

# CFO on Engagement with Investors

I was appointed CFO of Chugai on March 22, 2018. In my 35 years at Chugai I have been involved in planning and finance-related work. In the last few years, I was in charge of the Finance & Accounting Dept. under the former CFO, but now I will be performing the duties of the CFO myself.

Chugai will continue to tirelessly take on challenges as a top pharmaceutical company that consistently provides innovative products and services. To ensure

that Chugai remains in a position to do so, I will plan and implement strategies and work to effectively and efficiently allocate and use its assets. I want to create opportunities for dialogue with both internal and external stakeholders to share with them an honest view of Chugai's current state and the direction it intends to take in the future. I ask for your continued understanding and support.

1. Return on equity
2. Core: Core basis results are the results after adjusting non-Core items to IFRS basis results. Core basis results are used by Chugai as internal performance indicators for representing recurring profit trends both internally and externally, and as indices for establishing profit distributions such as returns to shareholders. EPS: Earnings per share CAGR: Compound annual growth rate

## Engagement Agenda Item 1

## Financial and Capital Strategy

**Q.** What are your views on financial targets?

**Sustained growth in absolute return by improving margins is an important financial KPI in our business model.**

ROE<sup>1</sup> is now being emphasized in Japan, and I get many questions about this metric from shareholders and investors. However, the financial target we have set in our mid-term business plan IBI 18 is Core EPS CAGR.<sup>2</sup> The reason for this is that we are aiming for sustained growth in absolute return over the medium and long term.

ROE is the product of the ratio of profit to revenues (the net profit margin), asset turnover and financial leverage. In Chugai's case, a large portion of our business is biopharmaceuticals, for which the manufacturing process is relatively lengthy, and we hold adequate safety stock to fulfill our duty of providing reliable supply. For these reasons, there are certain limitations on increasing turnover. In addition, to maintain our management



I will maintain an active dialogue with shareholders and investors so that they have a full understanding of Chugai's envisioned future and the state of its corporate activities, including non-financial aspects.

### Toshiaki Itagaki

Executive Vice President & CFO  
General Manager of Finance Supervisory Div., General Manager of IT Supervisory Div. and General Manager of Finance & Accounting Dept.

A handwritten signature in black ink that reads "Toshiaki Itagaki".

independence based on our alliance with Roche, we must keep Roche's equity share within a certain range. Therefore, we cannot reduce shareholders' equity with share buybacks and treasury share cancellation as easily as some other companies can.

Therefore, improving margins is our main driver for improving ROE, and the best indicator of sustained growth in absolute terms from the viewpoint of shareholders is Core EPS CAGR.

3. The number of days from the purchase of raw materials to the collection of cash from the sale of finished products
4. Operating profit after tax and capital charge
5. Weighted average cost of capital

**Q. Since you have no target for ROE, does that mean you are not conscious of the cost of capital?**

**The concepts of ROE and cost of capital are built into our internal management decision-making processes and mechanisms.**

Companies obviously have a responsibility to efficiently use the capital provided by shareholders to achieve a level of profits higher than they expect. At Chugai, we also work diligently to optimize turnover by managing inventories and the cash conversion cycle (CCC),<sup>3</sup> and to adjust shareholders' equity with a dividend policy that emphasizes balancing shareholder returns and investment for future growth.

In addition, we conduct management using OPAC,<sup>4</sup> which is adjusted for cost of capital, and

draw up strategies in formulating mid-term business plans to clarify the gap with targets that consider the capital spread. In assessing the business feasibility of investments and development themes, the concept of the cost of capital is built into our internal management decision-making processes and mechanisms in ways such as discounting present value at the WACC.<sup>5</sup> While we have only announced financial targets for Core EPS, we are by no means disregarding ROE and the cost of capital.

## Engagement Agenda Item 2

## Strategic Investments and Dividend Policy

**Q. What is the current state of cash flow and how will Chugai use cash flow going forward?**

**We will use robust operating cash flow for strategic investments in facilities and in research and development to increase corporate value.**

As of December 31, 2017, we held net cash of more than ¥240.0 billion. Cash inflow from operating activities is expected to increase as long as Core EPS continues to grow. Whenever we invest funds to bring new products to market or for in-house discovery and development, they are expensed on the income statement. However, most investments in future growth, such as in-licensing of technologies or development candidates, equity alliances, and capital expenditures, which require significant funding, are accounted for on the balance sheet. Chugai plans to invest aggressively in these areas.

