04 Financial Strategy

4-1 Dialogue between CFO and Outside Director

Free cash flow to grow to re-expansion phase
Progress of the management structure toward the new growth stage

Message from the CFO

To enhance corporate value, it is necessary to utilize financial and non-financial capital to achieve sustainable growth in cash flow and improve capital efficiency. In order to achieve this, it is important to improve cash flow and optimize strategic resource allocation, strengthen management mindful of capital cost, and improve management quality and transparency through active dialogue. I will explain these in the Interview Dialogue and the Financial Strategy page below.

Mizuho Ito
Director, CFO
Asahi Intecc Co., Ltd.

Interviewer:
Takahiro Kusakari
Outside Director
Asahi Intecc Co., Ltd.

Achievement of the Medium-Term Management Plan ahead of schedule and factors behind it

Kusakari: Our target was to achieve consolidated revenue of 110 billion yen in the fiscal year ending June 2026, and you expect to achieve that target ahead of schedule in the fiscal year ending June 2025. Let me confirm the factors driving this achievement.

Ito: The basis of the current Medium-Term Management Plan was to expand the global market share of the existing cardiovascular guidewire and catheter business as a basis for growth, to drive business performance by promoting globalization in non-cardiovascular areas such as peripheral vascular, neurovascular, abdominal vascular and gastrointestinal systems, and to lay the foundation for entering various business areas, including the field of robotics, as a seed for long-term growth. This basic strategy remains unchanged.

At the beginning of this Plan, we believed that the COVID-19 pandemic would soon end. In that sense, we faced a difficult period in the middle of the current Medium-Term Management Plan due to changes in external factors, including the prolonged COVID-19 pandemic. However, in the latter half of the Plan, the COVID-19 pandemic came to an end, and we were able to steadily increase our global market share, and with the support of foreign exchange rates, there was the possibility of achieving our goals ahead of schedule.

Currently, we have some challenges such as sales of non-cardiovascular products, which is one of our key strategies, having been slower than initially planned to penetrate hospitals and other customers, and still being in the middle of entering new business and requiring further evolution. However, I believe that we can continue to expand our business performance as a growing company by leveraging our company's technological capabilities.

We will announce the next Medium-Term Management Plan when it is certain that we can achieve the target ahead of schedule.

Improvements in cash flow

Kusakari: I would like to ask about cash flow. Currently, cash flow is finally improving. I understand that the deterioration in cash flow to date has been due to a combination of various factors, in addition to stockpiling for the MDR. Would you please summarize and explain the reasons?

Ito: Certainly the figure of free cash flow plus dividends turned red (see page 57), and our cash flow has been worse over the past several years, owing to an increase in capital investment, including upfront investment, and an increase in irregular inventories.

For these past several years, owing to the COVID-19 pandemic, the number of cases of catheter treatment decreased, and our company had difficulties in selling products and increasing market share because we were limited in our access to medical sites and were not able to conduct sales activities. However, we thought that as the COVID-19 pandemic was temporary, and in the future, the number of cases would recover and increase, and that it would be possible to further increase market share by resuming sales activities, etc. Therefore, even during the COVID-19 pandemic, we intentionally made upfront capital investments and invested various upfront expenses for future growth without restrictions.

In addition, inventories temporarily increased significantly over the last several years owing to a variety of factors, including the securing of safety stocks to respond to distribution concerns caused by the COVID-19 pandemic, increased inventories at EU sales bases and factories that ship directly to the EU in order to prepare for the risk of the EU revised Medical Device Regulations (MDR), and other factors.

I think the combination of these irregular conditions made free cash flow worse.

Kusakari: In the fiscal year ended June 2024, cash flows finally started to improve, and a sense of security spread in the stock market. At the Board of Directors, too, we discussed the fact that even if P/L was good, cash flow was not good, the analysis of the cash conversion cycle, and what was necessary to solve cash flow issues. I think the voices of institutional investors surely reached the board.

Ito: Yes, that's right. Even if our P/L was good, cash flow has been bad for the last few years. I believe that this deterioration was caused by both temporary factors and structural factors, so we needed to distinguish them, share a common understanding, and properly discuss them. We tend to think that as long as the P/L is good, it is all right, but I think that the Board of Directors has become more aware of the need for improvement of cash flow after discussions on the comparison with other companies, the comparisons with our past figures within the company, and the direction of improvement in light of our company's unique advantages, including the cash conversion cycle. I believe that this has been accelerated also thanks to the

strong supporting opinions of outside directors such as you, Mr. Kusakari.

