FY2023 1Q Financial Results Conference Call Q&A Summary

(May 15, 2023)

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

Q1	Please explain the reasons for the strong performance in the TUC and TUB businesses of your Chinese decorative paints business as well as market trends in the 1Q of FY2023. Please also tell us about your outlook for April and beyond.
A1	As I explained at the Medium-Term Plan update meeting in April, the 1Q performance in the Chinese decorative paints business depended on our March sales. It turned out that we fared well, in particular in the TUC business. In the 1Q of FY2022, we achieved very strong revenue growth of 28% YoY in the TUC business despite lockdowns in metropolitan areas. Our TUC business continued to achieve revenue growth of 19% YoY in the 1Q of FY2023, which gave us a renewed awareness of the strength of the TUC business. Revenue growth in the TUC business was driven mainly by volume growth. Prices did not increase because sales growth was higher in Tier 3-6 cities, which was driven by higher sales of economy products, than in Tier 0-2 cities, despite selling price increases. However, we don't see any urgent need to lower our prices given the powerful brands we have in the TUC business. The good news is that our profitability in the TUC business improved. Nevertheless, we must continue to drive market share gains in China. We will pursue both volume growth and profitability improvement by keeping a balance between the two. We are glad to see that the TUB business finally turned around to achieve 5% revenue growth in the 1Q after posting revenue declines for several consecutive quarters. Revenue growth was mainly driven by volume growth as with the TUC business. However, with market conditions recovering and raw material prices decreasing, we anticipate downward price pressure to develop. Therefore, our actions in the TUB business will be different from the TUC business where we will pursue both market share gains and profitability improvement. Regarding the market outlook in April and beyond, we haven't fully estimated how much demand will recover from the downturns caused by lockdowns between the 2Q and the 4Q of FY2022. However, we expect to fully achieve the FY2023 guidance after the very weak performance of the China decorative business in FY2022.

Q2	Am I right to understand that revenue growth in the TUC and TUB businesses in the 1Q was driven more by volume growth than price increases?
A2	That's right.

Q3	Can we assume that demand for the products of your group will remain relatively stable in the 2Q and beyond without much change even though the Chinese economy has not yet fully recovered?
A3	Given the increase in unemployment rate and other factors, it is somewhat risky based on our analysis to expect demand to start recovering following the lifting of lockdowns. We are pursuing market share gains due to volume growth as well as profitability improvement while maintaining proper vigilance. We are paying close attention to market trends. Regarding the real estate market, we believe the financial soundness of real estate developers is recovering compared to some time ago, and our market outlook is rather positive.

Q4	I believe that the operating profit margin in the TUC business improved significantly. Can we assume that the operating profit margin in this business will

	consistently exceed the level in the 1Q of FY2023?
A4	We consistently aim for high profitability, but this is not our sole priority. Rather, we will pursue a balance between volume growth and profitability improvement by closely monitoring market trends with sound vigilance and taking necessary actions such as price decreases with agility whenever necessary.

Q5	With raw material prices moderating, is there a need to lower selling prices in the TUC business at this time?
A5	Our plan is to use the power of our brands to avoid price reductions in order to improve profitability by benefiting from the decline in prices of raw materials. However, our actions may be affected by price cuts and other measures by competitors.

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

Q1	Please explain price trends in your major regions. According to page 3 of the presentation, the price/mix contribution to consolidated revenue growth in the 1Q of FY2023 was 1%. However, I believe this is rather low considering that the base prices were lower in the 1Q of FY2022 and raw material prices continued to increase throughout the year. I expect that this is largely attributable to a deterioration in product/mix in China. Were there any factors specific to some regions, such as Japan, Australia, and Indonesia or to some product applications? Our analysis is that raw material prices decreased significantly in the January-March period and the prices of some petrochemical products have already hit the bottom. I understand that the speed at which raw material price decreases are translated into cost decreases may be different in each region and country. But can you tell us when you expect to see the effects of the current raw material price moderation more, the January-March period or the April-June period?
A1	To answer your first question, we do not disclose price/mix by region. But as you would expect the situation differs from region to region. In Asia, both price increases and volume growth contributed to revenue growth in most regions. However, volume growth was not sufficient in some regions. For instance, in Türkiye, an economy in hyperinflation, price increases were the dominant contributor with volume growth roughly flat to slightly negative. In China, prices have not increased as expected due to the impact of product/mix. In Japan, we successfully increased selling prices. Our decorative and industrial businesses were negatively impacted somewhat by smaller-than-expected volume growth. However, we believe that there will be no problem with these businesses once volumes recover. In Australia, revenue growth was largely driven by price increases. In the Americas, price increases were the main driver and volumes decreased considerably. In advanced countries including the U.S., Europe, and Australia, sluggish volume growth was offset by price increases, which was what happened in Japan too. To answer your second question, raw material prices, including the price of TiO_2, have not increased as much as we expected. Although there are signs of slight price increases, the supply and demand balance is not tight. Considering this, we expect to benefit from a relatively low cost of raw materials in the April-June period and afterward. When you look at the outlook for FY2023, the situation differs from region to region, However, we believe that we have sufficient room for further margin improvements unless we will need to lower prices during the 2Q and 3Q, which is when demand is high.