For the time being, our main use of cash flow will be for investments in facilities and equipment. We are expecting to generate a steady stream of innovative projects through the use of our antibody engineering technologies and other means. To handle the simultaneous development of multiple projects and rapid product launches, we have been making investments for expansion of antibody API production capacity during the last few years. The new production facility (UK3) at the Ukima Plant is one example. It is expected to begin test production in 2018, with the start of full-scale commercial production planned for 2019.

Also coming up are major investments for expanding and enhancing our next-generation R&D infrastructure. We will complete the purchase of 170,000 m<sup>2</sup> of land for business use (Yokohama, Kanagawa Prefecture) at the end of 2018, and plan to commence construction of a new research laboratory there in 2019.

In addition, we will make strategic investments, such as in alliances with outside partners and in-licensing. Based on our agreement with Osaka University for comprehensive collaboration with IFReC related to immunology research, we will provide ¥10 billion over 10 years. Due to rapid advances in science and technology, we are on the threshold of an era in which disruptive innovation has the potential to dramatically alter industry structures built on former technologies and business models. We need to identify emerging trends, create opportunities for ourselves and draw up growth scenarios. The Science & Technology Intelligence Department was established in April 2017 as a specialized unit to handle such intelligence functions. It will actively look outward for acquisition of new technologies and partnerships with companies that possess innovative technologies, and will also seek opportunities for open innovation.

**Q. What is your policy on returns to shareholders?**

**We will meet expectations by increasing corporate value through our business activities. For the time being, profits will be divided evenly between dividends and internal reserves.**

First of all, we want to meet the expectations of shareholders by enhancing shareholder value. To accomplish that, we plan to continuously increase corporate value by creating groundbreaking drugs and innovative services. We will then return the resulting profits in the form of stable and steadily increasing dividends. Over the past several years, we have targeted a payout ratio of 50 percent of

Core EPS on average. As long as Core EPS continues to grow, we will be able to increase dividends, but we cannot neglect strategic investments for sustained growth. For the time being, we believe that we can fund investments with cash inflow from operating activities every year while maintaining net cash at the current level.

**Engagement Agenda Item 3****Dialogue with Investors****Q. How do you plan to engage with investors and other stakeholders?**

**I want to share values with stakeholders through dialogue so they can understand Chugai as it is.**

If I were to describe Chugai with one word, that word would be “integrity.” It has several definitions in the dictionary, but in my view the essence of integrity is “an attitude of sincerely facing yourself, your organization and society as a whole, and honestly pushing for what you think is best.”

When I joined Chugai 35 years ago, I was taught that “pursuit of economic performance,” “pursuit of social awareness” and “pursuit of human development” were the Company’s principles of conduct. I learned that as a public entity, a company cannot survive if any of these elements is lacking, and that pursuit of social awareness and human development were especially important for Chugai, whose business is closely related to life. I also think that ESG, which has been gaining attention recently, means conducting management with integrity and respect for society and humanity.

In terms of pursuing the principles of conduct that have been passed down through the generations at Chugai, ESG represents the aspects that companies must never forget if they want to grow sustainably in co-existence with society. Accordingly, I want to give stakeholders a detailed view of our activities, including these non-financial aspects.

One of my key responsibilities as CFO is to gain stakeholders’ support by ensuring appropriate and timely disclosure of both qualitative and quantitative information to give them an understanding of Chugai as it is. I will not limit this to one-way communication. I will use dialogue to get a full understanding of stakeholder expectations, and reflect those expectations in the Company’s management. I look forward to hearing our stakeholders’ candid opinions and requests.

**Status and Plans for Major Investments in Facilities and Research and Development**

Planned Time Frame	Planned Investment	Site	Details
2012-2021	SGD 476 million	CPR (Singapore)	Accelerate creation of clinical candidates utilizing proprietary antibody technologies
2013-2015	¥2.9 billion	Ukima Plant	Doubling of manufacturing capacity for investigational biologics (Simultaneous development of multiple projects)
2013-2018	¥6.0 billion	Utsunomiya Plant	Enhancement of high-mix, low-volume production capability for pre-filled syringe form products (Installation of tray filler)
2015-2017	¥6.0 billion	Fujieda Plant	Strengthening of solid formulation manufacturing facility, etc. (Achievement of quick launch and steady supply)
2015-2018	¥37.2 billion	Ukima Plant	Enhancement of high-mix, low-volume production of antibody APIs for initial commercial products (Expansion of production capability with construction of UK3 facility)
2016-2018	¥43.4 billion	—	Purchase of business site in Totsuka Ward, Yokohama, Kanagawa Prefecture
2017-2027	¥10.0 billion	—	Comprehensive collaboration in research activities with IFReC