling well, particularly due to increased home consumption triggered by the pandemic. Mainly affluent customers are eager to buy Hokkaido-branded milk.

Now that the company has confirmed the demand for Japanese dairy products in Singapore, its next target is the Chinese market. China has essentially stopped importing foods from Japan because of the nuclear energy disaster in Fukushima. However, once imports resume, Lacto Japan would like to export Japanese dairy products to the Chinese market as premium Japan-branded products.

(4) Enhance development of cheese and improve production systems (Asia Business, Dairy Ingredients and Cheese):

The company has been operating in Asia as a processed cheese manufacturer for more than a decade, but competition has been increasing in recent years. Nevertheless, it thinks it has a lead on its peers due to its strong ability to develop products suited to customer needs, as it already has a number of success stories. It currently has four or five products under development, and believes it can expect further growth as it steadily brings new products to market.

Since Asia has fierce price competition, the fact that Lacto Japan can procure competitively priced cheese ingredients from around the world works to its advantage.

Regarding the company's review of production systems, expansion of the Singapore plant is currently on hold due to the COVID-19 pandemic, but once the pandemic winds down, construction will resume and production capacity will increase. As the customer base is expanding, with European customers also showing interest in

products made in Asia, the company is considering exporting from Singapore. For this reason, it is working to obtain international certification for the Singapore plant. Once it obtains the certification, it will consider expanding its sales channels to Europe and the US.

With expansion of the Singapore plant, annual production capacity will increase by 1,000 tons. Currently, the plant operates in two shifts during the peak season, but the expansion will provide even more leeway in production. The company has not changed its sales volume plan despite the pandemic and postponement of plant expansion.

(5) Enhance sales capacity with focus on localization (Asia Business [dairy ingredient sales])

Localization has been an issue ever since the company first ventured into Asian markets outside Japan. The knowledge, sales style, and expertise it has cultivated in Japan have been well received by local customers elsewhere in Asia and up until now Japanese employees were conducting sales activities using the Lacto Approach. Hereafter, the company says it will train local employees in its methods. Currently, Japanese sales staff are training several candidates (one each in Singapore, Thailand, and the Philippines). The company believes sales staff trained in both Japanese and local Asian styles will be significant assets and intends to expand its training program to include additional countries such as Vietnam and Cambodia.

Outlook for longer-term use of funds

- ▶ Investments for growth of cheese manufacturing and sales business in Asia: Construction of new factories and other projects
- ▶ Further increase in financial soundness: Increase 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)
- ▶ Use funds to start new businesses: Consider business alliances and M&A

Review of previous medium-term plan, NEXT-LJ2022 (Reference)

- ▶ Build next-generation businesses: Lacto Japan established a functional food ingredients team in its business development division and began handling new products (including milk proteins, collagen, and glucosamine). It also enhanced coordination with overseas bases to make arrangements for handling new functional food ingredients.
- ▶ 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. However, the COVID-19 pandemic has delayed expansion of the Singapore plant (the company now expects the expanded plant to be operational during FY11/21).
- ▶ 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: In response to the pandemic, Lacto Japan began work style reform measures early, including establishing a telework system.

It also made progress on enhancing governance (resolving to transition to a company with an Audit & Supervisory Committee).

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 39% 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 clients 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 140 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 (as of FY11/20). The company has benefited from the fact that dairy product imports grew at a CAGR of 4.4% over the nine years from FY2010 to FY2019, while Japan's dairy product output declined at a CAGR of 0.4% over the same period. Since FY2000, however, domestic consumption of dairy products has grown at a CAGR of 1.3% only 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

