Financial/Capital Strategy

Nippon Shinyaku is prioritizing investment for future growth and establishing a revenue base not dependent on royalty revenues

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To overcome the patent cliff of Uptravi and achieve growth, the 7th Five-Year Medium-Term Management Plan focuses on actively promoting investment in R&D, in-licensed products, and M&A, etc. We will achieve sustainable growth as we establish a revenue base that does not depend on royalty revenue.

Review of the 6th Five-Year Medium-Term Management Plan

The 6th Five-Year Medium-Term Management Plan unfortunately did not achieve its quantitative targets. In FY2023, the Plan's final year, revenues of ¥148.2 billion fell slightly short of the revenue target of ¥150 billion, while operating profit was only ¥33.2 billion vs. a target of ¥40.0 billion. Although sales and all profit metrics recorded historic highs and high growth was achieved over the five-year period, these metrics earned a score of only 70 compared with the targets.

In the Pharmaceuticals Business, royalty revenue from Uptravi, which is a treatment for pulmonary arterial hypertension and chronic thromboembolic pulmonary hypertension, was above plan, but revenue was below plan, which was affected in Japan by the annual drug price revision and in the U.S., where the expected initial sales growth of a new product did not materialize, by a fall-off in treatment and consultations due to the impact of the COVID-19 pandemic. At the same time, revenues in the Functional Food Business achieved the ¥17.0 billion target, reaching ¥23.1 billion in FY2023. Also, return on equity, at 12.4%, was significantly higher than the 10% target.

We think that we made smooth progress on our six actions in qualitative terms, such as launching an average of at least one product per year, but the development of several products were delayed or terminated, and we realize that some issues remain with regard to the speed and success probability in clinical development. We are starting to use AI drug discovery, and we hope that this will be implemented during the 7th Medium-Term Management Plan and will help to speed up the development process. Also, regarding our overseas in-house marketing of Viltepso, a treatment for Duchenne muscular dystrophy, which was one of our targets, we launched the drug in the U.S. but not in China, so in terms of developing our global business, we went only halfway. However, in China, we started in-house marketing of Gaslon N, a gastritis and gastric ulcer treatment drug that has been marketed in Japan since 1989, so we are making steady progress in in-house marketing overseas.

The 7th Five-Year Medium-Term Management Plan for Growth beyond the Patent Cliff

Nippon Shinyaku has achieved significant growth from Uptravi, but due to the expiration of the patent, we expect royalty revenue to decline significantly in FY2028. The 7th Five-Year Medium-Term Management Plan, which was launched in April 2024, is placed as a scenario of overcoming this patent cliff and considered as what the Company will do over the next five years to realize future growth after accomplishing this. "Three key themes" have been proposed for achieving the plan. The first is fostering growth drivers to replace Uptravi, the second is expanding global development, and the third is continuous pipeline expansion, which is the most important theme for a pharmaceutical manufacturer.

During the 7th Medium-Term Management Plan, the Company will obtain in-licensed products related to R&D and will promote investment in M&A, so that the Company will achieve target revenue of ¥230 billion and operating profit of ¥30 billion in the Plan's final year and revenue on the order of ¥300 billion by FY2030.

Results of the 6th Five-Year Medium-Term Management Plan and Targets for the 7th Five-Year Medium-Term Management Plan (consolidated)

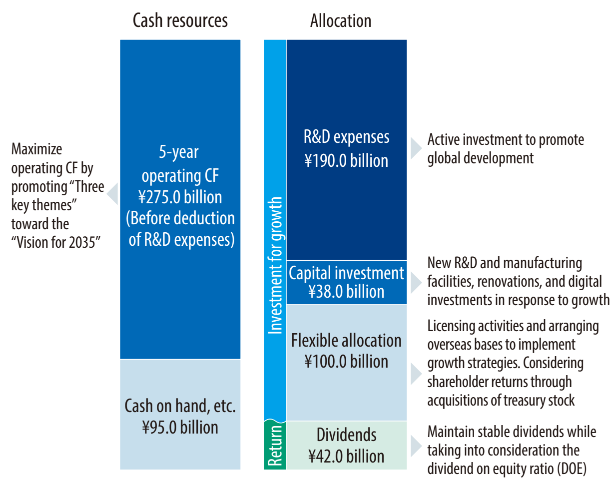
	6th Five-Year Medium-Term Management Plan targets	FY2023 results	7th Five-Year Medium-Term Management Plan targets	FY2024 forecast
Net sales/Revenue	¥150.0 billion	¥148.2 billion	**¥230.0 billion**	¥154.0 billion
Pharmaceuticals	¥133.0 billion	¥125.1 billion	**¥203.0 billion**	¥132.5 billion
Functional Food	¥17.0 billion	¥23.1 billion	**¥27.0 billion**	¥21.5 billion
Operating income / Operating profit	¥40.0 billion	¥33.2 billion	**¥30.0 billion**	¥32.0 billion
Net income attributable to owners of parent /Profit attributable to owners of parent	¥30.0 billion	¥25.8 billion	—	¥29.0 billion
EPS	¥445	¥383	**¥341**	¥430.57
ROE	10% or more during term of 6th Plan	12.4%	**8% or more**	—