From the fiscal year ended June 2024, the figures in free cash flow plus dividend payments improved. This improvement of cash flow resulted from the completion of a series of equipment investments such as the expansion of R&D bases and the establishment of a production plant capable of responding to future revenue goals of up to 150 billion yen, as well as the reduction of excess inventories to an appropriate level at once due to signs of relaxation of the EU MDR.

We revised the content of equipment investments during the fiscal term, so that the amount of the initial plan, which was somewhat excessive, was reduced. Analysis and judgment based not only on P/L but also on B/S and C/F are gradually spreading.

Capital allocation

Our idea for appropriate capital allocation towards sustainable enhancement of corporate value

Kusakari: What do you think as CFO about the strategy and future trends for cash flow, especially free cash flow? We disclose the capital allocation. But I'm afraid that investors' view may change if they become concerned that the company may limit its strategic investments owing to the increase in the dividend payout ratio and the reduction in borrowings.

Ito: While the capital allocation is described on page 54, we think that our highest priority for the use of funds is strategic investment such as equipment investments and M&A for business growth. Since our company is a growth company, I believe that strategic investment of funds to sustain this policy is of utmost importance. Therefore, there is no idea of narrowing down strategic investments.

As for the reduction of borrowings, originally, our company had intentionally increased its foreign currency-denominated liabilities to hedge against foreign exchange. However, owing to the recent rise in interest rates on foreign currency borrowings, we have been working to reduce the foreign currency-denominated liabilities by reviewing and improving foreign exchange exposure. Therefore, it is not intended to reduce strategic investments.

We have a scheme in which if we need to make strategic investments that exceed our cash reserves at hand, we will be able to flexibly increase our yen-denominated interest-bearing debt, so please rest assured.

As for the dividend payout ratio, we decided to raise it in June 2024 because it became more certain that the cash flow for the fiscal years ending June 2024 and 2025 would improve stably. We plan to further raise the dividend payout ratio if we expect continued improvement in cash flow.

We think that the financial strategies should not be considered in a uniform way for the present and future, but should always be adapted to the circumstances at the time, while also considering balance and responding flexibly. It is difficult to easily promise to buy back shares or raise the dividend payout ratio when cash flow is deteriorating, and I thought that our first priority would be to clearly demonstrate that we could improve cash flow.

As for the financial strategies, I have realized there are truly diverse opinions through dialogue with investors. This comes from the differences in visions between a short-term perspective and long-term perspective, differences in perception of whether a company is a growth company or a mature company, and differences in opinions, including comparisons with other companies under portfolio responsibility. I feel investor opinions are very varied.

We will listen carefully to the opinions of our investors, and we will consider what we can do to enhance our corporate value, with the management at the center, and respond accordingly.

About the new management structure

Kusakari: By the way, there was a sudden change in president in September 2024. What was the reaction within the company? What changes have you seen?

Ito: Certainly, it was a sudden change, so I think especially the employees were surprised.

Even from close up, I've seen that the president's job is extremely demanding, so if he's not in perfect health, he can't do it. Also, I believe that the chairman (the former president) himself was concerned about his poor health and made the heart-wrenching suggestion to change the president in order to avoid slowing down the company's growth.

Our employees understand well that both the chairman and the president have discussed various important issues as representative directors, and immediately after the replacement, the president and the chairman (the former president) gave a thorough explanation about the replacement directly at a meeting of management of the entire Group, which I believe employees feel easy about.

The new president comes from the founding family and he has not only led the company with strong leadership, but also values the organization, I think. As you know, while our group is growing rapidly, it is already too big for the top management to keep track of everything. As we further enhance our corporate value, I believe that such good balance will come into play.

Implementation of a management conscious of capital cost

Kusakari: The Tokyo Stock Exchange announced "Implementing management that is conscious of cost of capital and stock price," and I believe that this issue has been increasingly discussed at the Board of Directors. Then, let me ask about how you discuss, advance and manage this matter at the Management Executive Committee, etc.?

Ito: First, after the announcement by the TSE, we began to disclose the capital costs on IR and use them in the dialogue with institutional investors. At the Board of Directors, we discuss the status of dialogue with institutional investors, the growth expectations exceeding the cost of capital, and the developments in equity spreads, etc.

At the Management Executive Committee, we mainly discuss the KPI management from the perspective of corporate execution and management. In January 2024, the Management Executive Committee was established with the future separation of management and execution in mind. Up until now, the Board of Directors has been the same as the Executive Committee, but outside directors have pointed out that discussions are too meticulous and that the structure of the Board should be changed so that the management and execution functions are separated, which would lead to further changes in the organization. However, it is difficult to separate management and execution right away, so I think we are now in a transitional period.