(JPYmn)	Income statement										
	FY11/11	FY11/12	FY11/13	FY11/14	FY11/15	FY11/16	FY11/17	FY11/18	FY11/19	FY11/20	FY11/21 Est.
	Parent	Parent	Cons.								
Sales	56,089	55,201	75,943	96,550	98,001	88,679	101,335	115,441	116,794	110,838	115,000
YoY	20.9%	-1.6%	37.6%	27.1%	1.5%	-9.5%	14.3%	13.9%	1.2%	-5.1%	3.8%
CoGS			72,684	92,291	94,352	82,333	95,948	108,930	109,994	104,211	
YoY	-	-	-	27.0%	2.2%	-12.7%	16.5%	13.5%	1.0%	-5.3%	
CoGS ratio	-	-	95.7%	95.6%	96.3%	92.8%	94.7%	94.4%	94.2%	94.0%	
Gross profit			3,259	4,259	3,648	6,346	5,387	6,511	6,801	6,626	
YoY	-	-	-	30.7%	-14.3%	73.9%	-15.1%	20.9%	4.4%	-2.6%	
GPM	-	-	4.3%	4.4%	3.7%	7.2%	5.3%	5.6%	5.8%	6.0%	
SG&A expenses			2,559	2,727	2,928	2,996	3,463	3,502	3,656	3,667	
YoY	-	-	-	6.6%	7.4%	2.3%	15.6%	1.1%	4.4%	0.3%	
SG&A ratio	-	-	3.4%	2.8%	3.0%	3.4%	3.4%	3.0%	3.1%	3.3%	
Operating profit			700	1,532	720	3,349	1,924	3,009	3,144	2,959	
YoY	-	-	-	118.8%	-53.0%	365.1%	-42.6%	56.4%	4.5%	-5.9%	
OPM	-	-	0.9%	1.6%	0.7%	3.8%	1.9%	2.6%	2.7%	2.7%	
Forex gains (losses)			1,189	638	1,053	-1,537	1,159	-135	-114	3	
YoY	-	-	-	-46.3%	65.0%	-	-	-	-	-	
% of sales	-	-	1.6%	0.7%	1.1%	-1.7%	1.1%	-0.1%	-0.1%	0.0%	
OP + Gains (losses) on forex			1,889	2,170	1,773	1,812	3,082	2,874	3,030	2,962	
YoY	-	-	-	14.9%	-18.3%	2.2%	70.1%	-6.8%	5.4%	-2.2%	
% of sales	-	-	2.5%	2.2%	1.8%	2.0%	3.0%	2.5%	2.6%	2.7%	
Other non-operating income (expenses)			-219	-516	-430	-378	-560	-261	-284	-178	
YoY	-	-	-	-	-	-	-	-	-	-	
% of sales	-	-	-0.3%	-0.5%	-0.4%	-0.4%	-0.6%	-0.2%	-0.2%	-0.2%	
Ordinary income	1,497	787	1,670	1,653	1,343	1,434	2,523	2,613	2,747	2,781	2,600
YoY	70.9%	-47.4%	112.2%	-1.0%	-18.8%	6.8%	75.9%	3.6%	5.1%	1.2%	-6.5%
Profit margin	2.7%	1.4%	2.2%	1.7%	1.4%	1.6%	2.5%	2.3%	2.4%	2.5%	2.3%
Net income attrib. to parent company shareholders	845	422	1,007	988	831	946	1,755	1,784	1,963	2,062	1,850
YoY	49.4%	-50.0%	138.6%	-1.9%	-15.9%	13.8%	85.5%	1.7%	10.0%	5.1%	-10.3%
Net margin	1.5%	0.8%	1.3%	1.0%	0.8%	1.1%	1.7%	1.5%	1.7%	1.9%	1.6%
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										
	FY11/11	FY11/12	FY11/13	FY11/14	FY11/15	FY11/16	FY11/17	FY11/18	FY11/19	FY11/20
(JPYmn)	Parent	Parent	Cons.							
Cash and deposits	-	-	3,305	4,300	5,132	6,724	4,006	4,930	4,475	5,005
Notes and accounts receivable	-	-	11,908	14,941	12,695	14,278	17,199	15,873	17,852	13,849
Inventories	-	-	13,180	19,193	18,496	13,101	21,446	25,216	22,946	21,383
Merchandise and finished goods	-	-	13,053	19,040	18,331	12,910	21,178	24,873	22,618	21,008
Raw materials and supplies	-	-	126	153	165	191	268	343	328	375
Deferred tax asset	-	-	8	11	124	28	139	101	0	-
Other	-	-	708	1,694	316	1,001	700	318	501	386
Total current assets	-	-	29,109	40,139	36,764	35,133	43,491	46,337	45,775	40,623
Tangible fixed assets	-	-	344	715	698	663	560	597	569	691
Buildings and structures	-	-	117	142	268	262	205	250	191	175
Machinery, equipment, and vehicles	-	-	133	226	281	287	263	221	229	192
Lease assets	-	-	-	3	135	96	73	42	121	256
Other	-	-	12	12	14	11	11	33	28	28
Land	-	-	28	-	-	-	-	-	-	-
Construction in progress	-	-	53	332	-	7	7	52	0	41
Intangible assets	-	-	150	125	95	56	21	39	30	20
Investments and other assets	-	-	1,407	1,543	1,765	1,711	1,833	1,917	1,762	2,035
Investment securities	-	-	658	735	900	790	998	889	738	784
Deferred tax asset	-	-	181	149	45	82	102	117	160	273
Other	-	-	568	661	822	839	735	915	863	996
Allowance for doubtful accounts	-	-	-	-1	-1	-1	-1	-3	-	-17
Total fixed assets	-	-	1,901	2,382	2,558	2,429	2,414	2,631	2,360	2,746
Total assets	22,662	21,894	31,010	42,522	39,322	37,562	45,905	48,968	48,135	43,370
Accounts payable	-	-	6,559	10,189	8,620	6,890	11,411	11,174	12,649	9,740
Short-term borrowings	-	-	7,031	10,476	1,560	209	4,796	8,686	6,100	5,500
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
Income taxes payable	-	-	587	300	175	298	657	397	410	491
Deferred tax liability	-	-	-	378	-	130	-	-	18	40
Other	-	-	418	602	703	878	460	730	946	719
Total current liabilities	-	-	17,908	25,553	15,099	12,500	20,908	23,979	27,198	19,939
Corporate bonds	-	-	485	385	860	1,590	1,380	720	270	0
Long-term borrowings	-	-	4,839	6,708	12,202	11,209	9,926	8,493	4,050	5,060
Deferred tax liability	-	-	48	65	73	61	91	72	18	40
Net defined benefit liability	-	-	264	269	263	297	264	279	311	350
Provision for directors' retirement benefits	-	-	265	313	225	269	-	-	-	-
Asset retirement obligations	-	-	11	37	37	36	36	36	36	38
Other	-	-	60	60	171	181	515	982	287	351
Total fixed liabilities	-	-	5,973	7,837	13,832	13,643	12,212	10,557	4,972	5,839
Total liabilities	-	-	23,880	33,390	28,931	26,142	33,120	34,561	32,171	25,778
Shareholder's equity	5,170	5,664	6,698	7,673	9,646	10,446	12,050	13,655	15,416	17,328
(Treasury stock)	-	-	(11)	-	-	-	0	0	-53	-11
Accumulated other comprehensive income	-	-	401	1,459	744	973	700	666	480	195
Non-controlling interests	-	-	30	-	-	-	-	-	-	-
Share subscription rights	-	-	-	-	-	-	36	111	69	69
Total net assets	-	-	7,130	9,132	10,391	11,419	12,785	14,432	15,964	17,592
Net debt	-	-	12,362	16,877	13,531	10,378	15,679	15,962	13,038	9,045
Working capital	-	-	18,528	23,946	22,571	20,489	27,234	29,916	28,150	25,493

