

FY2024 Small Meeting (Held on March 4, 2024)

Meeting Record

Attendees from Kagome Co., Ltd.

Satoshi Yamaguchi, President & Representative Director

Takeshi Saeki, Managing Executive Officer, CFO and CRO

Sell Side

Q1

How capable is Ingomar? Tomato paste prices are expected to come down after peaking in 2024. What will Ingomar's performance be like then? How much in the way of synergies do you expect to generate?

A1

(Yamaguchi)

Tomato paste prices have skyrocketed, and Ingomar's profit structure has changed. How we view the future market conditions of tomato paste will change the way we view Ingomar's performance. The market for tomato paste is expected to peak in 2024 and then decline gradually, but it will not decline sharply. There are two reasons for this. One is that around 2020, when Ingomar's performance was poor, there was excessive competition among primary tomato processing companies in California in the United States. However, some of these competitors have already been weeded out, so there will be no excessive competition in the future as before. Demand for tomato paste is also expected to grow steadily. Another reason is water constraints placed on agriculture. Compared to the past, it is difficult to rapidly expand the planted area. For the above reasons, we do not expect a sharp decline in prices.

There are two types of synergies: short-term and medium- to long-term. In the short term, Kagome's manufacturing management and quality control know-how and knowledge will be applied to Ingomar, which raises the possibility of improving the company's manufacturing efficiency and quality consistency. In the medium to long term, the development and introduction of new plant varieties will be a theme of synergies. How much synergy there will be is still to be calculated.

Q2

How will you manage Ingomar as an agricultural company founded by farmers?

A2

(Yamaguchi)

Ingomar was founded in the 1980s with the investments of farmers. Today, it processes 1.5 million tons of tomatoes every year, and has established fundamental management capabilities. The current CEO also previously worked at an accounting firm. I have been watching the situation of the company since Kagome acquired a 20% stake. I have actually met the CEO before. By combining Ingomar's knowledge with Kagome's, we believe that we can raise the level of Ingomar's management.

Q3

In terms of Kagome's global tomato strategy, what is lacking and what needs to be reinforced? It is a bit difficult to see how Kagome will beat out competition.

A3

(Yamaguchi)

With the acquisition of Ingomar as a consolidated subsidiary, Kagome will become the world's third largest producer of primary processed tomatoes. Among the top companies, Kagome is the only one that has multiple locations globally, which makes us competitive. In the future, it will be important to roll out the varieties and cultivation technologies developed at the Global Agri Research & Business Center, which was newly established in October last year, at Ingomar's raw materials procurement bases and work on their practical application. In addition to acquiring a primary tomato processing company through this transaction, Kagome will collaborate with the Center to build a sustainable tomato processing business and increase its competitiveness. It takes time to develop plant varieties, but if we don't start now, it will be too late, so now is the time to start.

Q4

What will Kagome's next M&A transaction target? Upstream seed development or downstream secondary processing?

A4

(Yamaguchi)

We are compiling a long list of targets both upstream and downstream. North America will be our main area, but we are also expanding our scope beyond North America, so we will proceed with deals that meet the conditions and can be expected to generate synergies.

Q5

Has Kagome been able to secure its competitive advantages through development of tomato varieties, cultivation techniques, and Agritech, etc.?

A5

(Yamaguchi)

Until now, the development of plant varieties by Kagome's research and development department has focused on fresh tomato varieties, but since 2022, the ratio of processing tomato varieties has increased. A major theme is to increase competitiveness with the aim of building a sustainable tomato processing business, so we will work together with UG, which engages in the seed and seedling business, using our collective strengths. In terms of research and development related to tomatoes, we believe that we are not behind our competitors.

Q6

Kagome instituted price hikes in February. What is the situation recently?

A6

(Yamaguchi)

In-store prices have shifted, and we are proceeding almost as expected. As for the sales situation, some customers were buying in bulk before the price revision, so it will take time to find out the situation. We expect the situation to become clearer by mid-to-late April. At this point, there is not much difference from last year. We are monitoring the situation after price revisions frequently and are prepared to take action in the event of an unexpected situation.

Q7

With regard to your human resources strategy overseas, are you using in-house training, or are you hiring mid-career employees with know-how of overseas business?

