FY2021 Consolidated Earnings Revision Conference Call Q&A Summary
(October 12, 2021)

◆ Questions by Tomomi Fujita, Morgan Stanley MUFG Securities Co., Ltd.

Q1	I have questions about NIPSEA China. You mentioned earlier that the decrease in the operating profit forecast of 16.5 billion yen includes a potential provision for bad debt. A simple calculation using the operating profit margin indicates that the impact of provision is large. How much would this one-off expense be? Please give us a qualitative or quantitative explanation.
A1	The reasons for the decrease of 16.5 billion yen include increased cost due to higher raw material prices and a provision for bad debt. We have provided a reasonable provision for bad debt based on our internal estimation. Please note that we have not agreed with our auditors about this provision, and it is a rough estimate; we have not decided whether or not we will actually post this provision in the 3Q. To provide a rough estimate, we think that the one-off provision would account for around 20% of the 16.5 billion yen downward revision of the forecast. The remaining 80% would be the impact of higher raw material prices.

Q2	If the raw material price increase is the major reason for the downward revision of operating profit at NIPSEA China, I think the impact of higher raw material prices would be significant. Does the revised earnings forecast assume lower earnings in the automotive coatings business in China while the outlook for real estate market conditions and the Chinese decorative paints business remain unchanged from three months ago? Can we assume that the earnings figures are approximate numbers and actual sales are somewhat lower than the revised forecast, which is reflected in the operating profit forecast? Or, can we assume that the downward forecast revision is largely attributable to the higher cost of raw materials considering that the ongoing weakness in the new construction market will impact the decorative paints business with a time lag?
A2	I will answer your questions regarding revenue and operating profit separately. Revenue in the Chinese decorative paints business is slightly higher than the forecast announced in August. Our customers in the decorative paints segment in the so-called real-estate sector do not anticipate that the market will decline significantly until at least the end of this year. Revenue in the industrial segment centered on the automotive coatings business is slightly

	lower than the August forecast. The decorative paints segment accounts for a significantly larger percentage of total revenue than the industrial segment. As a result, overall revenue is expected to be slightly higher than the August forecast. This is how we see the market. The supply of raw materials became extremely tight in September and October, and we can now make a more accurate assessment of the inventory available for use in 4Q. As a result, our revision of the August forecast is based on firm estimates. In addition, we are considering selling price increases almost on a daily basis. In the next month or so, we will know how much of the impact of higher raw materials we can absorb. Therefore, we have estimated the raw material cost slightly conservatively. My explanation is based on our assumption that we can keep the impact of higher raw material prices to a certain level based on firm estimates of the cost of raw materials. It is true that higher raw material prices have had a significant impact.

◆ Questions by Takashi Enomoto, BofA Securities Japan Co., Ltd.

Q1	Please give us your outlook for automobile production. You mentioned earlier that automotive coatings revenue was significantly impacted by the decrease in automobile production in September and October. What is your outlook for November and December? Please tell how much of the decrease in the operating profit forecast is attributable to the automotive coatings business?
A1	We do not disclose the operating profit in the automotive coatings business. The downward forecast revision of automotive coatings revenue is considerably below 10 billion yen, and you can assume that the impact is roughly half that amount. Our forecast assumes that automotive coatings revenue will rebound to the prior-year level in November and December. However, we do not assume that our revenue will grow by 20-30% YoY from November onwards and offset the revenue decline in September and October. On the other hand, there may be a recovery in automotive coatings revenue next year driven as people rush to buy new vehicles. However, we assume that the automotive coatings business will remain sluggish throughout this year. These are our assumptions although there is a risk that parts and semiconductor shortages will continue in November and December.

Q2	Can we assume that you cannot expect a recovery in December as the shortages of parts and other key components continue?
A2	We expect that the parts shortage will end to some extent in November and December and automotive production will recover almost to the initially planned level. But automobile manufacturers will decide whether their output will rebound beyond that level. When that happens, we will focus on supplying products as required by our customers. The earnings forecast revision does not factor in an automotive production recovery beyond the initially planned level.

◆ Questions by Atsushi Ikeda, Goldman Sachs Japan Co., Ltd.

Q1	I would like you to give us more details on the impact of raw material price increases. Are the increases largely attributable to higher crude oil prices or to factors specific to China such as power supply restrictions? Do you expect that raw material price inflation will subside once crude oil prices settle down? Or do you think that the price increases could become structural in nature due to environmental factors? How is the NIPSEA China procurement team dealing with the higher prices of raw materials? Please give us an answer separately for crude oil-based raw materials and titanium oxide. Also, please tell us your strategies such as selling price increases in the DIY and Project businesses if raw material prices remain elevated.
A1	As I mentioned at the beginning of my presentation, our raw materials include crude oil, as well as monomers, solvents, resin, and titanium dioxide, and their prices are surging across the board. The cost of crude oil has increased significantly, but all raw material prices are climbing. The shortage of electricity is adding to this inflationary pressure. Therefore, I cannot explain the impact crude oil price increases and the power supply shortages separately. What I can say is that we are not optimistic about the situation. We are reviewing various actions assuming that raw material prices will remain high at least until the first half of 2022. Our management teams worldwide, including at NIPSEA China, are developing strategies for the next year right now because a relatively accurate assessment of our business performance for FY2021 has become available. Possible actions include selling price increases, cost reductions, and substituting raw materials. Of these, we will focus on increasing selling prices and reducing SG&A and other expenses.