Q2	We believe that overall raw material prices have not increased because of the slowdown in global economy, although the situation differs depending on products and regions. I believe you will be required to lower prices eventually. How long do you expect the benefit of price increases, including in automotive coatings formula, to continue? In addition, please tell us which regions and paint applications are likely to have selling price increases in the 2H of FY2023?
A2	In the B2B business, paint manufacturers are generally required to adjust selling prices in response to changes in prices of raw materials. In the decorative paints business at NIPSEA China, the TUB business may be required to lower prices. However, with our goal of achieving both margin improvement and market share gains, we will not cut prices whenever we can avoid it. In the B2C business, price elasticity of global demand for DIY products is not generally high. Therefore, we will continue to pursue market share gains without lowering prices to achieve both increases in market share and profitability. Although it depends on the competitive climate, we believe selling prices are relatively easy to maintain considering that profitability consistently declined in the past few years at our Group and at competitors. As to the possibility of lowering selling prices, we will continue to aim for margin improvements but there is a possibility that downward pressure on prices will increase around the 3Q or 4Q of FY2023. We were able to achieve a significant margin improvement, notably in China, in the 1Q.

Q3	You have been unable to increase prices in the automotive business except for the prices of primary raw materials based on formula pricing. Did you manage to raise prices in the 1Q other than the formula-based prices too? Please also explain your outlook for price revisions based on formula in the 2H and afterward.
A3	I will refrain from commenting on this topic because the automotive business is based on relationships with customers.

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

Q1	Please tell us how you evaluate your 1Q performance and what risks you see regarding your FY2023 guidance.
A1	I think our overall 1Q performance was basically good because our previous actions started to produce benefits, such as a further improvement in the operating profit margin in China despite concerns among investors. However, we are constantly aiming high and we will insatiably pursue rapid growth. There are many types of risk factors worldwide. For instance, we expect that the recovery of the Chinese economy will continue to have ups and downs, which may affect paint consumption. Our major agenda under these circumstances is how we can increase our market share and grow and how we can turn risks into opportunities. In Türkiye, we steadily increased our market share and selling prices despite the impact of the application of hyperinflationary accounting. However, there is a possibility of changes in the business climate, including inflation and FX, depending on events after the presidential election. In addition, the impact of hyperinflationary accounting will change with inflation rates. Naturally, we see these items as risk factors. In advanced countries such as the Americas, Australia, and Europe, a change in the economic climate can lead to a change in the speed of business growth, which we see as a risk factor. However, we believe we can offset the impact of this risk with higher growth in other regions. In addition, we believe it is possible for us to achieve the original guidance and targets in every region without depending on other regions through autonomous growth and synergy creation based on the Asset Assembler model.

	When the business climate is highly uncertain, as it is now, we constantly take various risks into consideration when making management decisions. But I am confident that the strengths of our business model and business characteristics are even more valuable in today's challenging business climate.

Q2	Can we assume that the impact of the risk involving raw materials will not be large?
A2	Raw material prices can be a major risk factor because raw materials account for a large percentage of our manufacturing costs. Our analysis, however, is that raw material prices are somewhat moderating from the extraordinarily high levels of not long ago. We constantly monitor raw material price trends. We will continue to consider actions by using a global perspective, such as the procurement of raw materials at lower prices and raising selling prices when the cost of raw material increases.