A7

(Yamaguchi)

The PMI team for Ingomar is comprised mainly of members who have been assigned to the United States in the past and were involved in this project. We will increase the number of human resources for our overseas business operations through both in-house training and mid-career recruitment. Currently, the ratio of mid-career hires is about 30%.

Q8

How are you approaching recruitment of mid-career professionals? How does Kagome appeal to professionals looking to change jobs?

A8

(Yamaguchi)

There are two ways that we recruit mid-career employees. One is to have the applicant register in advance on the Kagome website. About 3,000 people are registered. We hire from among those who register according to need. The other way is from Kagome to go out and recruit the people we are looking for. The mobility of human resources is progressing in Japan, and we have hired young people with less than 10 years of experience at other companies. There are many people who want to work in health and agriculture, and I believe that they are attracted to Kagome's vision that we communicate externally.

Q9

This question pertains to the domestic business. How will you utilize Kagome's strengths in growth domains?

A9

(Yamaguchi)

Growth domains for the domestic business include plant-based products, institutional and industrial use, and soups. In terms of the plant-based domain, in 2022, we released "Hatakeumareno Yasashii Milk," but it did not go as expected and was discontinued. In this domain, we will make use of our knowledge to date and reorganize our approach. The domain where we have seen a good response is institutional and industrial use. There is also a tailwind from inbound tourism. Against the backdrop of labor shortages for both food service and home meal replacements, sales of sautéed onions and other products that can shorten the time for preparation are strong. Soup sales are growing mainly through direct marketing. Vegetable beverages and vegetable soups are similar to each other, and Kagome's know-how can be utilized in vegetable processing technology and marketing.

Q10

How do Ingomar's strengths compare to Morning Star, a competitor in the primary processing of tomatoes? What type of growth rate do you forecast for processed tomato products?

A10

(Yamaguchi)

In terms of primary processing of tomatoes in California, Morning Star sits at the top. Ingomar is second. Ingomar isn't aiming to be Morning Star. There is also the advantage of being in second, and Ingomar has an advantage in flexibility in the production lot. In addition, many customers are based on multiple purchases, meaning Ingomar has firmly secured second position. Processed tomato products are expected to grow consistently by around 2%. Globally, the population is growing, and global food service companies, which are the largest customers, are expanding their restaurant openings worldwide. This suggests that demand will be resilient.

Q11

With the acquisition, will the number of products that Ingomar manufactures increase or decrease? Which direction will you take it: selection or concentration?

A11

(Yamaguchi)

Since it is not as large as its competitors in terms of scale, we will shift Ingomar from tomato paste, which is widely distributed, to primary processed products with high added value, such as those that retain a solid and fresh feeling.

Q12

With this M&A deal, do you expect the International Business to account for future profit growth?

A12

(Yamaguchi)

Exactly.

Q13

Kagome's free cash flow has been negative for two consecutive years. The reason I believe is higher valuation of inventories. Capital investment has also increased, and the fact that Kagome has been in the red for three consecutive years raises the question of whether it can actually generate cash. What are your thoughts as management?

A13

(Saeki)

In the third Mid-Term Management Plan, Kagome expected free cash flow of 60 billion yen, capital investments of 45 billion yen, and shareholder returns of 15 billion yen. On the other hand, at present, cash flows from operating activities are expected to be around 40 to 50 billion yen, and the capital investments around 35 billion yen. The increase in inventories in the first two years of the Mid-Term Management Plan will result in a decrease in these cash flows of 10 billion yen, but capital investment is also expected to decrease. Business investments will total 36 billion yen from this M&A. Funding is financed by bank borrowing, and as a result, our shareholders' equity ratio has fallen by about 10%. Kagome has already announced the possibility of selling its own shares to pay back this debt, but depending on the timing of the sale, the financial situation may be temporarily severe. We will proceed with the sale of treasury shares at an appropriate time and in an appropriate manner. This will be disclosed as soon as it is decided.

Q14

If outside capital increases, it should not pose a major problem because it will not result in losses. The fact that Kagome has posted negative free cash flow for three straight years raises concerns about its capabilities. Is it safe to assume that if tomato prices rise, Kagome will be able to capture the spread, which will have a positive effect?

A14

(Saeki)

Exactly.

