May 12, 2023

NIPPON EXPRESS HOLDINGS, INC.

Financial Results for Q1, Fiscal Year Ending December 2023: Questions and Answers (Summary)

The financial results presentation on May 12 was conducted via online meeting. The following summarizes questions received and explanatory answers.

(Forwarding Business Trends)

Q1: What circumstances led to the emergence of customers who do not go through NVOCCs/forwarders for ocean forwarding?

A1: Until the latter half of last year, space was extremely tight, and there was a growing need for forwarders like us to secure space. In these circumstances, we focused on securing and supplying space, remaining conscious of continuing relationships with new business partners and customers that have emerged. But as shipping space recovers, there is a noticeable tendency to return to the status quo before the pandemic, with shipping companies supplying space to the customer directly, as I explained. This is not the result for which we aimed, but under these circumstances, we believe the key for us is to provide value as a logistics provider and follow a volume strategy that leverages FAK rates.

Q2: Is there potential for a similar situation in air forwarding with an increasing number of customers working directly with shipping companies?

A2: The situation varies from region to region, but even in the same forwarding industry, the business model differs between air and ocean forwarding. In Japan, ocean forwarding is a business model in which shipping companies make contracts and rates directly with customers, whereas in air forwarding, forwarders take space risk and acquire cargo through their own sales force. Therefore, the question of whether the return of ocean forwarding to direct contracts with shipping companies will also occur in air forwarding is not applicable to air forwarding.

Q3: It appears that air cargo will be the key to second-half performance. What is your outlook for unit prices? What is the current level compared to the pre-COVID-19? And what change do you expect in the second half of the year?

A3: For air, March 2023 industry results showed a 37% increase in freight rates compared to the same month in 2019. With the easing of supply and demand, freight rates have been declining gradually, and we expect this trend to continue for the foreseeable future, although not back to 2019 levels.

Meanwhile, allow me to offer an overview of the forwarding business compared to our view at the beginning of the period:

(1) Air forwarding volume from Japan declined 30% year on year in Q1, while we maintained gross profit per unit of weight. At the beginning of the period, we expected volume to decline by about 10%, and volume is trending lower than that. On the other hand, gross profit per unit of weight remains high compared to our view at the beginning of the period. Therefore, we do not expect our annual profit forecast to change significantly from that at the beginning of the year.

(2) Ocean forwarding volume from Japan declined slightly more than 10% in Q1, while gross profit per TEU trended slightly higher. At the beginning of the period, we expected volume to decline by a few percentage points, but the decline was greater than that. However, gross profit per TEU remained higher than expected, so our profit forecast for the year remains largely unchanged.

(3) Next, air forwarding volume originating overseas was as expected in Q1, down slightly less than 30% year on year. We maintained gross profit per unit of weight, so our full-year profit forecast remains unchanged.

(4) Ocean forwarding volume originating overseas declined about 5% in Q1. Gross profit per unit is declining, as noted on page 44 of the financial results presentation. At the same time, volume has not fallen as much as we expected at the beginning of the year. As a result, our profit forecast for the year remains largely unchanged.

Once again, compared with 2019—and here, we're showing only data for transactions originating from Japan and not just unit prices for consigned forwarding—comparisons based on our accounting information confirm that unit sales prices and usage fee unit prices are still high for both air and ocean forwarding.

(Rate Revisions)

Q1: It seems you are seeing a certain level of yield in the difference between higher revenues due to rate revisions and the increase in payments to outsourcing partners. Can you tell us more about those circumstances?

A1: With regard to rate revisions, since cost increases intensified last year, we have been taking steps to optimize the fees we receive with a greater sense of urgency and concentration than before from the standpoint of business continuity. In Q1, revenues increased 2.2 billion yen, while subcontract expenses 1.8 billion yen, a difference of 0.3 billion yen. For the full year, we expect an increase in revenues of 17.5 billion yen and an increase in subcontract expenses of 12.3 billion yen for a difference of about 5.1 billion yen.