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

Q1	The operating profit margin in the Japan segment improved to 5.6%. Please explain the reasons for the margin improvement and whether this was due to a rebound from low earnings in the same period of FY2022. According to page 5 of the presentation, your outlook for the automotive market in the 2Q is strong. Is there a possibility that the operating profit margin in Japan will recover to around 6%-7% in the 2Q?
A1	I will refrain from going into details because we do not disclose the profit structure of individual businesses. What I can tell you is that the operating profit margin improvement was driven by the complex interaction of factors such as price increases, control of SG&A expenses, market share improvement, and business climate. A rebound from the 1Q of FY2022 was another reason. We will continue to drive margin improvement with the 1Q operating profit margin of 5.6% as the lowest point. I expect the operating profit margin will continue to improve in the 2Q and beyond, driven by incremental selling price increases in some businesses and a decrease in SG&A expenses due to workforce reductions and other actions, coupled with the recovery of market conditions. In the automotive business, we will aim for more growth through operating profit margin improvements driven by the recovery of automobile production, which still remains below the levels in FY2018-2019.

Q2	Do you expect volume growth to continue in the automotive and decorative businesses in Japan from the 1Q to the 2Q?
A2	We expect volume growth in the automotive business, but the ideal situation is that revenue growth is driven by both volume growth and price increases. We also expect some volume growth in the decorative business, but the 1Q turned out to be challenging for this business. The marine business, which is included in Other in the presentation, is expected to achieve revenue growth driven by both volume growth and price increases. The marine business both in Japan and overseas is reported under the Japan segment. We expect this business to continue contributing to improving the profitability of the Japan Group because of progress with selling price increases and sales promotion activities in Asia and other regions.

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

Q1	The operating profit margin at NIPSEA China has increased to 13.1%, a high level comparable with the levels in FY2021 and FY2022. Do you expect the operating profit margin to increase further to 15% when the TUB market is normalized and stabilized in the future? Do you expect the margin improvement to continue in the 2Q and the 3Q or level off? Please share your thoughts.
A1	Basically we will not be satisfied with the current operating profit margin and continue to aim for a higher level. The TUC business usually had a higher operating profit margin than the TUB business. Revenue growth in the TUC business was in low single-digits and revenue growth in the TUB business was 30%-40% at one time. As a result, investors were concerned about the possibility of a decline in the operating profit margin in the overall Chinese decorative business. At that time, I explained that the concern was justifiable if you think only about product mix. However, we can control SG&A expenses to a certain degree even while sales are growing. This is where we can benefit from leverage. In other words, we can improve our operating profit margin even when our gross profit margin decreases. We subsequently focused on the TUC business to respond to the pandemic and slowdown in the real estate market. Consequently, the proportion of the TUB business to the total China decorative paints business decreased, which led to an increase in our gross profit margin. If this continues, we can expect a further improvement in the operating profit margin. If we maintain the operating profit margin in the TUC business, which is characterized by the stability of selling prices, and with the impact of raw material inflation easing, I believe we can increase our operating profit margin in the overall NIPSEA China. At the same time, we will continue to aim for market share gains in China. Therefore, there is a possibility that we will take strategic pricing actions and price/mix will change as we expand business in Tier 3-6 cities. With this as a background, we may end up missing a business opportunity if we set a target for the operating profit margin, say at 15%. There is no one-size-fits-all solution.

Q2	You explained that the industrial revenue decreased at NIPSEA China because of streamlining and eliminating of unprofitable customers. Is this a measure/policy aimed at a further improvement of your operating profit margin? Can we assume that you are aiming for a further operating profit margin improvement in the industrial business, while in the TUC business, you are increasing marketing expenses appropriately to further benefit from decreases in raw material prices? That is, you are taking a balanced approach, am I right?
A2	The industrial business and the decorative business have very different business models. The industrial business is a B2B business: we need to have the option to decline to do business with a particular customer if we fail to secure profitability in the end based on negotiations with customers. On the other hand, customers in the decorative business are diverse and our responses to these customers are different from those in the industrial business. In the decorative business, customer relationships are very important in the TUB business. At times, we are required to pick which business deals to accept and which ones to abandon. We pursue increases of both market share and operating profit margin in the TUC and TUB businesses. In the TUC business, market share gains are important and we will continue to aim for a higher share. In the B2B business, including the TUB business, I believe we will need to end relationships with some customers.