Q15

Why are Ingomar's profit margins jumping sharply over the past three years?

A15

(Yamaguchi)

The reason behind the increase in profit margin is rising tomato paste prices.

Q16

Regarding tomato paste prices, you mentioned at the financial results briefing that market trends are changing in the United States, but there is a possibility that production in China will increase and competitors will increase globally. Is it true worldwide that primary processing is being culled as in the United States?

A16

(Yamaguchi)

Last summer, production in the Northern Hemisphere increased compared to the previous year. Reasons included tight inventories and the water situation in California was good. Two years ago, there was a shortage of water, but last year the water shortage eased temporarily. However, water constraints associated with climate change will not disappear in the future. Water constraints also limit the planted area of tomatoes. This makes it difficult to increase production rapidly, which is the reason why the market price will not decline rapidly. If you look at the planting situation this summer, you can understand the trends of this summer. California accounts for 25% of the world's production, and the impact on prices is significant.

Q17

I understand the documents you have released on the purpose of Kagome's acquisition of Ingomar. Which does it entail: the potential future growth of profits, a source of stable revenue, or synergistic effects?

A17

(Yamaguchi)

When we think about the time horizon of the next 10 to 20 years, it will be important to ensure the sustainability of the tomato processing business. As climate change becomes worse, we will combine Ingomar's farmers, fields, plants, plant variety development, and cultivation technologies with Kagome.

Q18

Kagome's acquisition of Ingomar appears to run counter to food manufacturers who are attempting to control volatility. Although you can expect medium- to long-term growth, won't stability of profits no longer be possible? If you are focusing on higher value-added solutions, would it not be better to focus on secondary processing rather than primary? How will you control volatility?

A18

(Yamaguchi)

We understand that earnings volatility will increase. Through the consolidation, we believe that Kagome will be able to control volatility to some extent more proactively than before, such as controlling planted area and manufacturing balance while monitoring the situation of

tomatoes around the world. Volatility will not disappear, but in the future, it may become difficult to secure a stable supply of raw materials, so we are focusing on a sustainable tomato processing business and stable procurement of raw materials. The effects of global warming are accelerating, and I believe it is very important to take action now.

Q19

The ability to control planted area and market prices is overwhelmingly in the favor of a competitor like Morning Star with its scale. Won't it be difficult for Kagome?

A19

(Yamaguchi)

Ingomar's strength lies in its strong relationships with contract farmers. In addition to increasing or decreasing the planted area, it will also be possible to cultivate new varieties. In addition to controlling the overall yield, we will deepen cooperation between our research departments. Since market conditions are determined by the price of commodity tomato paste, I don't expect Ingomar to be able to control the price.

Buy Side

Q1

With regard to Ingomar, are the profits of primary and secondary tomato processing linked? Will the profit cycle decline going forward?

A1

(Yamaguchi)

Over the past several years, inventories of primary processed tomato products have been tight worldwide. The price of secondary processed products manufactured using primary processed products is also rising in tandem. In the International Business, we have passed on high costs to product prices in line with market conditions. The market is expected to peak in 2024 and then decline gradually. It will not decline sharply. Primary tomato processing companies in California have been culled to some extent, so the market is unlikely to see excessive competition, and the planted area of processing tomatoes is limited by water, so it may not be easy to increase it. In addition, in the United States, demand for processed tomato products is expected to grow at an annual rate of about 2%. This means that the market is not headed for a sharp decline.

Q2

Can you share the background of Kagome's acquisition of Ingomar? Did Kagome approach Ingomar? Or did Ingomar seek out Kagome?

A2

(Yamaguchi)

Even before we acquired a 20% equity stake in Ingomar in 2016, we were purchasing raw materials from the company, and we had positive lines of communication open. Ingomar was the one to approach Kagome about acquiring an additional stake, which led to the acquisition.

Q3

Going forward, does Kagome plan to switch primary processed products purchased from other suppliers over to Ingomar?

A3

(Yamaguchi)

We are not looking to simply increase our sourcing of products from Ingomar. We procure tomato paste, a primary processed product, from a variety of suppliers. We determine these suppliers based on customer needs and supply side situation.

Q4

Won't the use of Ingomar's primary processed products generate synergies?