	Our Project and DIY sales are not decreasing. So, we are developing strategies that will allow us to deliver operating leverage to secure a solid bottom line (net profit) by further driving sales growth. This goal is based on the assumption that sales in these businesses will continue to increase or that we can there will be opportunities to increase our market share. If raw material prices increase further, the cat and mouse game begins. What is critical when the raw material prices are rising is that we can only increase our selling prices with a time lag. What we can do is to work out our strategies assuming that the upward pressure on raw material prices will continue throughout the first half of next year due to issues involving power supply restrictions, total supply and demand, and high crude oil prices.

Q2	My understanding is that the downward revision of the operating profit forecast includes a one-off provision for bad debt. The operating profit margin at NIPSEA China will decrease from a little over 11% to, say 3-4% in the second half of FY2021. In addition, you will be forced to accept a low operating profit margin in the short run in the first half of next year. When you have overcome these challenges and increased your market share, you will take actions to use operating leverage to recover profitability. Is my understanding correct?
A2	I will not go into numbers. But if you ask me if we will be satisfied with the same level of operating profit margin in the first half of next year as in the second half of this year, my answer is no. We will take actions such as selling price increases and cost reductions wherever we can in order to improve our operating profit margin. Our KPI are earnings growth as well as increasing sales and market shares. The management team in China is well aware of this, and is not settling for an operating profit margin in the first half of FY2022 that is on a par with the second half of FY2021. How much of an improvement we can achieve will depend on our capabilities. This is our thinking behind how we can improve the operating profit margin.

◆ Questions by Tomotaro Sano, JP Morgan Securities Co., Ltd.

Q1	I have questions about the timing and the degree of acceptance of selling price increases. Is the acceptance of price hikes, in particular in China, slower than anticipated in August, or progressing as planned? Do you think you can continue to increase selling prices? I guess increasing these prices too much

	will have an adverse impact on your market share to a certain degree. Please share your thoughts on this subject.
A1	Regarding the selling price increases, we have already raised prices in areas where we can do so. In reality, we are unable to fully absorb the impact of higher raw material prices by raising selling prices because raw material prices are increasing faster than we expected. As a result, we are forced to use higher priced raw materials at NIPSEA China due to factors including tightening supplies of raw materials. On the other hand, we have been able to increase selling prices steadily in other Asian countries and Australia, where we have a high market share. Given the low unit price of paint products, price increases are unlikely to lower demand that much. In addition, paint products, in a sense, are essential and have no substitute. Therefore, we believe we can make additional price increases by single-digit percentages, say by 5% or 8%. We are closely monitoring the raw material prices, in particular in China, to determine how we can pass on price increases. However, if we increase selling prices too quickly, for instance, in the Project segment, that would create a big gap with the prices of competitors. On the other hand, the DIY segment is brand-centric and therefore easier to raise prices. Our management team in China is working to ensure that we raise selling prices within an appropriate range while keeping a close eye on our competitors. In a nutshell, we are increasing prices in our operating regions and businesses where possible. However, we have to carefully choose where we can increase prices. We raise prices based on careful decisions at divisions that directly deal with customers so that we do not lose market share to our competitors as a result of increasing selling prices too much. I believe our resilience will pay off in the long run.

Questions by Atsushi Yoshida, Mizuho Securities Co., Ltd.

Q1	I have questions about revenue at Betek Boya. What are the reasons that you upwardly revised its revenue growth forecast from around 40% YoY to around 45% YoY? You explained that the downward revision of the operating profit margin is attributable to the weakening of the Turkish lira and increase in raw material prices. However, you did not change your exchange rate assumption for Turkish lira at 1 TRY = 13.2 JPY. Are there any other factors that would

	lower Betek Boya's operating profit margin?
A1	Figures on page 6 of the presentation use a local currency basis. When you look at Tanshin-base figures, only the exchange rate for Turkish lira decreased against the yen, declining from 13.2 yen per Turkish lira as of the August forecast to around 12.5 yen per Turkish lira currently. Therefore, there is a possibility that the yen-based revenue at Betek Boya will fall slightly short of our forecast. However, demand in Turkey has remained robust and our market share is increasing due to the great efforts of the Turkish team. Betek Boya, as with its competitors, depends on dollar-based, or euro-based imports for most of the key raw materials, which cannot be produced in Turkey. So, higher revenue at Betek Boya cannot fully offset the increase in import prices. As a result, Betek Boya's operating profit margin is declining, and operating profit is expected to be slightly below the August forecast.

Q2	Are you saying that Betek Boya is not increasing prices much? Or, are the price increases not catching up with the raw material cost increases?
A2	We are implementing price increases in Turkey as well in order to offset the impact of the higher cost of raw materials. In fact, we have raised prices several times this year. We raised prices by a double-digit percentage in the first half of this year. However, operating profit in Turkey is being adversely affected by the weaker Turkish lira. I believe all our competitors in the Turkish market are in the same situation.