Capital allocation

The figure below shows capital allocation over the five-year period of the 7th Medium-Term Management Plan. In particular, R&D investment is projected to be ¥190 billion, a 50% increase over the 6th Medium-Term Management Plan. In addition to active investment to promote development on a global basis, the plan also includes in-licensing of other companies' products that are at the clinical development stage in order to bolster the pipeline.

In March 2024, we entered into an alliance agreement with Eli Lilly Japan K.K. for pirtobrutinib, reversible, non-covalent inhibitor of the enzyme Bruton's tyrosine kinase (BTK), which was then under development. This treatment was approved in June, and launched in August. By promoting marketing alliances and in-licensing of products in the late stage of clinical development, the Company hopes to achieve results over the medium term rather than the short term. To broaden global expansion further, we aim for its development in Europe, considering alliances with or acquisitions of other companies in order to bolster its marketing network, which is premised on a flexible allocation on the order of ¥100 billion. This will be financed from operating cash flow and cash on hand for five years as the source, but the Company is thinking strategically in case of a shortfall, whereby it would borrow funds or create cash by divesting some of its securities holdings, including cross-holdings.

Capital Allocation



Strategy of growth through prior investment

Royalty revenues from Uptravi are earnings from industrial property rights, so they constitute profit. To make up for declines, we try to in-license products that are at the clinical trial stage, but in-licensing costs are trending upward as drug discovery is becoming more difficult and competition with other companies is becoming fiercer. Therefore, although the 7th Medium-Term Management Plan has a goal of growing revenues to ¥230 billion in the final year, at this point, we are targeting operating profit to remain about flat at ¥30 billion, while we prioritize investment during this five-year period. The rationale is that rapid growth in products that will be launched in the latter part of the 7th Medium-Term Management Plan will enable the achievement of revenues of around ¥300 billion and operating profit of around ¥50 billion in 2030.

Practicing management that considers capital costs

The Company recognizes that stable supplies of pharmaceutical products and functional food are critical for all of our stakeholders, including medical professionals, patients, and society, so our policy is to make the necessary investments while making sure that we have working capital.

Regarding capital efficiency, during the 6th Medium-Term Management Plan, we targeted ROE of at least 10%, but for the 7th Medium-Term Management Plan, the target is at least 8%. As stated previously, the policy under the current Management Plan is to hold down profits while prioritizing investment, so the ROE target has been set at a conservative level.

The 7th Medium-Term Management Plan sets business segment return on invested capital (ROIC) targets at 9% or more for both the Pharmaceuticals and Functional Food Businesses. Each business is to make thorough-going cost reductions and managerial capital allocations based on the priorities set forth in their business strategies, with the aim of ensuring that earnings will exceed capital costs. In addition, since the Company has no interest-bearing liabilities and is being managed to have no debt, it has set its weighted average cost of capital (WACC) as its hurdle rate, based on its own analysis of the yields expected by shareholders.