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

Q1	Can we assume that your business in Southeast Asia will remain robust in the 1Q and 2Q of FY2023?
A1	In our business in Southeast Asia, our operations are different in regions such as the Philippines and Vietnam, where our market presence is not high, and we are not doing well in Sri Lanka. On the other hand, our performance is very strong and stable in Indonesia, Malaysia, Singapore, and other regions where we have a strong market presence. In particular, our Indonesia business is doing very well both in terms of market share gains and profitability. We are further increasing the already high operating profit margin in Indonesia. We expect that the Indonesian economy will be relatively stable until the presidential election that is scheduled for 2023. In this manner, the situation is mixed from region to region due to different market characteristics. However, I believe our business is generally solid in Southeast Asia.

Q2	New housing starts are weak in the Chinese real estate market. In addition, the April housing sales data decreased significantly from a year ago. How do you see the sustainability of demand recovery? For instance, do you anticipate risk involving market adjustments in the July-September quarter or afterward?
A2	The real estate market is recovering and normalizing from the pandemic, giving us ample opportunities for winning business deals in a very favorable business climate. On the other hand, we must always be aware of the possibility that demand will soften, which is one of the difficulties of doing business in China. However, we need to focus on how we can increase our market share and stimulate demand rather than on trying to determine an outlook for a downturn in demand. Demand trends will not be a major factor that will cause a change in our strategy. All we can do is to continue selling products. Of course, we will closely monitor the risk of demand softening.

Q3	Can we assume that the strong market in the January-March period will continue at least in the April-June period?
A3	I hope that this trend will not change significantly.

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

Q1	In the Chinese real estate market, housing completions increased in February and March. However, housing starts are weak, which raises concerns about the market outlook. Could you give us your outlook including for the B2B market? I believe your competitors are cautious about reducing selling prices because profitability in the B2C business has declined due to intense competition in the B2C market as well as the B2B market. Do you think risks involving the competitive climate, in particular pricing, have emerged in the B2C business?
A1	I cannot make a general statement about whether pricing risk has emerged in the B2C business. For instance, we are aggressively expanding business in Tier 3-6 cities. It is quite possible that we will make a considerable investment in those cities, including for sales to distributors. In the premium product market in Tier 0 cities, on the other hand, downward price pressure is not that strong. Therefore, the situation is mixed from region to region and we are not encountering strong pricing pressure in the B2C business overall. Our approach in the B2C business is to aim for more growth while maintaining a proper operating profit margin as we leverage our brand power by using strategies with a span longer than a single quarter. In the B2B business, on the other hand, using a short-term strategy is also important and we will take actions

	by responding to competitors' moves and market trends. We will basically aim for growth in both the B2C and B2B businesses. To be more precise, we will aim for strong revenue and earnings growth in the B2C business and pursue growth in the B2B business while maintaining our market share. We believe we have sufficient potential for improving our operating profit margin in the overall Chinese decorative business. However, based on our analysis that Chinese economic conditions will not recover steadily, we will keep monitoring developments.

Q2	TUC revenue growth was 19% in the 1Q. Can you give us the breakdown of revenue growth expectations between Tier 0-2 cities and Tier 3-6 cities?
A2	I cannot disclose revenue breakdown by tier city, but I can tell you that our revenue is increasing in Tier 3-6 cities too.

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

Q1	Historically, you have revised your full year guidance in the 2Q. Based on your 1Q results, can we assume that you will revise the FY2023 guidance at the FY2023 2Q results announcement? Please share your plan for this year.
A1	We review our full year guidance and estimated results every quarter. In the 1Q, for instance, we reviewed our three-month results and assessed our estimated results for the remaining nine months of the year. We revise full year guidance based on the timely disclosure rules of the Tokyo Stock Exchange if revenue is expected to be above or below the guidance by 10% or operating profit is expected to be above or below the guidance by 30%. We also revise our guidance when there is an unexpected event that has a significant impact. There were two of these events in FY2022: the application of hyperinflationary accounting in Türkiye and an allowance for potential credit loss related to real estate developers in China. We do not customarily review and revise our guidance after the 2Q every year. Rather, we make an assessment including whether to review our guidance or not. I cannot tell you at this time if we will review the FY2023 guidance at the end of the 2Q. Our 1Q results did not exceed the criteria of the timely disclosure rules. For the remaining nine months of this year, our priority is to achieve the original full year guidance with certainty.

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