◆ Questions by Shigeki Okazaki, Nomura Securities Co., Ltd.

Q1	Regarding the raw material price increases, the cost of crude oil is increasing, but the increase is only about 10 USD per barrel compared with August. Considering this, can we assume that the downward revision of the operating profit forecast is mainly attributable to the power supply shortage and other factors? If you can, please give us a breakdown of the downward revision between raw material price increases and power supply shortages. Another question is regarding the price of titanium oxide. Its spot price has not changed over the past couple of months. Has titanium oxide contributed to the higher cost of raw materials? Will the increase in raw material prices impact other Asian countries and other regions with some time lag from China? In Indonesia and Oceania, where your market shares are high, can you raise selling prices

	even if the ongoing raw material price increases continue through the first half of next year?
A1	If the balance between supply and demand becomes even tighter, companies will work even harder on procuring goods. When the supply declines due to production suspensions of suppliers, the supply of necessary raw materials runs short even if we have a multi-sourcing system in place. As a result, in the past two weeks or so, we have been forced to purchase raw materials at higher prices because we cannot afford to risk running out of these materials. Our outlook through December is that higher prices of raw materials will adversely impact our earnings. I don't know if the impact of the power shortage will disappear by December, but we did not anticipate the current situation back in August. We will have to use our expertise to further strengthen our management of raw material inventories from the end of this year. We do not expect raw materials to be less expensive than they are now during the first half of 2022. We are considering various actions such as raising selling prices based on the assumption that raw material prices will become even higher. We expect titanium dioxide prices to increase by 2-3% and the prices of other raw materials such as resins and monomers to increase even more. In regions other than China, price fluctuations are basically not as large as in China. However, we will be affected by the supply of some materials which are sourced chiefly from China. For example, fluoropolymers are used in some of our products in Japan, but demand for fluoropolymers for EV batteries is growing very rapidly in China. Due to the allocation of a limited supply to industries that require fluoropolymers, the amount of fluoropolymers allocated to the paint industry is tightening to some extent. I expect that the impact of supply and demand will spread globally. However, we believe that it will be relatively easy to pass on higher prices of raw materials in Malaysia, Singapore, and other regions where we have a very high market share. In Oceania, although raw material prices are expected to remain high until early next year, we have been able to raise price somewhat without losing demand based on our 50% market share. We believe that we will achieve steady sales growth by raising selling prices and increasing sales volume in this low-growth market. In Indonesia, we adequately increased selling prices in the first and second half of this year. Although there is upward pressure on raw material prices, we believe that we can pass on the higher cost of raw materials

	in the decorative paints business, especially in regions where we have a high market share, albeit with some time lag.

◆ Questions by Yifan Zhang, CLSA Securities Japan Co., Ltd.

Q1	You explained that the price of titanium dioxide has remained almost unchanged while the price of propylene oxide acrylate is increasing. Please tell us if you are being impacted by higher raw material prices now. You had inventory procured at lower prices in May and June but you ran out of the low-cost inventory between July and September.
A1	Although the inventory situation is different from region to region, we expect our cost of sales (raw materials) to increase further from the 4Q as we use raw materials purchased at current market prices. The challenge is that we need to manage our raw material inventories on a global basis. The management of each operating region decides whether to purchase raw materials even if the prices are a little higher or to use the inventory of raw materials. I think we need to build up our inventories of raw materials to some degree during the remainder of this year to avoid running out and ensure a stable supply of products.

Q2	Many of the raw materials in the automotive coatings business are resins whose prices have increased faster than the price of naphtha. Is it difficult to pass on the entire higher cost of these raw materials in automotive coatings business?
A2	I cannot go into the details for the automotive coatings business. What I can say is that we have less flexibility for passing on raw material price increases in the automotive coatings business than in the decorative paints business.

◆ Questions by Yoshiro Azuma, Jeffries (Japan) Limited

Q1	What actions are you taking that your competitors are not using and what types of actions you are focusing on?
A1	For example, when the supply of raw materials is tight, the ability to develop paints that can deliver the same performance using alternative raw materials is important. In the industrial coatings business, paints produced using alternative raw materials cannot sold immediately because time is needed for

	customers to certify a new product. Sometimes a quick response to an urgent situation is possible and other times it is not. But we believe that our large scale of operations enables us to consider the use of alternate materials.

◆ Questions by Yifan Zhang, CLSA Securities Japan Co., Ltd.

Q1	You explained that the provision for bad debt is around 20% of the 16.5 billion yen reduction in the operating profit forecast. How much of that provision includes the risk of bankruptcy or delinquency of customers in the future.
A1	The bad debt provision of 3 billion yen is a very rough internal estimate. We have not reached an agreement with our auditors. We believe we can sufficiently control the impact of higher raw material prices and other events within the range of 16.5 billion yen. We will provide guidance for the FY2022 earnings at another time. The earnings forecast revision announced today are guidance figures that take various factors into consideration.

End