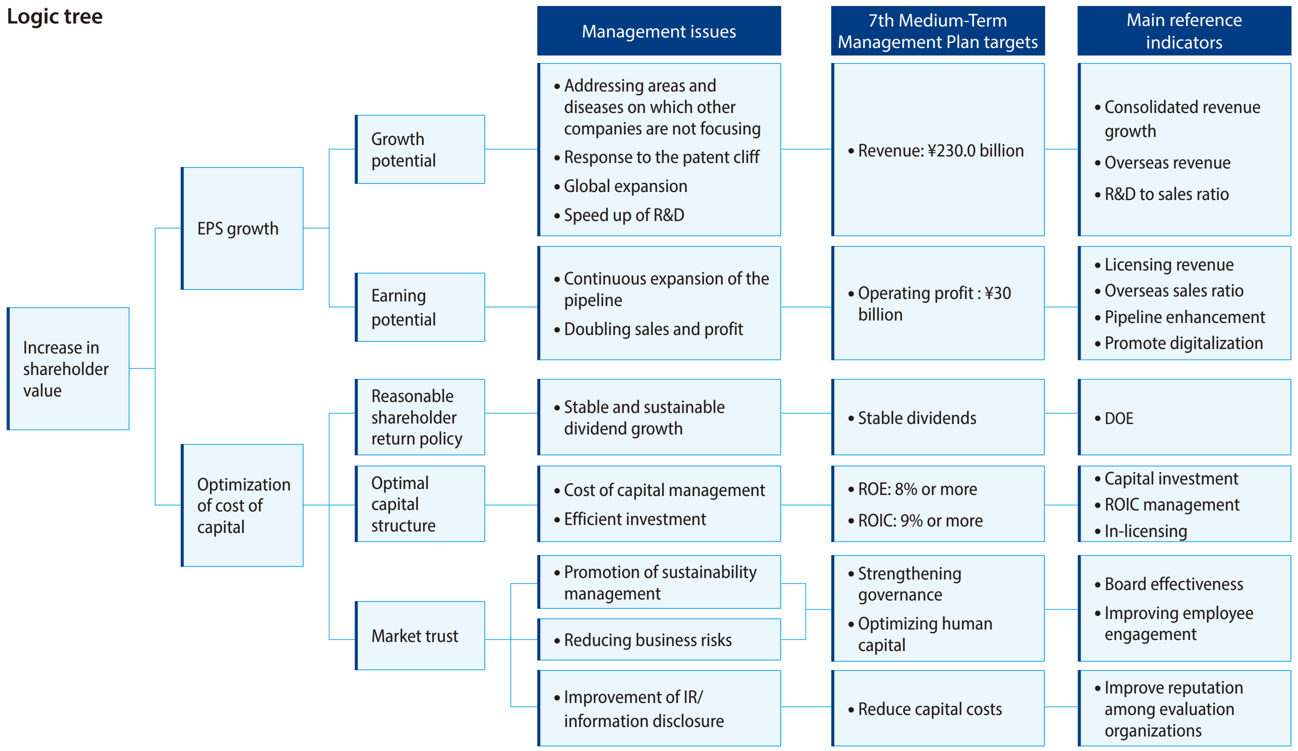
Investment Policy for Non-financial Capital

The Company is actively promoting investment in human capital in order to expand its drug discovery work, strengthen its clinical development, and broaden its global reach. In particular, to make up for our lack of knowledge overseas, we consider it critical to acquire human resources with a specialization in R&D. During the clinical trials for Viltepso in the U.S., we actively hired career professionals, and as our expansion continues, we will not have time enough to train our existing human resources to perform such jobs as global trials and negotiations with the Food & Drug Administration (FDA). Also, we need to have global human resources in a number of areas besides clinical development, such as reliability assurance.

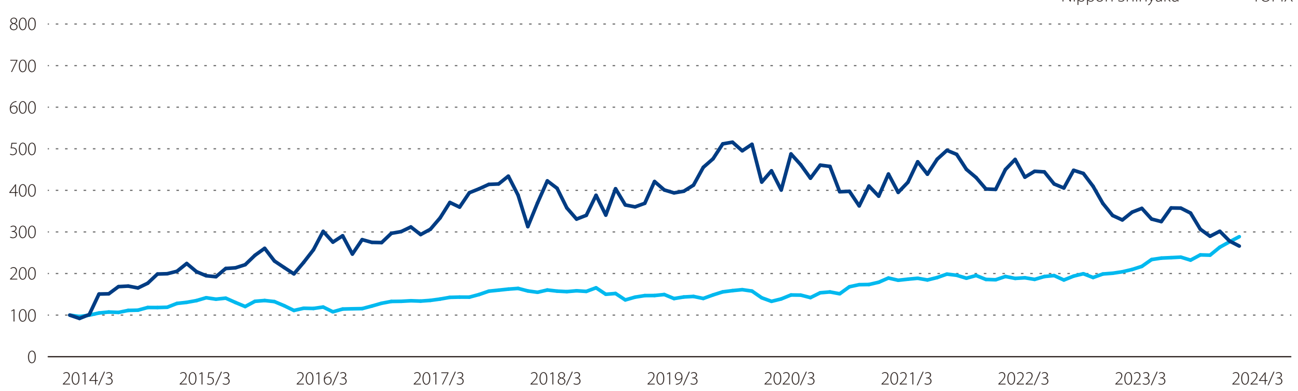
The job markets in the U.S. and Japan are different. In Japan, it is customary for employees hired as new graduates to acquire knowledge little by little and receive promotions and pay increases as they go along, but in the U.S., the salaries of sales representatives, researchers, and department heads are determined according to the job description at the time of recruitment. Human resources hired locally in the U.S. have a different pay structure than in Japan, and going forward, we will need to make our pay structure consistent for positions that require global job rotations. Our policy with respect to global expansion is to increase local hires in each region outside Japan, but we are not expecting much of an increase in our domestic workforce, as we plan to increase our efficiency through AI-driven productivity improvements resulting from active investment in digitalization.