(Acquisition of cargo-partner Stock)

Q1: In the context of this acquisition, you mentioned that the acquisition price was within your assumption of an EBITDA multiple of 13 times or less. Based on what specific stage of performance do you see the valuation below 13 times?

A1: We consider the price to be within 13 times EBITDA if we look at the first amount without including the earn-out. This calculation is based on 2024-2025 business plan values built from 2023 earnings forecasts reflecting 2022 earnings. We assume that there will be a certain recovery after the forwarding business environment peaks out. In the event of additional payments due to the earn-out, we assume EBITDA will increase according to payment terms. As a result, we estimate that the EBITDA multiple will be within 13 times.

Q2: In an M&A transaction, does an earn-out mean that a payment will be made in installments depending on the progress of business performance? Can you provide more details?

A2: Earn-outs are a relatively major method of M&A in Europe and the United States, in which certain conditions are established and a predetermined amount of money is paid when the conditions are met. This is one method to deal with the conflicting needs of the seller to sell at a high price and the buyer to buy at a fair price. In this case, if cargo-partner EBITDA and other indicators in 2024 and 2025 exceed certain standards, we will pay up to an additional €555 million, depending on the degree of achievement. We believe this arrangement allows us to respond to uncertainty and volatility in the market environment.

(Supplementary explanations other than the Q&A below)

・Our adoption of IFRS resulted in differences compared with Japanese GAAP. While the situation may be somewhat difficult to understand, we believe the main point is that we are making progress toward our IFRS-based business income forecast of 117.0 billion yen (excluding non-operating income/loss and extraordinary income/loss).

*Breakdown of 7.0 billion yen difference compared with 110.0 billion yen under Japanese GAAP

・Non-recording of unrecognized differences in retirement benefits on the PL	3.0 billion yen
・Change in financial classification of leases, etc.	2.3 billion yen
・Reversal of impairment loss	1.8 billion yen
・Non-amortization of goodwill	0.7 billion yen
・Other	-0.7 billion yen

Based on the assumptions above, we forecast business income of 117.0 billion yen:

・Q1 business income (IFRS) was 20.9 billion yen (difference of -8.3 billion yen) compared with the initial forecast of 29.2 billion yen. The cost increase in Q1 was about 6.0 billion yen compared with Japanese GAAP, with negative factors on income including 8.0 billion yen property tax at the beginning of the period.

・The accounting treatment for Q1 (provision for bonuses, etc.) includes -1.0 billion yen on an income basis, which we expect to be +1.0 billion yen in Q2.

・Therefore, excluding the above-mentioned accounting treatment differences, Q1 business income of 20.9 billion yen is about 1.0 billion yen short of our initial projection in terms of operating factors, which we consider in line with projections. We are working toward catching up to our previously announced financial results forecast in Q2.

・Our Q2 forecast for business income is 31.5 billion yen, an additional 10.6 billion yen on our Q1 results. This forecast is mainly based on the above-mentioned impact of 10.0 billion yen (8.0 billion yen at the beginning of the fiscal year for property taxes, etc., and +2.0 billion yen in accounting treatment differences).

・With business income of 52.5 billion yen in the first half, we expect business income of 64.5 billion yen (+12.0 billion yen) in the second half, mainly due to the above-mentioned 8.0 billion yen impact of property taxes and a recovery in volume in the second half and beyond.

・On the other hand, we estimate that the impact of wage hikes to be about 3.0 billion yen between Q2 and Q4, pushing down profits by about -1.0 billion yen over each quarter beginning in Q2.

- The future direction of the external environment is uncertain given the circumstances. Both best-case and worst-case scenarios are possible, and we believe the key points to achieving our financial results forecasts for this year include maximizing procurement control and consolidation efficiencies in the Forwarding Business, receiving appropriate fees, revising contracts, and improving work/operation efficiencies.

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