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

Per-share data (JPY)

Per-share data (JPY)										
	FY11/11	FY11/12	FY11/13	FY11/14	FY11/15	FY11/16	FY11/17	FY11/18	FY11/19	FY11/20
	Parent	Parent	Cons.							
Shares issued (year-end)	3,918,200	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
EPS	220.75	109.80	261.49	255.57	197.87	193.57	358.96	364.62	200.11	209.47
EPS (fully diluted)	-	-	-	-	-	-	354.31	356.97	195.98	205.73
Dividend per share	16.00	16.00	30.00	30.00	30.00	32.00	38.00	40.00	22.00	30.00
Book value per share	1,346.44	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

Source: Shared Research based on company data

Cash flow statement

Cash flow statement										
	FY11/11	FY11/12	FY11/13	FY11/14	FY11/15	FY11/16	FY11/17	FY11/18	FY11/19	FY11/20
(JPYmn)	Parent	Parent	Cons.							
Cash flows from operating activities	-	-	-3,229	-4,062	2,535	3,560	-5,048	356	3,365	4,534
Cash flows from investing activities	-	-	-130	-541	-242	5	-137	-864	849	-137
Cash flows from financing activities	-	-	3,802	5,412	-1,476	-1,655	2,385	990	-3,695	-3,764

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

Financial indicators

Financial indicators										
	FY11/11	FY11/12	FY11/13	FY11/14	FY11/15	FY11/16	FY11/17	FY11/18	FY11/19	FY11/20
	Parent	Parent	Cons.							
ROA (OI-based)	7.0%	3.5%	6.3%	4.5%	3.3%	3.7%	6.0%	5.5%	5.7%	6.1%
ROE	17.7%	7.8%	15.6%	12.2%	8.5%	8.7%	14.5%	13.2%	13.0%	12.3%
Inventory turnover	-	-	-	4.8	5.0	5.2	5.6	4.7	4.6	4.7
Fixed assets turnover	-	-	-	135.0	138.7	130.4	165.8	199.6	200.3	176.0
Current ratio	-	-	162.6%	157.1%	243.5%	281.1%	208.0%	193.2%	168.3%	203.7%
Net assets ratio	22.8%	25.9%	22.9%	21.5%	26.4%	30.4%	27.8%	29.2%	33.0%	40.4%

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 expects to pay a dividend of JPY30 per share in FY11/20 (+JPY8 YoY) and JPY32 per share in FY11/21 (+JPY2 YoY). At the same time, Lacto Japan aims to realize a 20% payout ratio in FY11/23 (versus 14.3% in FY11/20 and an estimated 17.1% in FY11/21). 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 Asia Business and will work to strengthen its financial position to achieve this.

Shareholders

Shareholders	As of November 30, 2020	
	Shares	Shareholding ratio
Custody Bank of Japan, Ltd. (Trust account)	1,411,900	14.3%
The Master Trust Bank of Japan, Ltd. (Trust account)	950,300	9.6%
Shigeru Yasumi	311,400	3.2%
The Nomura Trust and Banking Co., Ltd. (Trust account)	287,600	2.9%
Motohisa Miura	245,552	2.5%
Kiichiro Kamakura	243,000	2.5%
Custody Bank of Japan, Ltd. (Trust account 9)	233,900	2.4%
Ryosuke Morozaki	200,000	2.0%
Meiji Co., Ltd.	200,000	2.0%
Morinaga Milk Co., Ltd.	200,000	2.0%
Yotsuba Milk Products Co., Ltd.	200,000	2.0%
Shares issued	9,874,600	100.0%

Source: Shared Research based on company data

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	None
Disclosure of directors' compensation	None
Disclosure of executive officers' compensation	-
Policy on determining amount of compensation and calculation methodology	In place
Takeover defenses	None

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