To create innovations and respond to new technologies at our Discovery Research Laboratories, we are considering the construction of a new research building in Kyoto near our head office, and we are also seeking new modalities that will combine our strengths in nucleic acid medicines and small molecules. We will also proactively collaborate with academia and business ventures in striving for open innovation. In April 2024, we entered into a research alliance with MiNA Therapeutics of the UK with the aim of creating nucleic acid medicines that are expected to be applied to an intractable and rare disease in the central nervous system field. However, it will take a long time for this effort to bear fruit, as drug discovery is a process that takes decades.

Logic tree



Total Shareholders' Return (TSR)



Stock price performance

	One year	Three years		Five years		Ten years	
		Cumulative	Annualized rate	Cumulative	Annualized rate	Cumulative	Annualized rate
Nippon Shinyaku	-21.2%	-41.5%	-16.3%	-37.9%	-9.1%	+167.0%	+10.3%
TOPIX	+41.3%	+52.5%	+15.1%	+96.2%	+14.4%	+188.6%	+11.2%

• Total shareholders' return (TSR) is the total return on investment that takes into consideration capital gains and dividends.
• Nippon Shinyaku calculates TSR using cumulative dividends and change in stock price, and for the TOPIX, the dividend-included stock price index is used (calculated by Nippon Shinyaku using Bloomberg data, etc.)
• Figures in the graph assume the closing price on March 31, 2014, is 100, and the TSR-based market value is indexed to that (held through March 31, 2024).
• The return is the percent change of the initial investment generally used when calculating return on investment.

Shareholder Return Policy

Increasing shareholder value

Nippon Shinyaku has linked its management issues and strategies with related indicators in its efforts to increase shareholder value. The logic tree represents this graphically. From a financial perspective, some of the factors leading to increased shareholder value are growth of dividends and increases in the stock price. These are generally considered to be verifiable using long-term total shareholder return (TSR). Also, the stock price is sometimes calculated as a multiple of EPS, and growth of EPS is considered to be linked directly with growth in the stock price.

In line with its basic policy of maximizing corporate value, Nippon Shinyaku is strengthening its R&D structure and expanding its development pipeline. Furthermore, we will make investments and return profits to shareholders in order to build an organizational structure that can withstand intensifying competition and adapt to global business development, while remaining conscious of our capital structure and cost of capital.

Dividend policy

The 6th Medium-Term Management Plan targeted a consolidated dividend payout ratio of about 35%, with dividends being linked to performance, and in FY2023, we increased the dividend by ¥10, to ¥124, for a dividend payout ratio of 32.3%. We are planning to pay a dividend of ¥124 in FY2024 as well. At the same time, the investment-focused 7th Medium-Term Management Plan assumes total dividends of ¥42 billion over the five-year period, as our policy is to maintain a stable dividend in view of DOE.

Although our TSR is currently declining due to stock price volatility, we regard the stock price as a leading indicator, and we believe that it will start increasing again in the future as we carry out the future growth initiatives outlined in the 7th Medium-Term Management Plan and if investors are made aware of our efforts through our IR activities.

Our growth initiatives are publicized through our information disclosures about sales alliances, M&A, in-licensing, and the progress of our pipeline. To improve our communications with shareholders and all of our other stakeholders, in April 2024, we established an IR Section dedicated to investor relations. In the belief that individual investors will become more important in the future as the Company reduces its cross-holdings, we will improve our disclosure of information to individual investors as we strive to become a company that society trusts more than ever, as this is linked to improvement in how we are regarded externally, e.g., in regard to ESG, and improvement in our corporate value.

Through the 7th Medium-Term Management Plan, the Company will overcome the Uptravi patent cliff and establish a foundation for growth. We will also further strengthen the base from which we provide the world with products and services, so that we may become what we want to be. We hope that you will look forward to the future growth of Nippon Shinyaku in our quest to become a global healthcare company.