Giving TDK's new nonlinear evolution a strong push from the finance side

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Fiscal 2017 review

Placing emphasis on ensuring procurement of capital for acquisitions

In fiscal 2017, TDK pushed forward with a large-scale conversion of its business portfolio. Based on an agreement with Qualcomm related to the establishment of RF360, a joint venture company that provides high-frequency components and other products, in February 2017, TDK received approximately ¥130.0 billion, representing 51% of the funds from the transfer of its high-frequency components related business, and plans to receive the remaining equity amount, equivalent to 49%, in August 2019. Because the Company proceeded with M&As in fiscal 2017 ahead of the completion of this business transfer, ensuring we procured acquisition capital was a top priority in terms of our finance and capital strategies. We also set up a commitment line for the first time, part of our effort to secure an adequate capital procurement facility and ensuring our ability to carry out M&As.

Net sales in fiscal 2017 increased 2.3% over the previous fiscal year, while operating income rose by ¥115.3 billion year on year. Deducting the ¥144.4 billion in capital gains from the transfer of the high-frequency components business, ¥21.2 billion in structural reform expenses, and other one-time losses and gains for an actual operating income of ¥85.5 billion, the operating income ratio was 7.3%. Even assuming the transfer of the high-frequency components business, our outlook called for achieving the current Medium-Term Plan (for fiscal 2016 to fiscal 2018). Several factors, however, including (1) sluggish growth in profit levels from passive components and rechargeable batteries; (2) a delay in the timing of income contributions from acquired companies; and (3) delays in profit improvements, primarily in the magnet business, mean that achieving the management targets we have set, which call for an operating income ratio and ROE in excess of 10% each, will be difficult.

Fiscal 2018 positioning and priority measures

Working to stabilize our financial constitution by bringing free cash flows into positive territory

Fiscal 2018 is being positioned as a run-up period in preparation for the next Medium-Term Plan. The operating income projection of about ¥80.0 billion, intended to absorb the impact on results associated with the transfer of the high-frequency components business, was compiled assuming organic growth. Considering trends in orders received in existing businesses, this target is well within range. With impairment losses in the current fiscal year in HDD magnetic heads, aluminum electrolytic capacitors, and magnets, business structure reforms are in sight, and we have paved the way for conversion of our profit structure in fiscal 2018 as well.

Under the current Medium-Term Plan, investment has taken precedence, with active M&As and a plan for capital investment of about ¥490.0 billion over three years, equivalent to slightly less than double depreciation and amortization, and as a consequence, our stockholders' equity ratio has fallen to 47.7% as of the end of fiscal 2017. Because the acquisition of InvenSense was covered by borrowing, that ratio is expected to fall further in fiscal 2018, but through selection and consolidation of capital expenditures, and by generating solid results from our M&As, we will bring free cash flows into positive territory while stabilizing our financial constitution in preparation for the next Medium-Term Plan.

Direction of the next Medium-Term Plan

Increasing capital efficiency through investment based on rigorous selection and consolidation

In April 2018, we plan to announce our next Medium-Term Plan. We will offer an official briefing on our profit outlook at that time.

With regard to capital structure, we are aiming for an interim stockholders' equity ratio of greater than 50%, and improvement in our debt-to-equity ratio to approximately 0.3 from slightly more than 0.4 in fiscal 2017. This will allow us to carry out investments from a long-term perspective while ensuring flexibility in procuring capital, in the midst of an industry in which technological innovation is extremely rapid, and which is affected by currency exchange rates and macro-environmental shifts. To accomplish this, we will select and consolidate our capital expenditures, aiming for slightly more than depreciation, and generate solid free cash flows.

With regard to dividends, we have set a dividend payout ratio target of 30%, under a policy of working to steadily increase dividends through growth in profit per share. During the period of the next Medium-Term Plan, demand is expected to grow further, particularly in the market for electric vehicles in 2020 and beyond, and that may require investing in increased production. Acquisition of treasury stock as part of returning profits to shareholders will be included among our options for use of surplus funds generated through timely investment in response to increases in demand.

Organically linking strategy to the front lines

Ensuring growth strategy is incorporated in front-line policies

We are also focused on increasing capital efficiency. We will work to organically tie the growth vision conceived by management not only to our finance and capital strategy, but all the way to policies on the front lines. Part of that effort is our performance management framework (P.41 Linking Strategy to the Front Lines), which we are working to strengthen. TDK has introduced TDK Value Added (TVA) as a comparison of return against capital cost (the weighted average cost of capital, or WACC, multiplied by invested capital), which was introduced in 1999. Under the logic tree tied to this TVA, we not only evaluate the profitability of each business, the efficiency of business assets, and the ability to capture cash, but also factorize and monitor KPIs tailored to specific front-line policies and business characteristics. This not only allows as to unite as a single company in promoting our growth strategy, but, we believe, will enable us to build a financial constitution capable of achieving ROE of 15% or more by also tying that strategy to selection and consolidation of capital expenditures through stronger management of investment efficiency.