Also about ROIC and ROE, which are KPIs of our company, I understand that they are the indicators that institutional investors place importance on when making investment decisions. I feel that discussions on these KPIs with institutional investors have increased considerably over the last few years. There are elements to improve ROIC and ROE, and we are developing them as ROIC trees. (See page 54.) Their further breakdown has been discussed at the Management Executive Committee and is one of the matters for consideration. Now it is possible to monitor this on a monthly basis, so we will proceed with deeper analysis. In addition, not only at meetings of the Management Executive Committee, but also on a daily basis, we use the net present value (NPV) method and the internal rate of return (IRR) method and apply the capital cost of every fiscal year to examine profitability. Management that is conscious of capital costs is taking root.

Changes in profit margins and their improvement

Kusakari: As mentioned at the first part of the current Medium-Term Management Plan, the target revenue is already expected to be achieved ahead of schedule. What do you think of the profit margin target? I guess there were certain unexpected situations, including the external environment such as COVID-19 pandemic. Do you expect it will improve in the future?

Ito: Over the last five years, the gross profit margin has been on a downward trend due to an increase in capital investment resulting from upfront investment, the impact of the COVID-19 pandemic, and, most recently, production adjustments to reduce inventory. However, in the fiscal year ending June 2025, these factors finally came to a halt, and the gross profit margin will start to rise.

In addition, the SGA ratio increased owing to upfront investment in sales and the enhancement of the quality assurance system. However, we believe that as these efforts

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are coming to completion, the SGA ratio will not continue to rise as before.

In our company, the marginal profit ratio is naturally high, and we have a structure in which an increase in revenue tends to have a mass-market effect and the profit margin increases. For the fiscal year ending June 2025, we are forecasting high growth rates of 10% in revenue and 20% in operating profit compared to the previous fiscal year, assuming the same exchange rate as the previous fiscal year. (See page 53.)

As a result, if there are no irregular elements, we believe we can steadily achieve the 23 to 25% operating profit margin of the Medium-Term Management Plan, and we intend to do that.

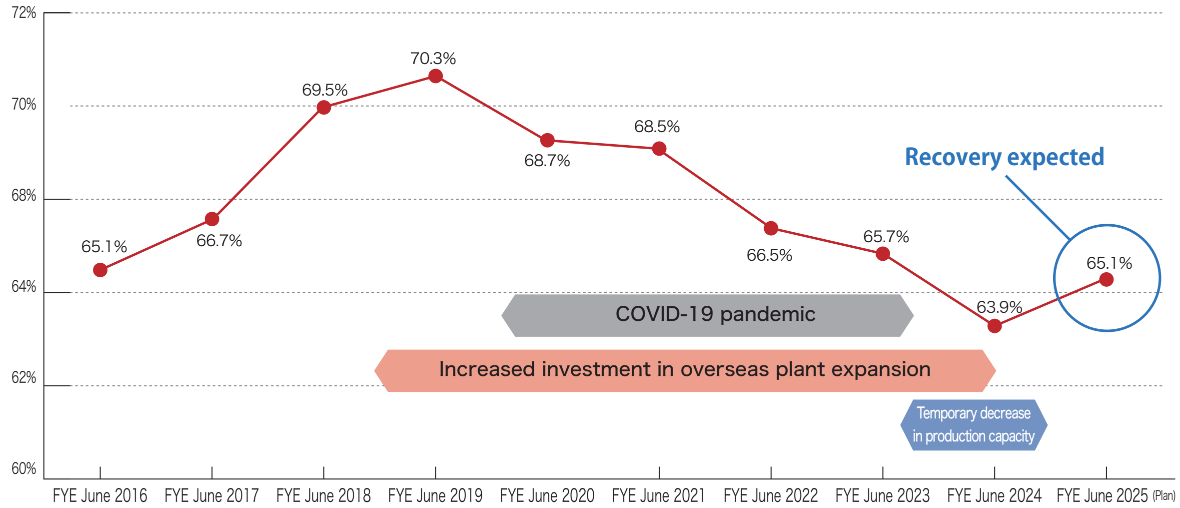
Kusakari: The new Medium-Term Management Plan was discussed at the Board of Directors meeting just the other day. Is there anything you can say about it?

Ito: Right now, it is under consideration and various discussions are underway.