A4

(Yamaguchi)

Over the short-term, there are areas where we can generate synergies with Ingomar's current lineup of primary processed products. Over the medium to long term, we plan to manufacture Ingomar's high value-added primary processed products, sell them outside the Group, and also use them as Kagome's own raw materials.

Q5

Ingomar's forecast for core operating income in 2025 is 7.3 billion yen. If market prices fall, will this number also fall going forward?

A5

(Yamaguchi)

The market will gradually decline heading toward 2025. We see Ingomar's earnings forecasts as conservative.

Q6

What are the demand side and supply side factors behind the decline in market conditions (prices)?

A6

(Yamaguchi)

The tomato paste market will vary depending on the demand for secondary processing sold to food service companies. On the supply side, the basic structure is that market conditions fluctuate depending on the increase or decrease in the production of processing tomatoes. However, as restrictions on water use in agriculture become more severe, it will be difficult to significantly increase production in the future. For this reason, we do not expect a significant decline in market conditions (prices).

Q7

What are your thoughts on synergies?

A7

(Yamaguchi)

There are short-term and medium- and long-term. In terms of short-term synergies, the Kagome Group's manufacturing management and quality control know-how will be incorporated into Ingomar, leading to stabilization of quality and cost reduction, which are synergies in terms of profits. Sales will increase due to increased supply to each of the Group's business locations. In the medium to long term, plant variety development will be a synergy theme.

Q8

Does the graph in the financial results briefing presentation provide the amount of synergies?

A8

(Yamaguchi)

The graph provides some examples and not the actual amount.

Q9

What do you expect for the 7.2 billion in cost of sales increases in FY2024? In FY2023, Kagome was able to significantly reduce cost of sales from the initial forecast.

A9

(Yamaguchi)

In the previous fiscal year, we initially expected an increase of 12.7 billion yen, which we were able to control through cost reductions and other measures. We have somewhat exhausted ways to reduce costs, and it is difficult to say at this point whether we will be able to further control the 7.2 billion yen in 2024. The budget is being built on the premise of a cost increase of 7.2 billion yen.

Q10

Logistics costs are set to increase by 1.1 billion yen. What percentage of an increase is this?

A10

(Yamaguchi)

In Japan, we spend a total of 10.7 billion yen on logistics, so this represents about a 10% increase.

Q11

What kind of effect do you expect your investments in the Let's Eat Vegetables Campaign will have?

A11

(Yamaguchi)

We have not yet reached the stage of confirming the return on investment. Although there were some restrictions on activities due to the COVID-19 pandemic, we will continue to actively implement the campaign, including disseminating information. The number of VegeCheck measurements has reached about 7 million, which marks a level that can be utilized in data base form. These measurements contribute to verifying sales in stores with the machines and cost-effectiveness.

Q12

What is the positioning of the DXAS* business and its future direction?

A12

(Yamaguchi)

Until now, DXAS had been working independently, but in October last year, we launched a new organization, the Global Agri Research & Business Center, to create a system that integrates cultivation technology development, plant variety development, and farm management services. The goal of DXAS is to efficiently increase yields with low inputs and high outputs. It will continue to be an important entity for Kagome in the future.

*A joint venture established in 2022 by Kagome Co., Ltd. and NEC Corporation to support the operations of processing tomato farms using AI.

Q13

In the domestic business, there is widespread competition, not just in the same categories. With Kagome having revised prices, what will happen to the competitive environment going forward?

A13

(Yamaguchi)

In the domestic business, sales of institutional and industrial use products are performing well. Due to the reopening from the pandemic and inbound tourism demand, the volume has not decreased even after the price revision. Sales of foods for consumer use have been stable. Due to the effect of events such as the Rice Omelet Stadium, foods for consumer use are making a more frequent appearance on dining tables in Japan. The challenge is vegetable beverages. After the price revision, although sales have been recovering on a volume basis, the recovery speed of major brands such as Yasai Seikatsu has been slow. As the same category as health drinks, vegetable beverages compete against protein drinks and lactic acid bacteria. In March, we will kick off a campaign centered on Yasai Seikatsu. In addition, we will promote initiatives to convey the value of carrots as well as tomatoes, and work to restore demand after price revisions.

End