We will continue to make upfront investments mainly in development to launch new business, but I believe that earnings from existing business will also grow steadily. In addition, as I mentioned earlier, the upfront investment, including equipment investment, has run its course, and we are already entering the payback period. So, the income amount and rate in existing businesses should improve. We are also considering new business on an ongoing basis. As for the past M&As, too, it is necessary to respond flexibly to various changes in the environment occurring during the PMI process. As a baseline, our company is a growing company, and in order to sustain its growth, it is important to constantly invest in development and upfront investments. Strategic options that can be implemented using cash on hand, including improving cash flow, are certainly expanding.

We are thoroughly reviewing various aspects such as sales strategy, production strategy, patent strategy and personnel strategy, led by the new president and executives, including outside directors, so please give us a little more time.

Changes in gross profit margin over the past 10 years assuming same exchange rates
(using the rate of the FYE June 2025 Plan for all the years)



ESG initiatives and governance

Kusakari: What are the challenges of your ESG initiatives?

Ito: Regarding the environmental issues, we have already disclosed Scope 1-2-3 on a global basis, but we are entering the phase of implementing Scope 1-2 in particular in terms of reduction per unit of production. Environmental protection initiatives have become widespread on a daily basis, but strategic decisions will also be required in the future. The EU's CSRD (Corporate Sustainability Reporting Directive) is also a thorny issue.

As for society, as the social environment is constantly changing, so I think it is important to keep up with it. The enhancement of diversity, including the participation of women, is an enduring issue, but we are implementing various programs (see page 81) with the aim of increasing the ratio of female managerial positions, mainly in Japan, and will continue to promote them.

With regard to governance, although we have received comments from outside directors that the evaluation of the effectiveness of the Board of Directors is appropri-

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FYE June 2025 Plan and year-on-year change
(using the unified rate same as FYE June 2025 Plan)

	Actual results for FYE June 2024	Plan for FYE June 2025	Year-on-Year		When using the unified rates Year-on-Year
			Change	Change rate (%)	Change rate (%)
Revenue	107,547	116,737	+9,190	+8.5	+10.2
Operating income	22,135	25,210	+3,074	+13.9	+19.1
Operating income margin	20.6	21.6	+1.0	-	-

ate, there are a number of issues that we are improving while flexibly considering, such as the extent to which the separation of management and execution should be advanced, the ideal form of the Nomination and Compensation Committee, and the ideal form of group governance in an expanding company. Since it is not beneficial to increase only the number of systems to hedge against risk, we will have to respond flexibly while identifying essential items and priorities to increase corporate value.

Kusakari: You talked about governance. What are your thoughts on cooperation with outside directors? This is my second year since I became an outside director, and the president and other directors respond sensitively to the opinions of outside directors. So, I feel that there are many opportunities to recognize the value we provide as outside directors.

Ito: I believe that the cooperation between inside directors who are on the executive side of our company and outside directors is deepening every year. As for the decision-making structure, discussions with outside directors have led us to decide to promote the separation of management and execution, and I think the voices of outside directors at the board meetings have become increasingly active. To be honest, as the executive side, I sometimes find it difficult, but on the contrary, I think it is because outside directors are functioning. Outside directors have their own specialties and characteristics, so it is important for them to function in a balanced manner, and their balance seems to be well maintained.

In governance, the effectiveness of the Board of Directors is called into question, but I feel that our board is essentially meaningful in the sense that we always exchanging frank opinions rather than making a superficial response to a questionnaire.

However, both outside directors and internal directors on the executive side are keenly aware that there are still many issues to be resolved. Our mutual purpose is how we can provide value to increase corporate value, so we would like to work together without leaving out that common purpose.

Finally, about the Integrated Report

Kusakari: As the general manager who is in charge of compiling the Integrated Report, please tell me the highlights of the Integrated Report 2024.

Ito: Last year, as we were promoting new business development, the previous Integrated Report 2023 was prepared with the aim of providing a better understanding of the strong leadership of the former president and the ideas leading to these strategies. This year's Integrated Report 2024 has been structured in such a way that, in addition to the succession of leadership by the new president, we want to show that we have strong human resources who support the organization in various fields.

In our last two integrated reports, we included frank discussions with investors in the form of interviews, and we received positive responses. We hold more than 200 meetings a year with institutional investors, and we place importance on always having opportunities for dialogue.

Our Integrated Report may be more voluminous than other companies', but our basic policy is to strive to provide comprehensive content that covers all the information which we see investors want to know through the meetings.

We believe that there is still much room for improvement, so we would like you to continuously give us your frank opinions and comments.

We look forward to your continued support.